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Statement of

The Honorable Kenneth M. Mead

Inspector General

U.S. Department of Transportation

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to testify on issues related to sales of airline tickets over the Internet. Last month we provided you with an interim report on the airlines' progress toward instituting a voluntary Airline Customer Service Commitment. The Commitment incorporated a variety of promises including a provision to provide consumers with information on their lowest fares. However, this provision was limited to information provided through the airlines' telephone reservation systems.

The Internet is growing rapidly as an avenue for consumers to research and purchase travel. In fact, this growth is fundamentally changing the airline distribution network. Concerns about what impact the Internet will have on consumers' continued ability to access lowest fares, along with other changes taking place in the ticket distribution network, led to a provision in the DOT's Fiscal Year (FY) 2000 Appropriations Act to review these issues. We have also undertaken an effort to identify the impact of Orbitz, the proposed jointly owned airline website. Our initial work is nearing completion. Today, I would like to make four points directly related to Internet sales of airline tickets.

- **Travel sales over the Internet are growing at a rapid pace**. Airlines have embraced the Internet as a means of significantly reducing ticket distribution costs. In 1996, less than ½ of 1 percent of airline tickets were sold online through airline websites or online travel agencies such as Travelocity or Expedia. Today, online purchases account for an estimated 5.9 percent. By 2003, industry analysts project that percentage to reach over 11 percent. The airlines have facilitated the shift from traditional channels to their websites through special offers such as bonus frequent flyer points and fare specials that are available only by purchasing travel on their websites.

  By 2003, analysts project that over $29 billion will be spent on all travel products over the Internet and that this will account for more than one-third of all product purchases made online. The Internet benefits consumers by giving them the ability to access a broad range of information 24 hours a day, 7 days a week, although for a certain part of the population – some senior citizens, individuals with certain types of disabilities, and the economically disadvantaged – access to the Internet is still problematic.

- **Wide disparities exist between distressed inventory "E-fares" and fares quoted simultaneously for identical itineraries in other areas of the airlines' same websites.**

  In a test of 20 published E-fares offered this summer, we found that "clicking" on separate areas within an airline website can result in fare quotes that differ by more than 1000 percent. For example, one airline offered a last minute E-fare of $140 for round-trip travel between Newark, New Jersey and New Orleans, Louisiana for the week of July 8, 2000. Requesting the same itinerary simultaneously through the airlines' normal website fare-search procedure turned up a round-trip fare of $1,791, a difference of 1,179 percent. The airline's search engine did return a lower price option of $1,200 for a different itinerary, but that was still higher than the E-fare by more than 750 percent.

  In almost all 20 of our test cases, airline telephone reservation agents could not or would not inform us that an E-fare was being offered on the Internet that could save us hundreds or even thousands of dollars. The technology exists to make this information available and consistent throughout these channels, and consumers would be best served if airlines pursued such a policy.

  While these fares are estimated to represent less than 3 percent of all online ticket sales, these fares also have been at the heart of the controversy over whether Orbitz participants will make their lowest fares available exclusively on Orbitz.

- **Orbitz could potentially benefit consumers and airlines by providing a wider range of fare options, bias-free displays, and reduced booking fees, but red flags raised by competitive issues, such as airlines potentially restricting their lowest fares exclusively to Orbitz, must first be resolved.**

  Orbitz is an online travel agency set to launch this fall that is jointly owned by five airlines: Delta, United, Northwest, Continental, and American Airlines. The site will offer comparative information on all airlines' fares and services, in much the same model as its competitors Travelocity and Expedia. Although Orbitz is currently wholly owned by the five airlines, it is soliciting investors and owners from outside the airline industry and may eventually consider a public offering.

  In exchange for airlines making their lowest published fares available on Orbitz, Orbitz will offer participating airlines a rebate that will offset as much as one third of Computer Reservations System (CRS) fees incurred for travel booked on the Orbitz site. With the average round-trip flight incurring CRS booking fees of $10 to $16, this rebate could result in substantial savings. If Orbitz' software

functions as it has promised and Orbitz abides by its charter, consumers could benefit from having access to a wider pool of options displayed free of bias. However, concerns about the airlines restricting their lowest fares – including the deeply discounted E-fares – exclusively to Orbitz or engaging in other anti-competitive practices will need to be resolved first by the Departments of Justice and Transportation.

In the short term, actions could be taken to protect against the potential for anti-competitive practices. For example, interim provisions could be established requiring airlines to make available any fares they provide Orbitz to any other entity willing to offer the same financial terms concerning booking fee rebates as Orbitz. Such a provision should be predicated on agreement by these entities to abide by the non-bias regulations that apply to CRSs.

