

BEFORE THE  
UNITED STATES DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.

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|                               | ) |                    |
| Notice of Proposed Rulemaking | ) |                    |
| Computer Reservation System   | ) | Docket OST-96-1145 |
| Regulations                   | ) |                    |
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COMMENTS OF THE DEPARTMENT OF JUSTICE

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COMMENTS OF THE DEPARTMENT OF JUSTICE

Over the past few years, the United States Department of Justice has conducted several investigations into the computer reservation systems ("CRS") industry for possible anticompetitive conduct and has filed comments with the Department of Transportation ("DOT") and the Civil Aeronautics Board on important rulemaking proposals relating to the industry.<sup>1</sup> More recently, the Department of Justice initiated an investigation into the parity provisions found in CRS/airline participation agreements to determine if those provisions violated the antitrust laws. Based on the information learned in its investigations, the Department of Justice hereby submits these comments in support of the DOT's Proposed Rule prohibiting parity provisions in contracts between CRSs and airlines ("participating carriers"). These comments

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<sup>1</sup> See Reply Comments of the United States Department of Justice, Notice of Proposed Rulemaking -- Computer Reservation System Regulations, Docket No. 46494, filed August 8, 1991; Comments of the United States Department of Justice, Notice of Proposed Rulemaking -- Computer Reservation System Regulations, Docket No. 46494, filed July 9, 1991; Comments of the United States Department of Justice, Advance Notice of Proposed Rulemaking -- Computer Reservation System Regulations, Docket No. 46494, filed November 22, 1989; Comments and Proposed Rules of the Department of Justice, Advanced Notice of Proposed Rulemaking -- Airline Computer Reservation Systems, EDR - 466, Docket No. 41686 (before the Civil Aeronautics Board), filed November 17, 1983.

also support an exception from that prohibition where a participating airline has an ownership share in or a marketing relationship with a CRS.

## I. Overview

There are four main CRSs in the United States, each one of which has one or more carriers as major shareholders. A CRS permits a CRS subscriber, such as a travel agent, to locate quickly important travel information such as flight schedules, fares, and seat availability, and to book and issue tickets. A CRS also serves airlines by providing them with an effective means to distribute such information to the subscribers of that CRS.

CRSs have substantial market power over most airlines, but generally not over travel agents. Travel agents tend to subscribe to only one CRS and can substitute among them. Consequently, all four systems appear to compete vigorously to sign up travel agents to their particular systems. Because travel agents are concerned about readily obtaining reliable and complete information, one area of competition is the content of the CRS -- what airlines are listed, how much information they display, and whether the airlines have easy ticketing capability through the CRS. Thus, CRSs have a strong incentive to entice each participating airline to provide as accurate and comprehensive information as possible.

CRSs, however, are not substitutes from most airlines' perspective. Each CRS provides access to a large, discrete group of travel agents, and unless a carrier is willing to forego access to those travel agents, it must participate in every CRS. Thus, from an airline's

perspective, each CRS constitutes a separate market and each system possesses market power over any carrier that wants travel agents subscribing to that CRS to sell its airline tickets.<sup>2</sup>

In return for the service it provides to participating carriers, a CRS charges the carrier a fee for each flight booked through it. Each CRS provides various levels of service to participating carriers, with the most basic level costing almost half as much per segment booked as the highest level. The highest level of service usually provides real-time access for seat availability and permits a CRS subscriber electronically to make reservations and issue tickets, while the basic level usually only allows the subscriber to view schedules and availability and requires that the subscriber call the airline directly to make bookings.

Three of the four CRSs in the United States (SABRE, Worldspan, and System One/Amadeus) place a "parity provision" in their contracts with participating carriers that requires the carrier to participate in as high a level in their system as in any other system. That provision prohibits a carrier that participates at the most basic level of SABRE, Worldspan and System One from upgrading to a higher level in, for example, SABRE, unless it also upgrades to a higher level in Worldspan and System One. Likewise, for example, if a CRS's product and service deteriorates, the provision prevents a carrier from downgrading its participation level in that CRS unless it also downgrades its level in every other CRS.

