

**STATEMENT
OF
D. SCOTT YOHE
SENIOR VICE PRESIDENT - GOVERNMENT AFFAIRS
DELTA AIR LINES, INC.
BEFORE THE
NATIONAL COMMISSION
TO ENSURE CONSUMER INFORMATION AND CHOICE
IN THE AIRLINE INDUSTRY
CHICAGO FIELD HEARING
JUNE 26, 2002**

Members of the Commission:

On behalf of Delta Air Lines, I would like to thank you all for the opportunity to provide testimony on the important issues being addressed by this Commission.

I am Senior Vice President - Government Affairs for Delta Air Lines. I have worked for Delta for 24 years. During this period, I have seen a number of changes in the airline-travel agent relationship, particularly in recent years as the e-commerce revolution has transformed our industry.

This Commission has been charged with considering two important questions: first, whether the financial condition of travel agents is declining, and if so, what effect that decline will have on consumers; and second, whether there are impediments to information regarding the services and products offered by the airline industry.

Delta appreciates the opportunity to submit our views to the Commission. Ensuring that consumers have full and complete access to information about our services is a goal that benefits Delta and our customers, and travel agents remain an important part of Delta's distribution network.

In answer to the first question the Commission has been charged with considering, Delta has always distributed its tickets in many different ways and it is critical to our success that we provide our tickets through each distribution channel that our customers want to use. Many customers prefer to use the services of traditional travel agencies, and therefore traditional travel agencies remain an important part of Delta's ticket distribution network. On the other hand, the e-commerce revolution has created new alternatives to traditional travel agencies that, in many cases, offer less expensive means to deliver airline services to the

public -- and many customers prefer the convenience and flexibility of these new low cost channels.

These new online alternatives to the traditional travel agency have created both challenges and opportunities for traditional agents. Many travel agencies have successfully adapted to these changes, finding new ways to deliver added value either to their customers or to airlines, or both. These agencies will continue to thrive and to play a critical role in Delta's ticket distribution system. On the other hand, some agencies have resisted change, and have failed to develop business models that deliver added value that consumers or airlines are willing to pay a premium for. Like any business that fails to adapt to change, such travel agencies are not likely to succeed.

It is absolutely clear, however, that the e-commerce revolution that is driving these changes will benefit consumers. E-commerce is making it much easier than ever before for consumers to get information about Delta's services, and it is driving the price of airline ticket distribution down. These changes are forcing airlines and travel agencies alike to find new ways to deliver value to consumers at a lower and lower cost. Competition can be hard for competitors who fail to meet the competitive challenge, but competition is good for consumers. Any regulatory intervention that blocks these changes or restricts this competition will inevitably result in less choice and higher prices for consumers.

The answer to the *second* question the Commission has been charged with considering is simple. The answer is "No." There are no significant impediments to the dissemination of information about air travel products -- to the contrary, the e-commerce revolution has made air travel information more available to consumers than ever before.

I. THE DOMESTIC AVIATION INDUSTRY IS FACING A FINANCIAL CRISIS THAT IS FORCING DELTA TO FIND WAYS TO CUT COSTS AND IMPROVE THE EFFICIENCY OF OUR OPERATIONS

Before I address in detail the specific questions the panel has been charged with considering, it is important to review the current financial conditions facing the airline industry. Even in the best of times, the economics of the airline industry are fragile -- over the last fifty years, the industry's net profit margin has been one-half of one percent, compared to the average for all industries of approximately six percent. But today, our industry is facing one of the most serious economic crises in its history -- largely as a result of the terrorist attacks of September 11 and their aftermath.

Last year, U.S. airlines collectively lost \$7.7 billion -- despite the federal emergency package enacted by Congress to prevent an industry collapse in the immediate aftermath of the attacks. Delta alone reported a financial loss of \$1 billion in 2001. The total aid package covered only a few short weeks of the tremendous losses that the airlines continue to sustain.

