

**BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.**

**In Re
Advance Notice of Proposed
Rulemaking Concerning
Computer Reservations Systems**

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Docket OST-97-2881

SUPPLEMENTAL COMMENTS OF AMERICAN AIRLINES, INC.

INTRODUCTION

American Airlines, Inc. submits these comments in response to the Department's July 24, 2000, invitation for supplemental comments on the Department's regulations concerning computer reservations systems ("CRSs"). 65 Fed. Reg. 45551 (July 24, 2000) In its call for comments, the Department properly focused on two issues: (1) the potential impact of the Internet on airline distribution; and (2) changes in airline ownership of CRSs, including the emergence of Sabre as an independent CRS.

Of these two issues, the development of the Internet is the more important. Although it has already fueled tremendous economic growth, only a small part of the Internet's potential has been realized. Internet sales comprise less than 5% of airline sales,¹ yet the promise of the Internet is so great that Priceline, an Internet start-up company, without any history of profits, achieved a market capitalization several times greater than that of any airline.

¹ Jupiter Travel Projection, April 2000. (Attachment A)

Federal and state governments have wisely minimized any regulation of Internet commerce. The rapid technical innovation and explosive growth that characterize the Internet create a poor environment for government regulation, and there is nothing unique about air travel that justifies regulating Internet distribution. Yet some commenters -- who provide or rely upon more expensive, CRS based distribution -- are calling for regulation that would short-circuit new competition from the Internet.

The worst possible outcome in the current rulemaking would be new regulation that prevents the Internet from bringing desperately needed competition to airline distribution costs. Fortunately, standards that the Department has previously articulated for determining when to regulate conduct, if properly applied, will serve the Department well in addressing proposals for more regulation. See 49 U.S.C. § 40101 (requiring the Department to rely to the maximum extent possible on market forces).

In determining what, if any, regulation is appropriate, the Department should be mindful of the following:

The Internet is an emerging distribution channel that should be defined by market forces, not government dictate.

The Internet has the potential to lower airline distribution costs dramatically.

Consumers will benefit from vigorous competition among the CRSs and developing Internet distribution. In virtually every industry, businesses are free to promote competition by giving

proportionately greater benefits to those suppliers that offer lower costs. Travel agencies, Internet sites, and CRSs, like other suppliers of products or services, should expect vigorous competition. Any regulation that shelters CRSs or travel agencies from competition will only inflate distribution costs and lead to higher fares.

The full impact of the Internet on airline distribution costs remains very much in the future. In the meantime, the Department should take steps to insure that CRSs do not leverage their existing market power into Internet distribution, and it should consider ways to bring new market forces to bear on CRS fees today.

Much of the current debate centers around Orbitz, a yet to be launched online travel agency that will be competing with, among others, Travelocity and Expedia -- two of the largest, most recognized, and well funded businesses operating on the Internet. When the hyperbole and unsupportable speculation is set aside, it is clear that Orbitz will lower airline costs and foster competition in the already highly competitive airline industry.

These comments will first explain why Orbitz will be good for airline competition, and why regulating the airlines' relationship with Orbitz -- a start up company with zero market share -- would be inconsistent with the Department's standards. American's comments will then turn to other Internet issues, including whether CRSs should be allowed to leverage their existing positions in airline distribution channels into stronger Internet positions, and what, if any, regulation

of Internet airline distribution would be appropriate. Finally, American will address other issues, such as what can be done to bring price competition to increasingly excessive CRS fees, and whether Sabre should be subject to the same CRS regulations that are applied to airline owned CRSs.

I. **Orbitz Is A Procompetitive Solution To Increasingly Excessive CRS Charges And Its Access To Airlines Fares Should Not Be Regulated**

A. **Why Orbitz Is Needed**

Since the inception of CRS regulation, the Department has recognized that (1) CRS fees are not disciplined by competition, but (2) price regulation is unworkable and, in the long run, counterproductive. 57 Fed. Reg. 43780, 43816-43817 (September 22, 1992) Both points remain true today. CRS fees are at supra-competitive levels and are continuing to increase. Yet, for the first time in many years, there is hope that developing Internet distribution channels will bring market pressures to CRS pricing. The CRSs recognize that, absent protective government regulation, the Internet threatens to introduce new technologies that will, at a minimum, put an end to supra-competitive CRS booking fees, and, at worst, bypass them altogether.

When the Department last modified the CRS rules, it found that each CRS had market power over airlines, that CRSs were using this market power to charge supra-competitive fees, and that these costs were being passed on to consumers in the form of higher air fares. 56 Fed. Reg. 12586, 12589 (March 26, 1991) In the intervening decade, the situation has gotten worse, not better. CRS booking fees per segment have increased 70%, despite reductions in

computing and telecommunication costs.² And excessive CRS fees continue to grow. According to an August 9, 2000, report in Aviation Daily, Sabre will increase charges by 7% this year, which compounded over ten years translates into yet another doubling of CRS fees.³ Since CRSs historically match price increases, airlines can expect a similar price increase from other CRSs.