In the long term, barring any anti-competitive behavior, Orbitz could generate competitive pressure on other online agencies to eliminate bias and upgrade search capabilities. It could also put competitive pressure on CRSs to lower booking costs and improve services. If airlines are successful in drawing consumers to distribution channels that incur lower booking fees – such as Orbitz – the CRSs that provide services for the higher cost distribution channels will lose business. If the CRSs want to keep this business, reducing their fees would give airlines more of an incentive to provide them with their lowest fares.

But there is the potential for harmful impacts on the travel marketplace. If Orbitz is extremely successful and eliminates its online competitors, Orbitz could develop the power to charge premiums to airlines to participate, benefiting its equity owners to the detriment of other airlines and resulting in higher fares to consumers. The Departments of Justice and Transportation need to evaluate the likelihood of these and other scenarios playing out in determining whether prior intervention is needed to protect competition and consumers.

- **CRS rules[1] are being rapidly eclipsed by marketplace changes and technological innovation.** CRSs are the vehicle through which travel agents receive information about and book airline tickets. The existing regulations were implemented in large part to protect consumers and competitors from the biasing of information by the airline-owners of these systems. The airline-owners were biasing displays of data to ensure their own flights got top billing on a travel agent's screen, even if the flights were not the best travel options.

  With the Internet potentially replacing many of the functions performed by the CRSs, questions have been raised over whether these regulations should apply to

[1] CRS rules were established in 1984 and amended in 1992.

the new distribution channels, and if they did, whether they would have any meaningful impact. The regulations apply to airline-owned CRSs but with recent airline divestitures of CRSs, even CRSs are unsure about whether they must still comply with the regulations.

Furthermore, travel agencies have never been subject to the anti-bias rules of the CRS regulations. But given the long history of airlines' anti-competitive CRS practices, the expansion of airlines and CRSs into ownership of online travel agencies raises questions about what regulatory protection may be needed. History has shown how difficult it is to fix problems with airline competition after they occur. If protections against abuses can be instituted early in the game, mistakes of the past can be avoided.

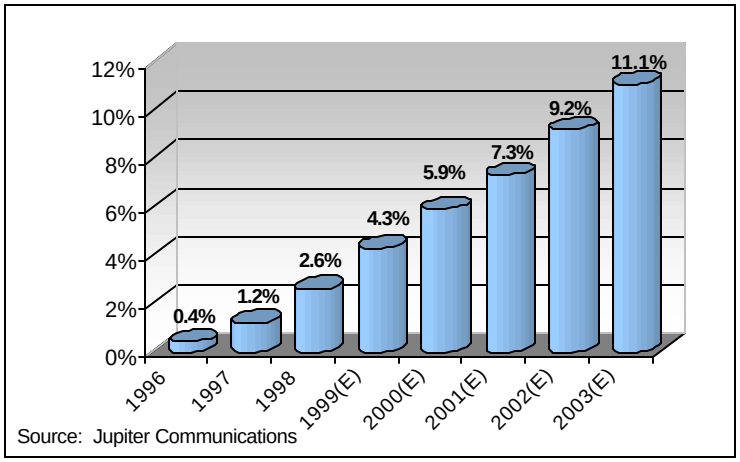
Technology is proceeding quickly to a point where travel agents and consumers may be able to bypass CRSs entirely to access fare and service information from the airlines. Such potential underscores the waning relevance of the CRS regulations.

The Department has responsibility for updating existing CRS regulations and has delayed this process three times since the 1997 sunset date. As the market continues to change rapidly, it is imperative that issues such as those just described, be addressed without further delay.

Travel sales over the Internet are growing at a rapid pace.

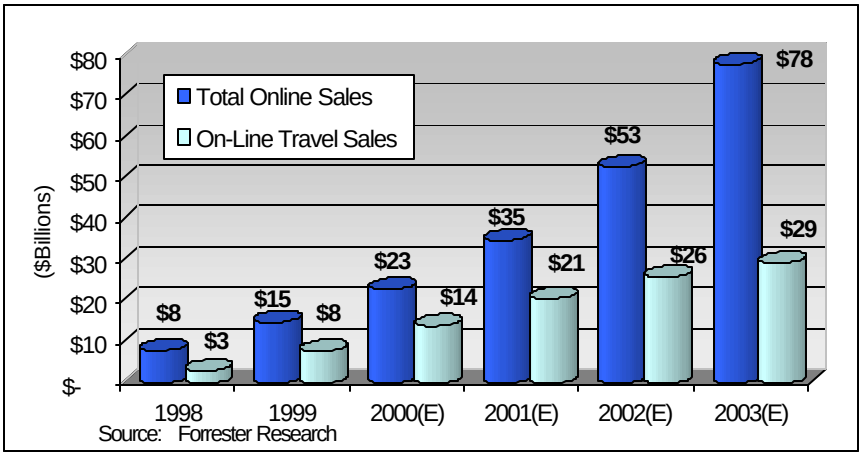
The past 4 years have seen dramatic changes in how airline tickets are sold, in large part a reflection of the growing commercial importance of the Internet. Analysts project that by 2003, more than 11 percent of all airline tickets will be sold through the Internet, nearly triple the 4.3 percent of online ticket sales in 1999 (see Figure 1). While this is an industry-wide average, some airlines have experienced much greater results. One start-up airline reported selling almost 73 percent of its seats online for the week ending July 9, 2000.