In the first quarter of this year, industry losses have continued to climb by an additional \$2.4 billion. The industry is carrying an on-balance-sheet debt burden of nearly \$110 billion, with debt-to-capital ratios more than double those of other industries. Early predictions of a return to profitability in 2003 now appear increasingly unlikely, with 2004 offering the first ray of hope. Industry revenues are down 20 percent from where they were a year earlier -- and that revenue shows little sign of returning any time soon.

A major cause of this financial crisis is the huge cost of complying with the waves of new taxes, government mandates, and other new costs that have been imposed on air travel since September 11. For Delta alone, the annualized impact of these new costs includes:

- Post 9/11 passenger security taxes: \$266 million.

- Increased terrorism insurance premiums, assuming FAA support ends, and the airlines have to rely on the commercial market: \$250 million.
- Security-related revenue losses from postal service and cargo restrictions, as well as unreimbursed security costs for cockpit door fortifications, ramp security, checkpoint document verification, screening of catering supplies and material, airport space occupied by TSA, security equipment, personnel training, and airline seating for Federal Air Marshals: \$175 million.
- And revenue losses due to customers deterred from air travel by the hassle factor: an estimated \$600 million.

Added together, these numbers would total approximately \$1.3 billion in pretax profit impact to Delta.

With all of the ticket taxes and fees that apply to airline ticket purchases, airline tax rates are now among the highest federal consumption taxes on any industry. To put this in perspective, the consumption taxes on a \$100 round-trip airline now exceed 44 percent. On a \$200 ticket they are over 25 percent; and on a \$300 ticket, over 19 percent. Those figures exceed even the intentionally high federal tax rate of 18.2 percent on cigarettes -- imposed, in part, to discourage consumption. Taxes on airline ticket purchases are nearly triple what they were in 1991.

In addition to these increased costs, the current economic conditions have forced down average ticket prices. Today, Delta's average domestic round trip fare is \$45 lower than it was during the same period last year. Delta effectively has no ability to pass these new costs on to consumers, which means these new costs have directly impacted Delta's bottom line.

For all of these reasons, the current financial crisis has forced Delta to seek ways to cut costs in almost every aspect of our operations. We have undergone the agonizing process of reducing our workforce by approximately 13,000 positions. Industry wide, some 100,000 airline employees have lost their jobs. Delta has cut its flight schedule back by approximately 15 %

from pre-September 11 levels, and many other U.S. carriers have similarly reduced their own networks. U.S. airlines parked or retired some 350 aircraft. Hundreds of aircraft orders have been canceled or reduced.

The financial crisis is placing even greater pressure than ever on Delta to find ways to reduce cost and improve the efficiency of operations -- including the costs of distributing tickets to our customers. Like any business, we must constantly find new and more efficient ways to deliver our products to our customers. But in the current context, this has become a matter of economic survival.

II. THE INFORMATION AGE HAS DRAMATICALLY IMPROVED CONSUMER ACCESS TO AIR TRAVEL INFORMATION AND CONSUMER CHOICE

With that context as background, let me address the specific questions the Commission is considering, beginning with the question of consumer access to information.

The e-commerce revolution has dramatically improved the access of every consumer to air travel information. Just a few years ago, consumers seeking airline fare and schedule information had little choice but to call individual airline reservations departments or to consult a travel agency that subscribed to one of the complex Global Distribution System (GDS) databases to obtain this information. Those two traditional options are still available to any consumer who chooses to use them, but they are no longer the only options available.

Today, anyone with a connection to the Internet has direct access to every airline's schedule and published fares -- information that is as sophisticated and complete as that delivered through the old GDS computer systems. Since almost any public library offers its patrons free Internet access, this wealth of travel information is available at little or no cost to any consumer who chooses to take advantage of it. Of course, many consumers have Internet access from their home or office, and many prefer the convenience and control that these new Internet tools make possible.