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<sup>2</sup> Some new entrant airlines with limited distribution needs have attempted to bypass CRSs by creating alternative arrangements for making bookings with the public. Although these attempts have met with varying degrees of success, the vast majority of tickets are still booked through travel agents using a traditional CRS, and airlines that desire access to consumers who purchase through such channels must participate in each CRS.

## II. The Parity Provision Has Reduced Competition Among CRSs for Higher Participation By Carriers

The parity provision reduces the need of CRSs to compete with each other to make their enhanced service levels attractive to participating carriers. If a carrier chooses to participate at a higher level in one CRS than in the other systems, that CRS will gain a competitive advantage over the others in its efforts to induce travel agents to subscribe to it.<sup>3</sup> Inducements to carriers to participate at higher levels will not give the CRS any competitive advantage with travel agents, however, if the participating airline must always participate in the other CRSs at exactly the same level. Consequently, parity provisions reduce the incentive for any one CRS to improve the value of its premium service levels since the provisions will prevent carriers from participating at a higher level on that CRS than the others.

### A. The Parity Provision Reduces the CRSs' Incentive to Lower Fees

The CRSs do not engage in price competition in order to induce carriers to participate at higher levels. Not coincidentally, the booking fees that CRSs charge are widely believed to be at supra-competitive levels and appear to have little relation to costs. While the costs of computing power have dropped dramatically over the last decade, the price of CRS services has risen substantially. Indeed, the price has now risen to the point that even airlines

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<sup>3</sup> See, e.g., ¶10 of Complaint, *American Airlines v. Alaska Airlines*, C.A. No. 4-94 CV-595-Y (N.D. Tex. filed Sept. 12, 1994). American alleged that if Alaska participated at a higher level in other CRSs "SABRE will be at an unfair disadvantage in obtaining and retaining travel agency subscribers which sell a significant number of seats on Alaska flights."

that own CRSs have publicly complained about the level of the fees.<sup>4</sup> Moreover, we learned from our investigation that more than three-quarters of CRS revenue is earned from airlines which see little price competition among the CRSs, while approximately ten percent comes from travel agents which see intense price competition.<sup>5</sup>

Without its parity provision, each CRS would likely have to respond competitively to a large booking fee decrease offered by one of its competitors to airlines. With the parity provision, however, each CRS knows that a participating carrier cannot be induced by price to upgrade its service level in a competing CRS without also upgrading in its own. Thus, there is little reason for any CRS to lower booking fees to induce participating carriers to upgrade their service levels.<sup>6</sup>

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<sup>4</sup> See, e.g., *Delta Files Protest Over Fees Charged by a Unit of AMR*, Wall St. J., Feb. 2, 1996, at B6; *Most airlines, though disgruntled, sign new Sabre contract; Delta is hold-out*, Travel Distribution Report (formerly CRS Update) Vol. 3, No. 21, Feb. 1, 1996 at 1; *Computer Reservation Systems Unmoved by Delta's Plea for Lower Fees*, Aviation Daily, Vol. 323, No. 4, Jan. 5, 1996 at 25; *Delta Asks CRSs to Cut Fees, Threatens to Reduce Participation*, Aviation Daily, Vol. 323, No. 3, Jan. 4, 1996 at 18; *Amadeus Says Northwest's Pledge to Downgrade Violates Agreement*, Aviation Daily, Vol. 323, No. 1, Jan. 2, 1996, at 7; *Northwest Drops Enhanced Levels to Protest Amadeus/System One Fee Increases*, Aviation Daily, Vol. 322, No. 46, Dec. 8, 1995, at 381.

<sup>5</sup> The remainder comes from other travel service providers such as hotels, and rental car companies and other miscellaneous sources.