Figure 1. Growth in Percentage of Airline Tickets Sold Online



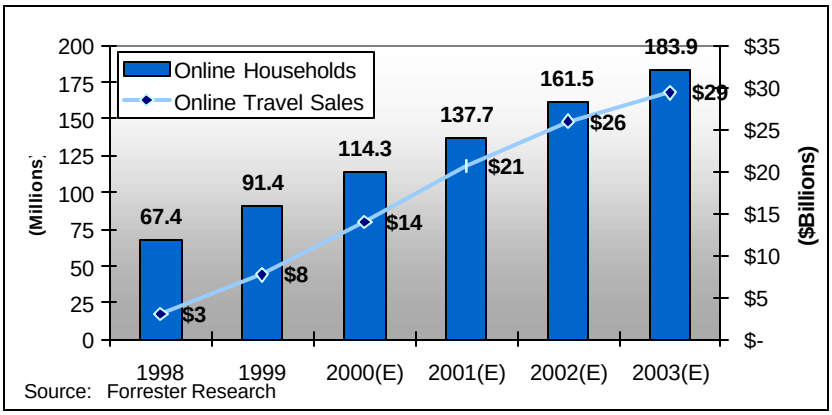
Sales of all travel sold online will almost quadruple. In 1999, online travel sales totaled nearly $8 billion, but industry analysts project that online travel sales will reach $29.4 billion by 2003. This will represent over one third of all purchases of all commodities made online (see Figure 2).

Figure 2. Growth of Online Sales and Total Travel Sales.



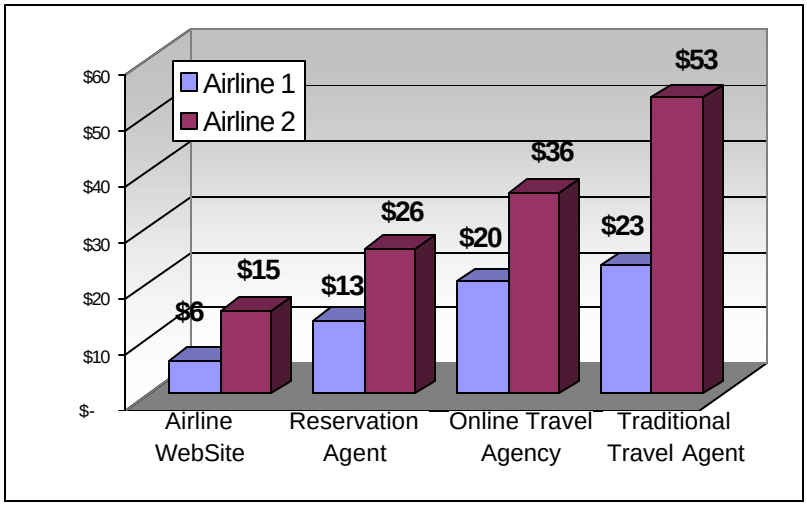
Growth reflects preferences of consumers and airlines. Consumers have embraced the Internet for convenience and the depth of information available through electronic channels, although for some sectors of the public – senior citizens, persons with some disabilities, and the economically disadvantaged -- access to the Internet is still problematic. The number of households online worldwide is expected to grow at an average annual rate of 17 percent in the next 3 years, but as consumers become more comfortable making purchases over the Internet, total online travel sales are expected to more than double over this period (see Figure 3).

Figure 3. Growth in Online Households and Online Travel Sales



Internet reduces distribution costs. Airlines and other travel providers realize that the Internet allows them to quickly reach a widely dispersed base of potential consumers while reducing distribution costs by 75 percent or more. Sales on an airline's own website are by far the least expensive avenue for airlines since the electronic search and booking capabilities allow airlines to avoid commissions, CRS booking fees, and reservation agent labor costs. Figure 4 illustrates the costs that two airlines estimate they incur through each of the identified outlets. Airlines' commission policies, labor costs, communications costs, and other factors can vary widely, resulting in wide variances in the costs incurred by each distribution channel.

Figure 4. Per Ticket Distribution Costs by Channel for 2 Major Airlines



Some Internet airfares vary substantially from fares for identical travel offered simultaneously through the same or other channels.