Online travel information takes several different forms. For example, virtually every major airline has developed an Internet website through which it provides detailed information about its own services directly to consumers. On *delta.com*, for instance, with the click of a mouse, customers can search for Delta fare and schedule information, purchase tickets, make or change seat selections, check on the status of flights or airport wait times, check in for a flight and print a boarding pass, request notification of flight delays, request and receive e-mail notices of special promotions, manage their SkyMiles accounts, redeem miles for free tickets, and so on.

In addition to airline websites like *delta.com*, several major online travel agencies operate websites that provide comprehensive travel information from a single online source. The largest of these are Travelocity, Expedia and Orbitz, each of which provides quick and easy access to schedule and fare information from as many as 450 different airlines -- enabling consumer searches for airline fare and schedule information, plus the ability to easily purchase airline tickets and a variety of other travel-related goods and services with the click of a mouse.

But airline websites and the largest online travel agencies are only the beginning of the wealth of consumer information the Internet provides at virtually no cost to the public. The entire Official Airline Guide, for example, is available in searchable format for free on the Internet. Many traditional "off-line" travel agencies have also launched their own Internet web sites. A recent search for "airline ticket information" on the Google Internet search engine returned some 290,000 websites offering air travel information to the public.

Of course, not all consumers take advantage of the travel resources the Internet makes available. Some consumers prefer to deal directly with an airline reservations representative, because they are more comfortable talking to a live sales representative than interacting with the airline via online channels. Many other consumers prefer to use the services of a traditional travel agent for a variety of different reasons -- for example, because they want to take advantage of their travel agent's special expertise and experience, or simply because they do not want to spend the time or effort doing their own travel research. Consumers who value

the services of a travel agent remain free to hire a travel agent to provide these services, and there are tens of thousands of independent travel agents willing to compete to provide consumers with these services.

In other words, there is no impediment to the dissemination of air travel information to consumers in the information age. To the contrary, the e-commerce revolution has made air travel information more available to consumers than ever before.

III. THE E-COMMERCE REVOLUTION HAS CREATED NEW COMPETITIVE PRESSURES THAT BENEFIT CONSUMERS

As to the financial condition of traditional travel agents, it is clear that the e-commerce revolution is profoundly changing the airline ticket distribution system. It is creating new competitive alternatives to the expensive, legacy GDS ticket distribution systems and traditional travel agencies that rely upon these systems. Like any business in any competitive marketplace, traditional travel agencies must adapt to change and competition. But while competition can be difficult for competitors who fail to meet the challenge, competition is always good for consumers.

A. Traditional Offline Travel Agencies Are A Critical Part of Delta's Distribution Network

Professional travel agents remain important to Delta's success as an airline. Traditional offline travel agents currently sell approximately 47% of all tickets for travel on Delta, and they generate approximately 64% of the revenue from Delta ticket sales. In other words, travel agents sell a disproportionate percentage of Delta's higher value tickets. These sales are critical to Delta's success, and Delta has thousands of valued business relationships with travel agencies across the United States.

For this reason, Delta continues to invest heavily in the sales efforts of traditional travel agencies. Claims by some that airlines like Delta now pay "nothing" for the distribution services of traditional travel agents are simply misrepresenting the facts. While it is true that Delta no longer pays a flat fixed "base" commission to every travel agent on every ticket sale, Delta still pays millions of dollars every year to subsidize airline ticket sales by traditional travel agencies.

Most notably, nearly all traditional travel agencies rely upon the expensive legacy GDS booking systems to book tickets for their clients. These GDS systems charge Delta high booking fees for each travel agency booking -- but they are typically cost-free to the travel agency that benefits from the use of the system. Delta's expenditures for GDS booking fees totaled over \$350 million in 2001, and these booking fees have increased from 4-7% every year since 1999, despite the falling cost of information processing and computer systems.

In addition, unlike most store front retailers in other industries, travel agents are not required to enter into merchant agreements with the major credit card vendors to sell airline tickets. Instead, they are authorized to accept credit card payments as an agent on behalf of the airline whose ticket they are selling. In this way, Delta subsidizes the operations of each agency in every credit card transaction, because credit card companies charge the merchant accepting these cards up to 3 % of the charged amount as fees for the transaction. Delta spent approximately \$190 million paying these credit card merchant fees on behalf of travel agents in 2001.