<sup>6</sup> If increased CRS competition does result in lower fees (or at least restrains the future growth of fees) charged to airlines, those savings should be passed on to the flying public because of competition among airlines for passengers. Worldspan in its response to Alaska's petition for rulemaking stated that any higher booking fees would be passed on by airlines in the long run. See Comments of Worldspan, L.P. at 5, Docket 49812, filed Jan. 9, 1995. There is no reason that the cost savings from lower fees would not also be passed on.

B. The Parity Provision Reduces the CRSs' Incentive to Tailor Their Product to Meet an Airline's Needs

The lack of competition among CRSs for higher levels of participation by carriers is reflected in the product they provide to carriers, as well as in the supra-competitive price. Because of the parity provision, the CRSs have not felt compelled to work with carriers to create levels of service that meet their individual needs.

For example, for historical reasons Southwest Airlines participates only in SABRE's CRS. Southwest has no contracts with the other CRSs, and thus their parity provisions do not bind it. As a result, the parity provisions of the other CRSs do not limit SABRE's incentive to induce Southwest to increase its level of participation. In this unique situation, SABRE could increase its competitive advantage in obtaining travel agent subscribers by persuading Southwest to raise its participation level in SABRE. Not surprisingly, in January 1995, SABRE created a new participation level tailored to meet Southwest's unique needs that was above the old "Call Direct" level in which Southwest had participated. *See, e.g., Sabre Unveils No-Frill Lines' Booking Level (Southwest to Be First Customer), Travel Weekly*, Vol. 54, No. 5, Jan. 19, 1995 at 1.

In contrast, our investigation revealed that Reno Air, which like virtually all airlines participated in all CRSs and therefore was subject to the parity provision, undertook a study to determine its distributional needs. It then looked for a CRS that would work with it to develop a product to meet those needs. Each CRS refused to work with it, and Reno ended up downgrading its participation level in each of the CRSs.

C. The Parity Provision Reduces the CRSs' Incentive to Enhance the Service They Provide Airlines

Finally, the parity provision has reduced the incentive for the CRSs to provide satisfactory service to the participating airlines. Given the market power of each CRS, often the only recourse an airline has to a CRS's poor service (or high price or inferior product) is to threaten to lower its participation level in that CRS unless the service improves. However, the parity provision removes an airline's ability to obtain better service by credibly threatening to downgrade its participation level. With the parity provision, the downgrade threat is unrealistic because the CRS knows that the airline would also have to lower its participation level in every other CRS (including any where service was good) and to risk the loss of sales from travel agents using those systems.

The CRS industry's response to the airlines' complaints of passive and fictitious CRS bookings illustrates how the parity provision insulates the CRSs from competitive pressure to improve service. Passive and fictitious bookings are bookings made by travel agents that do not necessarily result in tickets purchased. However, even though the airline never gets paid for a ticket, the CRS will bill it for the bookings. For years, a large number of airlines have complained about paying for these bookings. Some claim that these bookings account for 20% of their CRS costs. Airlines have been billed for bookings for fictitious persons such as Micky and Minnie Mouse and for bookings to locations where they do not even fly. The CRSs would likely be more responsive to these complaints if the parity provision did not take away the airline's best market mechanism to prod the CRSs to act -- the real threat of a downgrade on only the offending CRS vendor. To the extent that the parity provision has made the CRSs



“unresponsive to consumer preferences,” it is anticompetitive. See *National Collegiate Athletic Assn. v. Board of Regents of Univ. of Oklahoma*, 468 U.S. 85, 106-07 (1984).

### III. **The Parity Provision Has Created Inefficiency**

Not only has the parity provision dampened the incentives of CRSs to compete for higher carrier participation by offering better service and a more tailored product at a lower price, it has created inefficiency by requiring airlines to participate in CRSs at price/service levels that they would not otherwise choose. The airlines do not view all CRSs as equal. They know that the CRSs have varying regional strengths as measured by the percent of travel agents that subscribe to each CRS in different cities. This fact alone may cause some airlines (especially small start-up airlines that are trying to gain a foothold in some region of the country) to desire to participate at a higher level on one CRS than another.