Our tests of last minute Internet specials (E-Fares) showed that these fares were in some cases over 1000 percent lower than fares for identical travel offered simultaneously on the airline's same website.[2] Additionally, the E-fares were, on average, 560 percent lower than airline ticket reservation agents quoted as their lowest available fares.[3] When asked, nearly all of the 20 agents we contacted for

[2] Our original test consisted of 20 E-fares (offered by 8 airlines) that we compared to quotes from 7 other distribution sources including the normal fare search procedure on the airlines' websites. We subsequently performed additional tests (100 total from 20 airlines) that compared E-fares and fares offered through the websites' normal fare search procedure. We did not seek fare quotes for these 100 tests from other travel agents or airline ticket reservation agents.

[3] Results represent findings from the 20 original tests that included comparisons between E-fares and quotes from airline ticket reservation agents.

fare information were either unable or unwilling to provide information about the possibility or existence of lower fares on their Internet sites.

While these fares are estimated to represent less than 3 percent of all online ticket sales, these fares have been at the heart of the controversy over whether Orbitz participants will make their lowest fares available exclusively on Orbitz.

E-fares currently represent a small portion of Internet airline sales. E-fares are the deeply discounted fares that airlines have begun to make available 2 to 3 days prior to departure as a way of filling seats that would otherwise have flown empty. Comparisons that we performed with sample 3-week advance purchase fares indicated that the E-fares were about one-third less than the airlines' 3-week advance purchase price for similar travel. E-fares may be called different names by the airlines -- "dot.com specials," "web-fares," "cyber-savers," etc. -- but all refer to last-minute deeply discounted fares that are only available over the Internet.

In 1999, the airline industry as a whole reported Internet ticket sales of about 4 percent. Most of these represented regular fares sold at a limited discount (i.e., 5 to 10 percent off) or at undiscounted rates over the airlines' own websites or through online travel agencies such as Travelocity. Industry analysts estimate that last minute E-fare specials represent less than 1/10th of 1 percent of total airline sales.

E-fares are far more restrictive than regular fares sold on an airline's website. Although deeply discounted, E-fares with their many restrictions are only suitable choices for a small percentage of travelers. The E-fares are often not announced until Tuesday or Wednesday for travel only on and over the approaching weekend. Airlines do not offer these fares every weekend and only do so in a limited number of varying markets. In some cases, travel is directional (i.e., E-fare from Miami to Detroit on Friday is not valid for travel from Detroit to Miami on Friday.) Dates, times, and seat availability are often severely restricted, with outbound travel required on specific days (often Friday or Saturday) with a return usually on Sunday, Monday, or Tuesday.

Test comparison between last minute E-fares and last minute walk-up fares. As a means of gauging the potential degree of variation in fare quotes from different ticket distribution channels, we tested a sample of 20 E-fares offered between June 17 and July 8, 2000. We selected E-fares from specials posted by eight carriers for the approaching weekend, and simultaneously solicited fare quotes from seven other sources, including airline websites, reservation agents, online travel agencies, and brick and mortar travel agents. Because these E-fares are only available 2 or 3 days before departure, the comparable fare quotes we received from other sources represented full coach fares that are often the only fares that airlines make available within 3 days of departure.

Test Results:

"Clicking" on different parts of an airline's website can result in fare disparities of over 1000 percent. Our testing showed that in some cases it is possible for a consumer to simultaneously get two different – and widely variant – fare quotes for the exact same itinerary just by "clicking" on different areas of an airline's website. For example, on one carrier's website, clicking on the "dot.com specials" section of the website turned up an E-fare between Newark and New Orleans of $140. Entering the identical itinerary (same dates, same flight numbers) through the regular fare-search engine on the website resulted in a fare quote of $1,791, a difference of over 1,100 percent. Table 1 provides examples of simultaneous round-trip fare quotes received for identical itineraries on the same travel dates by searching different areas of four airlines' websites.

Table 1. Variations in Fare Quotes from Different Areas of an Airline's Website.

City Pair	E-Fare	Regular Fare on Web	Difference
Boston - Los Angeles	$ 273.50	$2,223.50	713 %
Detroit – Nagoya, Japan	$ 449.00	$2,826.90	530 %
Boston – Salt Lake City	$ 178.00	$1,971.50	1008 %
St. Louis – Toronto	$ 159.00	$1,325.39	734 %
Detroit – Buffalo	$ 119.00	$ 719.00	504 %
San Jose – Portland	$ 191.00	$ 342.00	79 %
San Francisco – Los Angeles	$ 138.00	$ 276.00	100 %
St. Louis – Boston	$ 192.00	$1,541.00	703 %
Houston – Washington, D.C.	$ 157.00	$1,726.00	999 %

- **Airlines should consider disclosing existence of E-fares when an itinerary is requested through the website's normal fare-search procedure.** Airlines understandably offer a variety of fares through different distribution channels as a means of maximizing revenues, but we found some airlines' practices of

simultaneously quoting widely disparate fares for the same product within the *same* channel somewhat disturbing.[4] The E-fare tickets have more restrictive policies on exchanges and cancellations, but a strong case could be made for giving consumers the option to choose between an $819 ticket with no penalty for changes and a $147 ticket with a $75 change fee.