American expects to spend over \$300 million in CRS charges this year, making CRS charges one of its largest cost items. CRS operating margins are routinely double that of the airlines they serve, and it is not unusual for CRS fees to equal 10% to 15% of the fare charged. A simple itinerary with four segments (two segments each way on a round trip) that is changed twice can generate as much as \$25 in CRS booking fees. On a \$250 fare, that amounts to 10% of the ticket price. If the PNR is changed more times, CRS charges can become staggering.

CRS charges will continue to be excessive until the CRSs are no longer able to dictate the next rate increase. Airlines have had no choice but to participate in each CRS; otherwise they exclude themselves from an intolerably large percentage of the market. 57 Fed. Reg. 43780, 43783 (September 22, 1992) Since CRSs have never had to bargain with airlines for access to inventory, fares, or other information, the CRSs have consistently raised prices, even as telecommunication and computing costs have gone down.

² Testimony of DOT Inspector General Mead, Before the Senate Committee on Commerce, Science, and Transportation, p. 16 (hereafter, Mead Testimony) (Attachment B)

³ Aviation Daily, August 9, 2000 (Attachment C)

The Internet has the potential to reduce distribution costs by as much as 75%.⁴ Although the Internet is still in its infancy, supra-competitive CRS fees are clearly at risk, and the CRSs have responded aggressively to the threat of new competition. Sabre owns Travelocity, the largest travel Internet site, and earlier this year purchased Preview Travel (then the third largest online travel agency). Travelocity now boasts over 21 million members and \$2.44 billion in annualized sales.⁵ It is now the sixth largest travel agency in North America. Even more recently, Sabre announced the acquisition of GetThere, its largest competitor in the online corporate travel market. With this acquisition, Sabre will have contracts with over 700 corporations (many of them Fortune 500 companies) using a major corporate booking tools.⁶ These acquisitions give Sabre an increasingly large and even more deeply entrenched position in online distribution channels.

Travelocity's most significant competitor is Expedia, a Microsoft subsidiary, which is equally well entrenched, extremely well funded, and serviced by Worldspan. Together, Travelocity's and Expedia's share of online travel agency sales approaches 80%.⁷ Because Expedia could obtain access to virtually all airline fares through Worldspan, it (like Travelocity) had no need to negotiate with the airlines for access to fares and inventory. In fact, since CRSs

⁴ Mead Testimony, p. 7 (Attachment B)

⁵ Forrester Study Names Travelocity the Leader in Online Travel (Attachment D)

⁶ Travel Weekly Articles (Attachments E and F)

⁷ This figure excludes opaque sites, such as Priceline, and airline web-sites, since they do not purport to offer unbiased information concerning published fares.

can extract supra-competitive fees, Worldspan was able to offer Expedia a huge incentive payment to run Expedia sales through its CRS. These incentive payments will be at risk if CRS fees reach competitive levels.

Orbitz was created to help spark the competition needed to bring the Internet's promise of lower distribution costs to the airlines.⁸ Its business plan calls for it to eventually match the distribution costs of the airlines' own web-sites. By offering both immediate and long-term cost reductions, Orbitz will make it economical for American to distribute through a third party the highly discounted Internet-only fares that were previously available only at AA.com. American is willing to provide these fares to Orbitz -- despite the fact that doing so may reduce AA.com traffic -- because Orbitz has offered substantial distribution cost savings on every ticket it sells, not just those tickets with highly discounted Internet-only fares. Moreover, Orbitz has promised to develop and implement technology that will eventually allow airlines to bypass the CRSs' heavy fees on online sales. Until these other alternatives become available, CRSs will have no incentive to reduce booking fees or to make their systems a more cost-effective means of distributing airline inventory.

By operating or servicing a few mega-sites, the CRSs would prefer to leverage their current positions into protected positions in the online world. Thus, it is hardly surprising that they are encouraging the Department simply to graft its CRS regulations onto online distribution. While 14 CFR § 255.7 has required virtually all of the major carriers to participate at the highest level in each CRS, despite the costs, the CRS rules have not regulated the terms of CRS

participation beyond requiring the CRSs to offer similar terms and conditions to all carriers. Thus, the terms of CRS participation have been both unregulated and non-negotiable.

If left unconstrained by competition, Travelocity and Expedia present a much greater threat to airline competition than does Orbitz, which has yet to sell a ticket or sign up a member. In 1984, when the Civil Aeronautics Board first regulated CRS practices, Sabre and Apollo, the two largest CRSs, were used by travel agencies responsible for 70% of airline sales. 49 Fed. Reg. 32540, 32544 (August 15, 1984) Today, Travelocity and Expedia account for almost 80% of online travel agency sales.