Delta also enters into contracts with individual travel agencies to pay a sales commission -- known as an "incentive commission" -- designed to reward agents who meet sales goals for promoting Delta services. Incentive commissions reward those travel agencies who are most valuable to Delta's sales efforts. These contracts implement a "pay for performance" system in Delta's travel agency sales network. They set specific sales goals for key travel agencies that are most important to Delta's distribution efforts, and reward those agencies based upon the sales performance they actually deliver to Delta.

The bottom line is that Delta wants to be able to sell tickets through any distribution channel that its customers want to use to buy Delta tickets. Because many Delta customers prefer to use the services of a travel agent, Delta fully expects traditional travel agents to remain an important part of Delta's ticket distribution network for the foreseeable future.

B. E-Commerce Is Creating New Competitive Alternatives to Traditional Travel Agencies

While traditional travel agencies remain an essential part of Delta's distribution network, the e-commerce revolution has created new choices for consumers. It has made it possible for customers to choose to take control of their own travel needs in ways that were never possible before -- by interacting directly with Delta via *delta.com*; by using the comprehensive online travel agency websites such as Travelocity, Expedia and Orbitz; by bidding for special deals at "name-your-own price" websites such as Priceline.com; or by taking advantage of the thousands of other online ticket distribution outlets that offer many other unique consumer benefits. As with any other technological and competitive developments that create lower cost alternatives to existing competitors, the e-commerce revolution has created challenges that traditional agencies must meet if they are to succeed in the new competitive environment.

Many consumers have made clear -- by voting with their wallets when they buy airline tickets -- that they prefer the convenience, control, and flexibility that these new online channels provide. Delta ticket sales through *delta.com* generated \$ 1.1 billion in revenue for Delta in 2001, a 45% increase from 2000. Major online agency transactions also continue rapid growth. Sales via Expedia grew 54% from 2000 to 2001. Sales via Travelocity grew 18% during the same period. Delta currently sells approximately 24% of its tickets either through *delta.com* or online travel agencies.

These e-commerce alternatives provide a means of distributing airline tickets to the public that costs less than the traditional travel agency distribution channel. The Internet is a highly efficient means of selling airline tickets, just like it provides a highly efficient way to sell

many other services. Perhaps the most direct analogy is online financial and investment services websites -- where major financial services providers have given consumers the power to use the Internet to take control of their own finances. Consumers who prefer this convenience and control can now make their own stock trades on the Internet for less than \$10 rather than paying the hundreds of dollars in commissions that traditional stock brokers charge.

The Internet is bringing similar benefits to consumers who want to purchase travel services. Like the sale of financial services, airline tickets and other travel services are uniquely suited to Internet distribution, because electronic ticketing eliminates the need for any delivery costs. Travel suppliers who sell their services on the Internet -- either directly or through online travel agencies -- can easily deliver their product to any consumer anywhere because there is no longer any physical ticket that must be delivered in most cases. Electronic ticketing eliminates the need for even the minimal cost of mailing a paper ticket. All a consumer needs is the confirmation that their electronic ticket has been issued.

In addition to this efficiency, online distribution channel alternatives reduce airline distribution costs because these online alternatives have created competition for the dominant GDS systems that traditionally controlled the distribution of information on airline schedules and published fares. Direct sales through *delta.com*, for example, avoid these high GDS booking costs altogether. These direct sales via *delta.com* are Delta's lowest cost distribution outlet -- it costs Delta roughly 75% less to sell a ticket via *delta.com* than through a traditional travel agency using the expensive GDS booking engines. The savings through other online channels are also significant. Because Delta has negotiated significant rebates of the GDS booking fees from the major online travel agencies, it costs Delta roughly 50% less to sell a ticket through these online agencies as through traditional travel agencies.