- **Airline reservation agents are unable or unwilling to assist consumers with finding lower Internet fares.** Our testing also revealed substantial disparities between the E-fares found on the airlines' websites and the lowest available fares quoted simultaneously over the telephone by the airlines' ticket reservation agents. In nearly every case, the lowest fare quoted by the reservation agent, the full coach fare, was substantially higher than the E-fare. The differences ranged from 64 percent to over 1,100 percent. *On average, the fares offered through airline ticket reservation agents for identical itineraries (same flight numbers on same travel dates), were more than 560 percent higher than available E-fares.* The tests were conducted simultaneously to limit the possibility that the differences were due to changes in seat availability.

[4] Four of the eight carriers included in our original test have established mechanisms that recognize an itinerary entered into the regular fare search engine as one being offered as an E-fare and will provide the E-fare quote.

Table 2 highlights examples of fare differences found between airline website E-fares and airline ticket reservation agents over the telephone. It also shows the fares being offered simultaneously through the normal search procedure on the website.

Table 2. Variations in Fare Quotes Between E-Fares, Regular Web Fares, and Airline Reservation Agents.

City Pair	E-Fare	Regular Web Fare	Airline Reservation Agent	Difference from Regular Web Fare	Difference from Airline Reservation Agent
Newark – New Orleans	$140.00	$1,791.00	$1,791.00	1,179%	1179 %
St. Louis - New York City (LGA)	$169.00	$1,593.00	$1,593.00	843%	843 %
Dallas (DFW) – Minneapolis	$160.00	$ 160.00[1]	$1,330.50	0%	732 %
Las Vegas – Los Angeles	$ 80.00	$ 80.00[1]	$ 179.00	0%	124 %
Minneapolis – Austin	$189.00	$1,469.00	$1,469.00	677%	677 %
Cincinnati – New Orleans	$139.00	$ 139.00[1]	$1,095.00	0%	688 %
Denver – Philadelphia	$252.00	$1,716.50	$1,869.00	581%	642 %
Pittsburgh – Indianapolis	$127.00	$ 127.00[1]	$ 816.00	0%	543 %

[1]Four airlines' regular website search procedures returned the E-fare specials with their associated restrictions. Unlike the full coach fares returned by other airlines, these fares are non-refundable and have the same heavy restrictions as the E-fares.

When asked, none of the airline reservation agents we spoke to could or would tell us whether an E-fare was being offered that weekend for travel we were purchasing, even when our request was for an itinerary that we knew was being offered as a low-cost E-fare. All indicated that even if one were available, it could not be sold at that price over the telephone.

One carrier indicates on its website that the E-fares listed on the website can also be purchased through a telephone reservation for an additional $20. During our testing, however, we found that this carrier's reservation agents were still not able to provide information about whether these fares were being offered.

We believe the consumer would be best served if information were available about the possibility of alternate fares being available through other channels. This does not mean that every fare should be accessible through every channel, but that airline reservation agents disclose such possibility when it exists. The technology exists to support such a policy.

Orbitz could potentially benefit consumers and airlines by providing a wider range of fare options, bias-free displays, and reduced booking fees, but red flags raised by competitive issues, such as airlines potentially restricting their lowest fares exclusively to Orbitz, must first be resolved.

In exchange for airlines making their lowest published fares available on Orbitz, Orbitz will offer participating airlines a rebate that will offset as much as one third of any CRS fees incurred for travel booked on the Orbitz site (rebate equivalent to approximately $3.00 to $5.00 per ticket booked). If Orbitz' software functions as it promises and Orbitz abides by its charter, consumers could benefit from having access to a wider pool of options displayed free of bias. However, concerns about the airlines' restricting their lowest fares, including the deeply discounted E-fares, exclusively to Orbitz or engaging in other anti-competitive practices—such as charging airlines to participate in Orbitz if it becomes the dominant online ticket source—should not be dismissed and need to be resolved first by the Departments of Transportation and Justice.

Orbitz is an airline-owned online travel agency. Last fall, Delta, United, Northwest, and Continental Airlines announced their intent to jointly launch an online travel agency that would compete with established travel websites such as Travelocity and Expedia. American Airlines signed on this spring after Sabre, the CRS that owns Travelocity — a future Orbitz competitor — was spun off as an independent entity. Although Orbitz is currently wholly owned by the five airlines, it is actively soliciting private investors and owners outside of the airline industry. Orbitz may eventually consider a public offering.

Each of these five airlines, and most other commercial airlines, have established their own individual websites to sell their own tickets and services over the Internet. While these websites provide the least expensive way to distribute tickets, the airlines know that many consumers prefer the multi-carrier travel agencies where they can compare the fares and services of competing airlines to get the best prices.