If anything, Travelocity's and Expedia's tremendous market share promises to grow, as experience on the Internet has shown that the first sites to achieve scale reap a disproportionate percentage of customers and investors. Amazon is five times larger than its next largest competitor; eBay is eight times larger, and Yahoo is twice as large. Statistics show that Travelocity is growing 20% to 30% faster than online travel agency distribution. Although it is a common phenomenon for the first player that brings a service to market to enjoy some unique benefit, new regulation that protects the entrenched "first movers" from new competition in Internet distribution would be extremely ill conceived.

⁸ Orbitz is owned by United, Delta, American, Northwest and Continental.

B. Orbitz Is Good News For Consumers

Orbitz will not only reduce airline distribution costs, it will be very good news for consumers and for airline competition. Although Orbitz will initially be owned by five airlines⁹, it has adopted a corporate charter that ensures a level competitive playing field for all carriers. Orbitz has agreed to:

Provide an unbiased display in which the lowest fare will be displayed first, regardless of whether the carrier is an owner, associated carrier, or a non-participant;

Search for the lowest fare using the best technology and utilizing more customer selected parameters; and

Offer significant (and the same) distribution cost savings to all carriers.¹⁰

Moreover, because Orbitz will lower online distribution costs, some airlines have agreed to give Internet-only fares to Orbitz, which will show all of these fares in a single display, together with all other travel options.

All of this benefits consumers. But it is not surprising that Travelocity, Expedia, and others do not want to see Orbitz succeed. They benefit from the existing, CRS-based distribution system that generates supra-competitive CRS fees and increasingly large CRS incentive payments to some travel agencies. Nor do they want to see a new competitor with low fare searching capabilities

⁹ Orbitz's management has stated that it intends to diversify its ownership and eventually intends to become a publicly traded company.

that surpasses anything they offer. Simply put, Orbitz promises to raise the competitive bar in several ways.

C. Orbitz Access To Internet-only Fares Is The Result of Competition -- Not Anticompetitive Conduct

The airlines' agreement to provide Internet-only fares to Orbitz in return for cost savings has led Travelocity and others to call for new regulation that would require carriers to give these fares to every online travel agency. Yet in 1997, Sabre saw the issue exactly right when it proclaimed, "Sabre strongly believes that CRSs should be permitted to and encouraged to compete with each other to have access to distribute [Internet-only fares]." ¹¹

Orbitz does not have exclusive access to any fares. Rather, it is the only online agency that has offered the airlines significant short-term and long-term distribution cost savings in return for access to Internet-only fares. Travelocity, Expedia, and others have been selling airline tickets over the Internet since the mid-1990s, yet they have never offered American anything close to the cost savings promised by Orbitz. Even today, Travelocity refuses to match the distribution cost savings that Orbitz promises. Aviation Daily recently reported that the offer Sabre has made to airlines for access to Internet-only fares is a promise to raise booking fees by something less than the 7% increase that it otherwise intends to push through. ¹² That, of course, is no cost saving. Sabre is

¹⁰ Testimony of Jeffrey G. Katz, Before the Senate Committee on Commerce, Science, and Transportation, p. 3 (Attachment G)

¹¹ Reply Comments of Sabre, p. 10

¹² Aviation Daily, August 9, 2000 (Attachment C)

apparently confident that it will gain access to these fares through government mandate, rather than through competition and negotiation.

In simple terms, Orbitz, at long last, is bringing the airlines lower distribution costs, and now that competition has arrived, Sabre and others want regulatory protection. Any such regulation would exceed the Department's authority, distort the marketplace, and, in the long run, lead to higher fares.

D. The Department's Authority And Standards For Regulating Conduct

The Department acknowledges that its authority to regulate Internet commerce is an open issue. In prior rulemakings, the Department relied primarily upon 49 U.S.C. § 41712 (formerly Section 411 of the Federal Aviation Act) which gives the Department authority to prevent "unfair or deceptive practices or unfair methods of competition in air transportation or the sale thereof." The Department has said that its regulations are designed to prevent conduct that is either "anticompetitive or likely to cause consumers to be misled." 65 Fed. Reg. 45551, 45554 (July 24, 2000)

The Department may not prohibit conduct simply because that conduct has an impact on competition the Department does not like or with which it disagrees. Rather, regulation is appropriate only if the conduct impacts airline competition in a way that violates antitrust laws or principles. Id.