C. Delta Web Fares Have Benefited Consumers

Like any other cost savings, these developments are good for consumers. They make it possible for airlines to offer lower fares and increased services. The lower costs associated with

direct distribution via the Internet have led Delta and other airlines to offer lower prices to consumers in the form of "web fares" -- special discounted fares that an airline offers on the Internet but does not publish through the traditional GDS system.

Some traditional travel agents have complained that an airline's decision to offer these special fares only on the Internet is "unfair" to traditional travel agents and to consumers who choose not to take advantage of the new online channels. These complaints distort the facts:

First, any traditional travel agent can sell Delta web fares to its customers. Delta has created a special travel agency-only website -- Delta's "Online Agency Service Center" -- that allows any Delta-accredited travel agency to book any published Delta fare (including any discounted web fare) without using the GDS system that results in high booking costs to Delta. Some travel agents may choose not to take advantage of this opportunity because they prefer to rely on the high cost GDS computer system for booking tickets. The fact that travel agencies choose not to take advantage of the tools that Delta has created for them to better serve their customers, however, is purely a matter of business judgment on the part of each agency.

Second, there is nothing unique about web fares. Delta (and many other airlines) have for many years sold their tickets in many different ways. In addition to the published fares in GDS systems that any travel agent can sell, Delta has traditionally offered many different special prices through privately negotiated arrangements -- for example, to government agencies, corporate clients, tour and cruise operators, ticket consolidators, and so on. Web fares simply represent one more way for airlines to market their products.

Finally, the bottom line is that low fares *benefit* the consumers who choose to take advantage of them. Any regulatory attempt to interfere with the free market by prohibiting airlines from offering special discounts on the Internet would harm these consumers. The fact that some consumers may choose not to shop online does not make it "unfair" to offer discounts to those who do. Many businesses offer discounts to consumers who shop through less expensive distribution channels, whether that is an Internet web site, a warehouse superstore, or a

rural factory outlet. Airlines are no different. It is no more "unfair" to offer discount airline tickets on the Internet than it is to offer discount commissions for online stock trades or discount prices for consumer products in a warehouse superstore.

D. Orbitz Has Benefited Consumers

Many travel agencies -- both traditional and online agencies -- have also complained about Orbitz, the new online travel agency launched by five major airlines. Like the complaints about web fares, these attacks on Orbitz by its competitors have seriously distorted the facts:

Orbitz is a success with customers because it offers a superior web site that consumers want to use. The site uses state of the art technology to provide consumers with an online tool that instantly searches the fares and schedules of some 450 different airlines and displays those fares for consumers in a balanced, unbiased and easy-to-read format. Orbitz is unique among the major online travel agencies in that it is a truly unbiased source of travel information.

Orbitz has also benefited consumers by creating new competition for online travel agencies. Most of the distorted criticism of Orbitz is really an attempt by its competitors to shield themselves from this competition. Prior to the launch of Orbitz, the online agency business was dominated by two companies - Travelocity and Expedia - that controlled as much as 75% of the agency online market. These two travel agencies both continue to enjoy almost twice as much Internet traffic as Orbitz:

Top Three Travel Web Sites
(based on the number of visits made in March 2002)

Expedia	11.6 million
Travelocity	10.2 million
Orbitz	6.6 million

Source: Nielson/Net Ratings

Most of the criticism of Orbitz has centered around the myth that carriers like Delta have given Orbitz an unfair advantage by offering Orbitz "exclusive" access to their web fares. Delta's contract with Orbitz is not exclusive and Orbitz has no unique access to Delta web fares. To the contrary, any travel agent can book any Delta web fare via the Delta Online Agency Service Center, as I just described. Orbitz earned the right to sell Delta's web fares on the Orbitz website by offering Delta (and any other airline who chose to participate, whether or not the airline was an Orbitz owner) significant rebates of the expensive GDS booking fees. Delta has recently signed deals with Travelocity and Expedia that allow these agency -- like Orbitz -- to sell Delta web fares on their websites in exchange for rebates on GDS booking fees. The beneficiary in all of these arrangements is the consumer who is willing to shop in these low cost channels.