On Orbitz, consumers will be able to enter desired travel destinations, dates, and other criteria and the search engine will evaluate the spectrum of possible schedule options and then display a menu of travel options and fares. Orbitz intends to provide links to hotels, car rentals, and other traveler services.

Orbitz is an attempt by the airlines to lower ticket distribution costs, and most pointedly, to reduce what they believe to be excessive and growing CRS booking fees. Between 1990 and 2000, fees for direct access (the highest level of participation available at that time) on one large CRS have increased from $2.10 to $3.54 per segment booked, a growth of almost 70 percent (most round-trip flights have between two and four segments per ticket). While CRSs maintain that the increases reflect improvements to the systems, critics have pointed out that the fee growth has far outpaced cost savings achieved during this time from improvements in technology.

Orbitz has attempted to extend an invitation to every airline to become charter associates. Charter associates would be required to provide Orbitz with any fare they have made publicly available anywhere else, and to contribute in-kind marketing support.[5] In return, Orbitz will rebate to the airlines a percentage of CRS booking fees incurred for all tickets booked through Orbitz. Orbitz anticipates that these rebates will effectively reduce airlines' booking fees through Orbitz by about one third. This rebate is possible because Orbitz has negotiated a volume booking incentive agreement with Worldspan, the CRS that will handle the booking functions for Orbitz. Eventually Orbitz hopes to establish direct links with the

[5] In-kind marketing refers to advertising, marketing and promotions for the Orbitz website sponsored by the charter associates. These may include print, television, or Internet advertising; name/logo included on in-flight magazines or videos, Affinity program supplements such as free or discounted upgrades, or other mutually agreed upon ventures.

airlines' internal reservation centers which would allow Orbitz to bypass the CRS and avoid its fees entirely. The technology to do this is not far in the future.

To date, over 30 airlines have signed letters of intent expressing their desire to become charter associates. Airlines that do not choose to participate as charter associates will still be listed in an unbiased way on the Orbitz site. These airlines will not be required to provide their lowest fares to Orbitz, but they also will not benefit from the rebates on CRS booking fees.

Orbitz is not subject to CRS Regulations. Orbitz views itself as an online travel agency, similar to Travelocity or Expedia, and contends that, like those agencies, it is not subject to the CRS rules. The CRS rules were intended to cover airline-owned CRSs, and did not extend to travel agencies, regardless of their ownership. As such, travel agencies are permitted to bias in favor of a particular airline the information they receive from their CRSs and report to their customers or even to exclude information from some airlines if they choose. The airlines also may negotiate selective and exclusive deals, such as commission override agreements, special fare sales, and marketing promotions, with individual agencies. The airlines are not required to make these deals universally available.

Potential Contributions to the Marketplace. If Orbitz abides by its charter and presents an unbiased display, the site has the potential to provide a valuable tool for

consumers to compare fares and services as well as provide smaller airlines a platform to compete on an equal basis with the major carriers.

- **Orbitz may offer more low-fare options.** Orbitz contends that one of its greatest strengths is not its access to airlines' last minute E-fares, but its search engine that can search millions of possible flight combinations to identify lowest fares. Orbitz' competitors have criticized its claims in this area, citing the restrictions and caveats associated with the lower-fare travel that Orbitz software identified in sample comparisons. For example, one trip option required travel to an alternate airport 50 miles away from the destination city. We agree that this option may not appeal to many consumers regardless of any cost savings, but believe that consumers are best served if presented with the choice and permitted to evaluate the trade-offs for themselves.

  Other online travel agencies are skeptical about the ability of Orbitz' software to perform as seamlessly as Orbitz predicts. We plan to evaluate Orbitz' performance when the site is operational.

- **Unbiased displays provide consumers with more accurate and comparable information.** Orbitz believes its other strength in the marketplace is its commitment to provide unbiased information on all carriers, regardless of the level of participation by each carrier. The fact that Orbitz is jointly owned by

competing airlines creates a unique operating constraint. Orbitz' charter specifically states that all information on Orbitz will be displayed without bias, with priority display based exclusively on lowest airfare. Given Orbitz' joint ownership, a decision to allow display advantages to be purchased (i.e., "selling bias" to a particular airline) would have to be made by the owner airlines who would stand to be harmed by such purchase.

If Orbitz abides by its charter and provides unbiased information to the consumer, it will become quickly apparent to consumers that other outlets may not truly be working in their best interest. These channels may be pressured to reduce or eliminate bias in their own displays.