Moreover, the Department may not regulate conduct based upon mere speculation. Regulation must be based on facts that show that competitive harm is not merely possible, but likely. Finally, the Department has said that its

regulations do not protect market participants from new technologies or emerging market trends. To the contrary, the CAB stated that it considers “intervention in the CRS market to benefit a particular competitor as wholly inconsistent with our effort in the proposed rules to give maximum flexibility to CRS industry participants to respond to the needs in the market.” 49 Fed. Reg. 11643, 11669 (March 17, 1984)

The Department’s standards are consistent with standards applied by other agencies in exercising their rulemaking authority. Recently, the Federal Trade Commission closed its investigation concerning Covisint, a joint venture involving five major automobile manufacturers. The FTC concluded that it would be premature to decide what, if any, regulation was appropriate, since Covisint has yet to launch its site.¹³

Even where it has authority to regulate, the Department has wisely recognized that regulation often breeds inefficiencies and market distortions that can be worse than the problems that regulation is intended to remedy. Although CRS booking fees are undisciplined by market pressures, the Department has denied repeated requests to engage in price regulation. As the Department explained:

We are avoiding regulations that would force us to engage in unnecessarily detailed oversight of CRS operations. We agree . . . that regulating business conduct is not desirable unless clearly necessary. Regulation obviously imposes costs of its own, e.g., by interfering with management decisions to respond to market forces (and, in this case, potentially frustrating technological change).

¹³ Federal Trade Commission Press Release, September 11, 2000 (Attachment H)

57 Fed. Reg. 43780, 43783 (September 22, 1992) Concerns over the impact of regulation on technological innovation are particularly relevant to the development of the Internet.

In sum, proponents of regulation must show a legitimate threat of conduct that *is likely* to negatively impact *airline competition* in such a manner that it *violates antitrust laws or principles*, making it *clearly necessary* to impose new government regulation that will *not frustrate technological change or create market distortions that outweigh the benefits of that regulation*.

E. Regulating The Distribution Of Internet-Only Fares Would Be Inconsistent With These Standards

Commenters asking the Department to regulate the distribution of airline fares over the Internet have fallen woefully short of establishing that regulation is “clearly necessary.”

The CRS regulations are intended to protect airline competition, not the economic interests of CRSs and travel agencies. Admittedly, access to Internet-only fares will help Orbitz in competing against Travelocity and Expedia. However, proponents of regulation must establish a direct connection between Orbitz’s access to Internet-only fares and a clear and immediate danger to airline competition. The only argument that they can make is as follows: Orbitz’s access to Internet-only fares will put other online travel agencies at such a distinct competitive advantage that, over time, they will be unable to compete, thereby allowing Orbitz to gain market power, and, thereby, diminishing public

access to unbiased information concerning air fares. For a number of reasons this argument is both wholly speculative and fundamentally unsound.

1. Orbitz Does Not Have Exclusive Access To Internet-only Fares.

Orbitz does not have exclusive access to Internet-only fares. Rather, it is the only online agency that has offered the airlines significant distribution cost savings in return for access to these fares. These cost savings will apply to every ticket that Orbitz sells, regardless of fare type.

Like any business, airlines need the ability to reward low-cost suppliers; otherwise, the airlines will have no control over a significant component of costs, and consumers will end up paying higher fares. Other businesses routinely give unique benefits to those suppliers and distributors that provide lower costs or superior service. Automobile manufacturers, for example, allot more of their hottest selling vehicles to select dealers. Airlines need the same ability to identify and give proportionate benefits to those suppliers and distributors that prove to be the best long-term partners. Indeed, as the Department has already noted, it is not at all unusual for airlines to offer special fares to agencies that offer the airlines lower distribution costs or unique value. 65 Fed. Reg. 45551, 45553 (July 24, 2000)

There has been no showing that airlines would not make Internet-only fares available to other online agencies, including Travelocity and Expedia, if those agencies were willing to offer savings comparable to Orbitz. Indeed, airlines have a strong incentive to spread distribution cost savings to as many online sales as possible. The revolutionary costs savings generated by Orbitz

will be many times greater if those savings can be applied to the sales of other online agencies as well, particularly if those agencies are as large as Travelocity and Expedia. Any airline that refuses to provide Internet-only fares to a distributor willing to reduce the airline's costs will confront non-competitive distribution costs as other airlines take advantage of every opportunity to reduce distribution costs. Indeed, DOT Inspector General Mead has noted that "several airlines have indicated that if other sites can provide financial incentives comparable to the Orbitz rebate on booking fees, they are willing to make the low fares they provide to Orbitz available to other outlets."¹⁴

These are some of the market dynamics that have been missing from CRS distribution for decades and that the CRSs and others would like to see short-circuited by government regulation. However, the Department has said that, wherever possible, it wants the market, and the judgment of business people, to dictate conduct. Regulation is a measure of last resort. In this instance, the proponents of regulation have given the market no time to act; they want regulation to be the first resort -- even before Orbitz has sold a single ticket -- because they know that the market will, at long last, begin to discipline CRS pricing and CRS rebating to travel agencies.

¹⁴ Mead Testimony, p. 21 (Attachment B). American does not know what representations were made by other airlines to Inspector General Mead. However, it is important to note that Orbitz offers the airlines much more in cost savings than a booking fee rebate. Orbitz's other commitments include a different commission structure and an obligation to pursue aggressively a direct connection with airlines. All of these obligations must be matched to provide airlines the same incentives Orbitz has offered.