E. New Competitive Alternatives & Economic Crisis Led Delta to Eliminate "Base" Commissions For Traveling Agents, Allowing Consumers To Choose Whether They Want to Pay for A Travel Agent's Services

Finally, many travel agents have criticized Delta for one of the many cost-cutting moves that Delta took in its efforts to deal with the current economic crisis facing the airline industry -- the decision that effective March 14, 2002, Delta would no longer pay a "base" commission on travel agency ticket sales in the United States. This "base" commission -- a fixed amount paid to any agency who sells a Delta ticket, regardless of the value actually delivered by the agency to Delta in the ticket sale -- was a vestige of the days of airline regulation by the Civil Aeronautics Board, which had mandated a fixed industry-wide commission payment. After deregulation, airlines were free to offer whatever commission payment they chose to travel agencies. One result of this was the creation of the "incentive commission" that Delta continues to pay to key agencies -- individually negotiated commissions that tie payment directly to the agency's sales performance, rather than a flat commission paid regardless of the agency's actual value as a part of the Delta sales network. A second result was that, market forces began to drive down the amount of fixed "base" commissions paid to travel agencies.

Delta's elimination of "base commission" in March 2002 recognized the fact that travel agents function as middlemen in the airline ticket sale transaction. They provide services both to the airline and to the agency's customer. Because travel agency ticket sales benefit Delta, Delta continues to invest heavily in supporting the travel agency distribution system, both by paying the expensive GDS booking fees that subsidize the GDS booking engines travel agents use to sell their services, and by paying the merchant fees that allow travel agencies to accept credit cards for airline ticket sales at no cost to themselves. Delta also continues to reward key travel agencies with targeted incentive commission contracts that reward agencies for excellent sales performance on Delta's behalf.

Much of the value that travel agents provide, however, are provided not to the airline, but to the travel agency's clients. Researching air fare alternatives, planning travel itineraries, providing travel management services, and offering the benefit of special travel expertise and experience, for example, are all services rendered by the travel agent to their customer -- not to the airline. Consumers who value these services are willing to pay the travel agency for them. Like any business, travel agents can and should charge their customers for the services they provide. Most U.S. travel agencies have begun doing so, and agencies who deliver value to their customers have found that their customers are more than willing to pay for it.

Many consumers, however, do not need or want the services provided by a traditional full service travel agent. They prefer to take control of their own travel planning, and the e-commerce revolution has empowered them to do so. These consumers should not have to pay for the services of a full services travel agent -- any more than an investor who does not need the services of a full service stockbroker should be required to pay hundreds of dollars in commission for a stock trade. When an airline chooses to pay a flat "base" commission to every travel agent on every ticket sale, this "base" commission is necessarily built in to the price of every ticket. In other words, every customer ends up paying this commission -- regardless of whether the customer needs or wants a travel agency's assistance. The elimination of base commissions from the ticket price allows each customer to make his or her own choice. Those

customers who value and want the assistance of a travel agent, can choose to pay for it (in the form of travel agency service fees). Those who do not want or need that assistance can take control over their own travel needs, and save. Either way, the consumer is the ultimate winner.

CONCLUSION

Delta recognizes the valuable contribution travel agents make to the travel industry. We have thousands of valued business relationships with travel agencies across the United States. We understand that travel agents -- like airlines -- are suffering from reduced revenues in the present business environment. But like all businesses, travel agencies must compete and deliver value to succeed in a competitive marketplace.

Delta is committed to extending our reach to all consumers, including both those who chose to use the Internet and those who prefer to use the services of traditional agencies. The success of all of our distribution partners, whether traditional or online, are key components of Delta's overall distribution strategy. The e-commerce revolution has increased the amount of information about airline fares and services to the public. It has increased consumer choice in airline ticket purchases. These developments are good for consumers. Many customers still prefer the services provided by traditional travel agents, however, and Delta believes that traditional agents who provide a level of service that consumers want and are willing to pay for will continue to serve an essential role in the sale and distribution of Delta tickets for the foreseeable future.