- **Orbitz' claims of benefits for small airlines are met with skepticism**. Orbitz contends that smaller airlines will benefit most from its non-bias commitment. Larger airlines that have marketing budgets sufficient to purchase display preferences from travel agencies often do so to the detriment of smaller airlines that do not have these budgets. As a result, even if the small airline has a better fare, it may not get top billing on these agencies' displays. In websites that restrict participation, it may get no billing at all. Still, small airlines have expressed skepticism about the intentions of a distribution outlet controlled by the major airlines. Other airlines, including Southwest, believe that the venture proposed by Orbitz does not fit their business strategy.

Red flags have been raised about Airlines restricting lowest fares exclusively to Orbitz. The most vocal concerns have been expressed by Orbitz competitors who fear that the airlines will restrict their lowest fares exclusively to Orbitz, which will impede their ability to compete. They view this as an anti-competitive act by the airline owners of Orbitz, aimed at putting their competitors out of business. The critics fear that if the airlines are successful in eliminating their competition, consumers will no longer have choices about where to purchase travel online. This, in turn, could have the effect of raising costs to consumers if Orbitz began to charge airlines premiums for participating in Orbitz once its online competitors were eliminated.

Orbitz counters that its charter agreement does not contain any provisions barring any airline from making any fare available through any channel, and adds that it actually contains an "affirmative non-exclusivity provision" that explicitly states that no airline is prevented from making any fare it chooses available through any channel it chooses. Orbitz contends that in an unregulated environment, airlines are free to set their own prices and decide where to offer their products for sale, and if airlines acting individually choose to make certain fares only available on Orbitz, that is within the airline's legal rights. In statements made publicly, Orbitz has indicated that it agrees that it would be legally problematic if its charter required exclusivity. A recent statement noted, "if [Orbitz] agreements did *collectively*

require that certain fares not be sold through other channels, that would be an illegal boycott."

We have reviewed Orbitz' charter and its agreement with participating airlines, and we agree that Orbitz' characterization of its non-exclusivity provision is accurate. This provision, however, is not sufficient reason to dismiss the concerns that have been raised. Airlines acting individually could refuse to participate in other distribution outlets with their lowest, Internet fares, with the intent to maintain Orbitz as the premier supplier of online airline services.

The airlines have stated their intent to continue to participate in a wide range of distribution channels after the start of Orbitz, citing the need to "be on every shelf." Several airlines have indicated that if other sites can provide financial incentives comparable to the Orbitz rebate on CRS booking fees, they are willing to make the low fares they provide Orbitz available to other outlets. It will be important to ensure that the airlines actually follow through on this intent if such offers are presented.

In the short term, actions could be taken to protect against the potential for anti-competitive practices. For example, interim provisions could be established requiring airlines to make available any fares they provide Orbitz to any other entity willing to offer the same financial terms concerning reduced booking costs, as

Orbitz. Such a provision should be predicated on an agreement by these entities to abide by the non-bias regulations that apply to CRSs.

Long-term impacts need to be evaluated. In the long term, barring any anti-competitive behavior, Orbitz could pressure other online agencies to eliminate bias and upgrade search capabilities. It could also pressure CRSs to begin competing through lower booking costs and improved services. But there is the potential for harmful impacts on the travel marketplace. If the airline equity owners of Orbitz refuse to make their lowest Internet fares available to online competitors, Orbitz would have a significant marketing advantage that could allow it to achieve a dominant online market share or even to eliminate its online competitors. In either case, airlines would likely feel compelled to be listed on the Orbitz system or risk foregoing significant business to their competitors.

At such a point, with its market power over the airlines established, Orbitz might choose to charge premiums to airlines to participate (i.e., raise costs) rather than offering reduced costs through lower booking fees. Such an outcome would benefit Orbitz' equity owners to the detriment of other participating airlines. The Departments of Justice and Transportation need to evaluate the likelihood of these and other scenarios playing out in determining whether prior intervention is needed to protect competition and consumers.

Marketplace changes and technological innovation are rapidly eclipsing CRS rules established in 1984.

The existing CRS regulations were implemented to protect consumers and competitors from the biasing of information by the airline owners of computer reservation systems. With the Internet potentially replacing many of the functions performed by the original systems, questions have been raised over whether these regulations should apply to the new distribution channels, and if they did, whether they would have any meaningful impact. The regulations apply to airline-owned CRSs, but with recent airline divestitures of CRSs, even the CRSs are unclear whether the current regulations still apply.

The changing environment of travel distribution demands a near-term reevaluation of the applicability and sufficiency of existing regulations to protect consumer interests. The Department has already delayed a reevaluation and readoption of the existing CRS regulations three times from their 1997 sunset date. As the market continues to change rapidly, it is imperative that these issues be addressed without further delay.

Regulations were developed to protect against airline abuses of CRSs. Following the deregulation of the airline industry, airlines relied on CRSs to provide travel agents access to the complex and extensive fare and service information that

developed as a result of new competition between carriers. In the early 1980s, CRS regulations were introduced to protect consumers from the airline owners biasing information in their CRSs to favor their own carriers.