2. **There Has Been No Showing of Any Significant Risk that Orbitz Will Obtain Market Power or Harm Airline Competition.**

Even if it were assumed (incorrectly) that Orbitz had exclusive access to Internet-only fares, there is absolutely no evidence that airline competition would be harmed. Indeed, the only way airline competition could possibly be affected is if other online distributors were forced off the Internet, and consumers were ultimately left with no choice other than Orbitz. That proposition is, quite simply, baseless.

Internet-only fares constitute less than one tenth of one percent of airline sales.¹⁵ These fares are highly restricted and capacity controlled, and their availability on any route at any given time is highly unpredictable. Orbitz would likely enjoy some competitive benefit from having access to Internet-only fares, but to assume that access to these fares would transform Orbitz into an Internet category-killer -- and thereby ultimately severely limit consumer choice -- is pure speculation.

Orbitz will be competing against Travelocity and Expedia, both of which have a five-year head start and other huge competitive advantages. Travelocity has an exclusive agreement with America Online, the world's largest Internet service provider; a cooperative marketing agreement with Priceline, the leading distributor of opaque fares; marketing agreements with Excite, Yahoo, and Netscape, all leading Internet portals; and access to content from Frommers and

¹⁵ Mead Testimony, p.9 (Attachment B)

other strong brand names in travel media. Expedia is owned by Microsoft, which directs Internet users to Expedia in many ways, including agreements with MSN, Vacation Spot and others. And, perhaps most importantly, Travelocity and Expedia have tens of millions of members that already routinely visit their sites.

The assumption that Orbitz's access to Internet-only fares, in and of itself, could possibly overcome all of these competitive advantages, and thereby threatens the viability of Travelocity and Expedia as alternatives to Orbitz, is completely unproven. There is no factual basis for the Department to conclude that government regulation is "clearly necessary" to protect airline competition -- even before Orbitz has sold a single ticket. Indeed, given the present state of online travel distribution in which two sites have a huge share of the market, providing Orbitz with some advantage to off-set the many advantages enjoyed by Travelocity and Expedia would enhance competition by helping Orbitz mount a competitive challenge.

The Department has never introduced new regulation on a record so devoid of evidence of competitive harm. Before regulating CRSs in the first instance, the CAB (and later the Department) determined that CRSs were essential facilities for airline distribution. Here, access to heavily restricted, capacity controlled, and highly unpredictable Internet-only fares has never been shown to be "essential" to being a successful distributor of airline tickets. To the contrary, these fares have been only been available on airline websites for years, yet many other non-airline sites have prospered. Moreover, as the Department has already noted, airlines have historically restricted the distribution of some

fares to selected travel agencies, without any significant impact on competition.

65 Fed. Reg. 45551, 45553 (July 24, 2000)

Second, when the CAB decided to regulate CRS conduct, 70% of airline tickets were being distributed through Sabre and Apollo, the two largest CRSs. Orbitz, in contrast, has a market share of zero. Jeffrey Katz, CEO of Orbitz, has testified that he expects Orbitz to account for less than 2% of airline sales in the next four to five years.¹⁶ It is Travelocity and Expedia, not Orbitz, that have a huge percentage of online sales. Regulation that protects the existing dominant competitors from a start-up company would be a profound mistake.

Finally, before it regulated CRS conduct, the CAB concluded that airline owners were using CRSs to negatively impact airline competition. CRSs were biasing their displays in favor of their owners and charging different carriers different booking fees. Orbitz has no intention of repeating these practices on the Internet. Its corporate charter, and its agreements with participating carriers, guarantee that the display will be unbiased, and that all participating carriers will enjoy the same cost savings.

In sum, the state of competition on the Internet, the type and number of fares involved, the size of Internet sales overall, and Orbitz's voluntary undertakings, do not justify new regulation.

II. **Comments On Proposed Interim Regulation**

DOT Inspector General Mead correctly noted that airlines are embracing the Internet and that Orbitz has the potential to reduce ticket distribution costs significantly. He also stated that Orbitz has other pro-consumer features and

could generate competitive pressure on other online agencies to eliminate bias and upgrade search capabilities. Inspector General Mead did, however, express some concern that if Orbitz is “extremely successful and eliminates its online competitors,” it could develop the market power necessary to charge premiums to airlines. He encouraged the Department to evaluate the likelihood that government intervention is needed to protect competition and consumers, and he suggested interim regulation that would require airlines to provide all fares given to Orbitz to distributors that provide the same cost savings.¹⁷ Although this proposal is well-intentioned and properly recognizes the importance of the cost savings that Orbitz promises, it is neither necessary nor consistent with the Department’s desire to rely on market forces whenever possible.

A. There Is No Evidence That Interim Regulation Is Necessary

Inspector General Mead correctly noted that regulation is only appropriate if Orbitz is likely to “eliminate its online competitors,” leaving consumers with no other choices in purchasing airline services. For reasons already explained, Orbitz will not eliminate competition, nor do the airlines have any desire to see a single distributor achieve market power over airline distribution. Regulation based on such an unlikely outcome is, by the Department’s own standards, improper over-regulation.

If the Department has any serious concerns with Orbitz’s impact on airline competition, the best course of action is the one that the Department has taken in the past – defer to the market unless and until it is shown that regulation is

¹⁶ Katz Testimony, p. 17 (Attachment G)

¹⁷ Mead Testimony, p. 3 (Attachment B)

necessary. In rejecting calls to regulate booking fees, the CAB emphasized that it could, and would, act if airline competition were ever seriously threatened. 49 Fed. Reg. 32540, 32553 (August 15, 1984) The Department is always free to act to protect airline competition based upon a proper showing of competitive harm, and there is no need to regulate precipitously.

B. Interim Regulation Would Distort Market Pressures And Reduce Incentives To Reduce Airline Distribution Costs.

Interim regulation would be more than benign over-regulation. It has the potential to distort the market and lead to higher overall costs. First, it would not be a simple task to determine if other distributors have matched Orbitz's cost reduction commitments. Orbitz promises the airlines much more than a short-term reduction in booking fees. It has made long-term commitments to continue to reduce distribution costs aggressively – for example, by developing direct connections with participating carriers. These commitments are extremely valuable to the airlines, and they are a big part of the consideration that Orbitz offers the airlines.

Regulation that would require the Department to decide if other distributors have, in fact, matched Orbitz's commitments and are pursuing them with sufficient diligence would be exceedingly difficult to administer. This intrusion into the market place and business decision making would be no less severe than the booking fee regulation that the CAB and the Department have wisely avoided since 1984. Any such regulation would only generate disputes, litigation, and attorney fees, all of which would only increase the cost of doing business.

Second, regulation requiring airlines to give the same deal to every market participant means that online distributors will have no incentive to be a leader in reducing airline costs. What incentive would Orbitz have to establish direct connections with the airlines if its competitors – none of which took any initiative to lower airline costs – automatically get the same deal? Put simply, markets often reward leaders; and the airlines, like any other business, should have the ability to give proportionate benefits to distributors that prove to be the best long-term partners. That is standard practice in other industries. Regulation that prevents these market dynamics from occurring in airline distribution would reduce competition and lead to higher distribution costs and, ultimately, higher air fares.

C. **If Interim Regulation Is Adopted, The Department Needs To Make It Clear That Online Agencies Must Match All Of The Commitments That Orbitz Has Made To Reduce Airline Distribution Costs**

If interim regulation is adopted, the Department needs to insure that those travel agencies seeking access to Internet-only fares truly match the savings offered by Orbitz. Otherwise, the opportunity to bring new competition to airline distribution costs will be lost. At a minimum, this means: (1) booking fee rebates on every ticket sold through the distribution channels controlled by or affiliated with the online agency; (2) a commission structure that matches Orbitz; and (3) a clear and enforceable obligation to implement a direct connection to the airlines. Moreover, these commitments need to be long-term commitments that cannot be simply disregarded if the competitive threat of Orbitz is eliminated or somehow reduced.

III. **CRSs Should Not Be Permitted To Leverage Their Existing Position To Gain An Unfair, And Protected Position, In Internet Distribution.**

The real threat to Internet airline distribution is not Orbitz, but the possibility that CRSs will leverage their existing market power to obtain access to fares and inventory for Internet distribution, without competing for that access. There is a substantial risk that CRSs, unwilling to subject their supra-competitive booking fees to market pressures, will insist that airlines give them access to Internet-only fares through participating carrier agreements that are not negotiated.

American agrees with the comments of other airlines that CRSs should not be allowed to tie CRS distribution to Internet distribution or access to Internet-only fares. Although the Internet promises to bring new competition to CRS booking fees, that promise remains very much in the future. Tying Internet distribution and traditional CRS distribution -- where the Department has found that CRSs have market power -- implicates significant antitrust principles and may, as argued by Delta, constitute a violation of Section 2 of the Sherman Act. Allowing CRSs to tie these two distribution channels threatens to cut off competition before it has even begun, and therefore this practice should be prohibited.

IV. **The Department Should Bring New Competitive Pressures To Booking Fees By Abolishing The Mandatory Participation Rule And By Making CRS Fees Transparent To Consumers**

Rumors of another Sabre rate increase leave no doubt that CRSs will continue to increase already excessive booking fees. As Internet distribution becomes an increasingly significant threat to excessive fees, CRSs may be motivated to increase booking fees even more to fund investments like Sabre's purchase of GetThere. The excessive profits that CRSs have consistently generated on booking fees are being used by the CRSs to build an increasingly large position in Internet distribution. The Department should therefore consider ways to bring more immediate market forces to bear on CRS fees.