The airlines' biasing practices harmed consumers by denying them access to unbiased information, and also harmed non-owner airlines that were victims of this bias. The regulations applied to airline-owned CRSs that provided information to travel agents. They prevented CRSs from improving the position of particular flights on integrated CRS display screens based on the identity of the carrier and also required airline-owners of CRSs to participate equally in every other CRS.

The regulations were thought necessary because the travel agents that used these systems were locked into contractual relationships with the CRSs. If the travel agents were receiving biased information, so were their clients. The regulations stopped short of requiring travel agents to present unbiased information to consumers. The rationale was that consumers are free to choose where they get their information since they do not have contractual relationships with travel agents.

Changing marketplace and technological developments raise serious concerns about the sufficiency and relevance of current CRS regulations. The current regulations are designed to promote competition and to protect the consumer from unfair and deceptive practices, but the new state of information accessibility poses

some difficult questions concerning what protections are needed in the modern marketplace. Confusion exists over whether these regulations apply in the current market, to whom they apply, and how. The issues are complex and we do not have all the answers to these questions today. We can, however, give some context to the controversy.

- **Airlines have begun to divest themselves of CRS ownership raising the question of whether non-airline owned CRSs are covered under existing regulations.** One large CRS has recently become independent and some have contended that it is no longer subject to CRS regulations because it is no longer airline-owned. The Department of Transportation, however, has indicated that it does not agree with this interpretation. This issue needs to be clarified. As airlines divest ownership in CRSs, protections are no longer needed to prevent the airline-owners from biasing data to benefit themselves. However, an independent CRS may have an incentive to solicit participating carriers interested in purchasing preferential display.

- **Existing CRS regulations do not prevent travel agents from biasing information they provide to consumers.** Neither online agencies nor brick and mortar travel agencies are covered by existing bias regulations. Online travel agents such as Expedia or Travelocity may appear to be different entities than brick and mortar travel agencies with retail locations, but from a regulatory

standpoint, they are identical. Both act as intermediaries between the airlines and consumers, albeit one has a human interface and the other relies upon a computer program. Both rely upon CRSs to provide information on schedules, fares, and availability, and use the CRS to book travel reservations. Neither is subject to CRS regulations and is not legally bound to provide information in an unbiased manner.

- **Views differ on whether Orbitz should be covered by the CRS Regulations.** Critics have suggested that because Orbitz is airline-owned and providing information on airline fares and services to consumers, it is essentially functioning as a CRS and should be regulated as such. Orbitz contends that it is a travel agency, albeit airline-owned, and should not face different regulations than other online or brick and mortar agencies. Like these agencies, Orbitz will provide information directly to the public. When the original CRS regulations were developed, the determination was made that travel agents did not need to be regulated because consumers were free agents and could make choices about the quality of information they received from various sources.

The critics who believe Orbitz should be regulated as an airline-owned CRS contend that the owner-airlines are violating the CRS regulations if they do not post the same fares they post on Orbitz on all CRSs. These regulations were developed to prevent CRS airline-owners from limiting their participation in

other CRSs as leverage to force travel agents to contract with their own CRSs. For example, absent the regulations, if a travel agent wanted to sell a particular airline's tickets, it might have to use that airline's CRS because the airline would not be listed on any other CRS.

If Orbitz were subject to the CRS regulations, the five airlines with equity ownership in Orbitz would have to make any fares they make available to consumers through Orbitz also available to every travel agent using another CRS system, even in the absence of equivalent financial considerations such as reduced booking costs. However, it is important to recognize that these other travel agents would not be subject to a similar requirement, even if they were in partnership with a CRS or had commission override agreements with airlines that led them to bias their information displays toward a particular airline.

- **Airline and CRS entry into the travel agency business and technological advancements raises questions about the need for regulatory protections.** Travel agencies have never been subject to the anti-bias rules of the CRS regulations. But given the long history of airlines and anti-competitive CRS practices, the expansion of airlines and CRSs into ownership of online travel agencies raises questions about what regulatory protection may be needed. History has shown how difficult it is to fix problems after they occur. To the

extent that protections against abuses can be instituted early, mistakes of the past can be avoided.

Some parties have suggested that all travel sales over the Internet should be subject to the CRS regulations. Since online travel agencies are virtually identical in structure to brick and mortar agencies, and in some cases represent actual extensions of them, it would be difficult to apply regulations to online agencies without extending them to all travel agencies.

Orbitz and other entities are nearing a point where direct links can be established with carriers' internal reservation systems to access fare, schedule, and seat availability data, making it possible to bypass CRSs entirely. When this occurs, a determination will need to be made as to whether any protections need to be instituted to safeguard consumer interests, and if so, what these should be.

This concludes our statement. I would be pleased to answer any questions.