A. **The Mandatory Participation Rule Should Be Abolished**

Since it no longer has any ownership interest in a CRS, American is not subject to the mandatory participation requirements of 14 CFR § 255.7. Yet American supports the positions of others that the mandatory participation rule should be abolished. This rule -- like some of the other CRS regulations -- has had the unintended consequence of stifling market forces. Under this rule, CRSs have been able to demand participation at the highest level from practically all of the major carriers, and therefore the regulations have only enhanced CRS market power. Today, no airline owns a large enough percentage of any CRS to justify losing airline sales to enhance the competitive position of one or more

CRSs.¹⁸ All airlines, regardless of whether they retain some ownership interest in a CRS, should be allowed to decide whether it is in their best interest to continue to pay increasingly excessive booking fees in every CRS.¹⁹

B. The Department Should Reconsider A Department of Justice Recommendation That Would Allow Airlines To Add CRS Fees To The Fare Paid By Consumers

The Department should reconsider a proposal made by the Department of Justice during the last rulemaking that would allow airlines to add a CRS charge to tickets sold through a CRS, thus making excessive CRS fees visible to consumers and part of the cost they pay for air transportation. Currently, there is an asymmetry in the market since the travel agencies that select CRSs do not pay the booking fee, and the airlines that pay the booking fees have no say in which CRSs are used.²⁰ If CRS fees are passed on to consumers, travel agencies that used expensive CRSs would risk losing consumers who could obtain airline tickets less expensively at another agency. In turn, CRSs that continue to charge supra-competitive fees would risk losing subscribers as travel agencies compete to pass on the lowest possible cost to their customers.

¹⁸ American recognizes that it took a different position in its 1997 comments. Since 1997, however, the market has changed substantially, and several airlines, not just American, have reduced or eliminated their ownership positions in CRSs.

¹⁹ As it has said for years, American believes the Department should rely on the market whenever possible. Indeed, American believes that United's position that the CRS rules should be abolished in total is worth serious consideration. American doubts, however, that the Department is willing to take such a step at this time, and therefore it has identified those areas where the rules can be modified to put more reliance on market forces.

²⁰ This is another example of where the CRS regulations have only strengthened the market position of the CRSs. Under the current rules, airlines cannot tie commissions or other rewards to the use of a particular CRS. Thus, airlines cannot offer inducements to travel agencies to use a CRS with lower booking fees.

In rejecting this proposal in 1991, the Department cited three concerns, all of which appear to be less relevant today. 56 Fed. Reg. 12586, 12612 (March 26, 1991) First, the Department questioned whether passing CRS charges on to consumers would be sufficient to discipline CRS booking fees. The airline industry is, if anything, price sensitive. Since 1990, CRS booking fees have nearly doubled, and as explained above, on some itineraries CRS fees can be staggering. After an agency has had to explain to some of its customers why it is charging \$25 to \$50 or more for ticketing an itinerary, that agency will have a strong incentive to find less expensive alternatives. Moreover, since many large corporations buy thousands of tickets, even a few dollars per ticket can add up very quickly. Finally, as more airline sales move online, consumers are likely to become even more price sensitive. On the Internet, many travel agencies are an equidistant click away, and there is no convenience penalty for going with the absolute lowest price.

Second, the Department was concerned that passing on CRS fees would cause more consumers to book directly with the airlines. That fact, however, simply reflects the economic reality that direct booking is often the most cost efficient way to distribute tickets. Hiding costs to protect a more expensive distribution channel distorts the marketplace and is not a proper regulatory objective. And in any event, fears that significant numbers of consumers will stop using travel agencies ignore the value that travel agencies bring to airline distribution. Some consumers are reluctant to purchase tickets directly from the airlines because they want unbiased information. There is no reason to believe

that consumers will stop using travel agencies simply because they pay CRS fees directly.

Indeed, the market will insure that the cost differential between a direct booking and a travel agency booking will decrease over time as the market comes to an equilibrium that properly reflects consumer preference for travel agency services. CRSs receive no booking fees on sales made directly by airlines, and thus they will have a strong incentive to minimize the cost differential generated by supra-competitive booking fees. CRSs will, in effect, begin to compete on price with direct bookings.

Finally, the Department questioned whether Justice's proposal would be effective since some travel agencies might split their commissions with consumers to reimburse consumers for this CRS cost. However, if a travel agency can select a CRS with a lower booking fee, and reduce its rebate to the consumer, it will do so. That, of course, is exactly the type of incentive that is now missing when the agency selects a CRS.

For all of these reasons, this suggestion by the Department of Justice merits serious reconsideration.

V. **Other Internet Issues**

A. **Airline Internet Sites Should Not Be Subject To Regulation**

None of the comments submitted in 1997 argued that the Internet sites operated by airlines should be unbiased. When consumers go to AA.com or another airline's site, they are not expecting unbiased information. Thus, there is

no question of consumer deception or competitive harm akin to a violation of the antitrust laws.

However, some travel agencies have argued that airlines should be required to distribute any fares made available through their own site to all travel agencies. Essentially, without having offered any cost savings, these commenters argue that airlines should be required to offer highly discounted and low yield sales to the airlines' most expensive distribution channel. The argument that airlines must treat all distribution channels the same, despite significant costs differences, would deprive airlines of the opportunity to grow the most cost-effective distribution channels, and in the end would discourage airlines from offering these fares. Internet-only fares make economic sense for the airlines, in part, because the airlines' costs in selling these highly discounted fares are lower. Any regulation that imposed higher costs on these highly discounted fares would only mean that these fares would be offered less frequently and at higher prices.

In addition, airlines have been distributing Internet-only sales through their own sites for several years now. Yet none of the commenters has shown that consumers have no online alternatives. There is no showing that the practice of making Internet-only fares available only through the airline's own site is diminishing airline competition in any respect. To the contrary, these fares have made air travel even less expensive.

B. American Supports Regulation Requiring Internet Agencies to Disclose Bias

Unlike when they visit an airline's Internet site, consumers do expect unbiased information from an online travel agency. If an agency biases its site, without telling consumers, there is a risk of consumer deception. Undisclosed display bias presents the same risk to airline competition if it appears on the CRS screen in an agency or on the computer screen of a customer. Indeed, to some extent, undisclosed display bias may be worse with online distribution. Before CRSs were regulated, at least the agencies knew that they were working with a biased display, and they knew how to find other options. Today, few online customers are likely to ferret out display bias at an online site. At a minimum, if an online agency is allowed to bias its displays, it should be required to disclose that the information provided is biased.

VI. CRS Regulations Should Apply To CRSs, Irrespective Of Whether They Are Owned By Airlines

The CAB (and later the Department) began to regulate CRS conduct based on the conclusions that CRSs were essential facilities for airline distribution, and that bias within these essential facilities adversely affected airline competition. The fact that airlines have reduced their ownership positions in CRSs does not diminish the airlines' need to use CRSs, the CRSs' market power over airlines, or the impact of bias in CRSs. If the Department finds that these conditions still exist, it needs to regulate all CRSs equally.

The effect of display bias on airline competition is the same regardless of whether it results from system ownership, retaliatory conduct, or a promotional fee paid by a carrier. Likewise, the formality of CRS ownership does not diminish the impact on airline competition caused by a CRS charging airlines different rates, or providing disparate functionality, for a service that the Department has concluded is essential to all airlines.

Moreover, any regulation that treats competitors differently invites market distortions. Sabre provides the same services to airlines and travel agencies as the other three major CRSs. Unless the Department is willing to de-regulate CRS practices, as suggested by United, treating Sabre differently from its competitors could give it an unfair competitive advantage.

The Department's call for comments correctly notes that, in the past, the Department has relied upon the airlines' ownership of CRSs to establish its authority to regulate CRS practices. More specifically, the Department has cited 49 U.S.C. § 41712 (formerly Section 411 of the Federal Aviation Act) which gives it authority to "investigate and decide whether an air carrier, foreign air carrier, or ticket agency has engaged in an unfair or deceptive practice or unfair method of competition in air transportation or the sale of air transportation." Although it might be argued that a CRS is neither an air carrier nor a ticket agency, the Department can regulate the commercial relationship between CRSs and airlines or agencies, if it finds that CRS practices will adversely impact airline competition in a way that violates section 411. For example, the Department may require

travel agencies to use a CRS that complies with its regulations concerning unbiased displays, nondiscriminatory pricing, and equal functionality.

Moreover, the Department has also relied upon 49 U.S.C. § 40105 as a jurisdictional basis for its CRS rules. Section 40105 requires the Department to act consistently with the United States' obligations under treaties and bilateral agreements. Many of these treaties and agreements guarantee airlines a fair and equal opportunity to compete, and some specifically address CRS issues. For example, the recent agreement with the Republic of the Ukraine states that primary CRS displays must be comprehensive and unbiased, and that CRS charges must be nondiscriminatory. These bilateral obligations concerning CRSs extend to all CRSs and make no distinction based on airline ownership.

In sum, the need for, and the logic behind, the CRS rules do not turn on the formality of ownership. If the Department intends to continue to regulate CRSs, based on a finding that CRSs are an essential facility to airline distribution, and therefore have market power over airlines, it should regulate all CRSs equally, regardless of their ownership structure.

CONCLUSION

American appreciates the opportunity to be heard on these issues, and encourages the Department to continue to defer to market forces whenever possible. It should resist the temptation to regulate developing Internet distribution precipitously, and it should consider ways to bring needed competition to CRS charges.

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Respectfully Submitted,

R. Bruce Wark
Senior Attorney
American Airlines, Inc.