For example, our investigation determined that, last year, one airline ("Airline A") participated at the highest level in one CRS ("CRS B") and just below the highest level in the other CRSs. The other CRSs were actually dominant in the region of the country where Airline A was located, but Airline A's main competitor for flights within the region did not participate in CRSs at the highest level. Airline A already had a significant share of the traffic within the region and believed that if it raised its level of participation in the other CRSs, it would significantly raise its CRS costs without generating much additional traffic. Airline A, therefore, did not believe it was in its commercial best interest to raise its participation level in those CRSs.

On the other hand, CRS B's presence, while weak in the region, was stronger elsewhere in the country. Airline A concluded that by participating in CRS B at the highest

level, it gained better access to travel agents that were not as familiar with it and sold more seats. Airline A was willing to pay CRS B more for each segment booked because the higher participation level raised sales through CRS B by a significant percentage. One of the other CRSs, however, discovered Airline A's strategy and, instead of offering a better price or service package, invoked the parity provision. As a result, Airline A had to lower its level of participation in CRS B. Thus, the parity provision prevented Airline A from purchasing its optimal amount of CRS service.

The parity provision also imposed an inefficiency on Reno Air. Reno currently participates at a moderate level ("Full Availability") in each of the CRSs. To make more sales, it would like to raise its level of participation in SABRE or Apollo, which have a strong presence in the regions that matter to Reno. Reno, however, is unwilling to upgrade in System One and Worldspan, which have a weak presence in Reno's region. Thus, the parity provision prevents it from purchasing as much CRS services as it deems optimal.

#### **IV. The DOT Should Make An Exception to the Parity Provision Rule**

In the above examples, the airlines would like to choose the level of CRS participation that would result in the most passenger sales at the lowest cost. If airlines have the ability to choose their CRS participation based on the value of the service, CRSs will compete to provide better value. However, airlines that are associated with a CRS through an ownership interest, an affiliate's ownership interest, or a marketing arrangement will have a different calculus. If given the chance, such airlines are likely to choose their CRS participation level based at least in part on the impact their selection will have on the profits of the CRS with which

they are associated, rather than solely on the intrinsic value of the CRS service to their airline operations.

The result is that owner-airlines and airline marketers would likely lower their level of participation in other CRSs for a reason unrelated to CRS price or quality -- to put the competing CRSs at a competitive disadvantage. Where an airline has significant market share, as the U.S. owner-airlines do in the United States and many foreign carriers do in their homelands, its participation in a CRS is critical to make the CRS attractive to travel agents. Without that airline's participation, the CRS would have great difficulty convincing travel agents to subscribe to the system.

To avoid such effects in the U.S. CRS market, the DOT has proposed, in effect, a "parity rule" for CRS owners that prohibits them from lowering their participation in competing CRS systems below the level of their participation in their own system. *See* 14 CFR § 255.7. An exception to the rule proposed here that would allow use of a parity provision in contracts with any carrier that owns or markets a CRS would be consistent with section 255.7 and help prevent carriers from varying participation levels for reasons that will not induce better CRS performance.

To include this exception, the language of the proposed rule, 14 CFR §255.6(e), could be changed to read:

No system may require a carrier (other than a carrier that owns or markets, or is an affiliate of a person that owns or markets a foreign or domestic system) to maintain any particular level of participation in its system on the basis of participation levels selected by that carrier in any other foreign or domestic system.

For clarity, an additional section should then be added to the Definitions section (§ 255.3) that would define "to market."<sup>7</sup> That section could read:

*To market* means to cause, encourage or persuade a person or entity to subscribe to a particular foreign or domestic system in return for some material benefit that is conditioned upon the number of subscriptions achieved.

V. **Conclusion**

For the foregoing reasons, the Department of Justice supports the DOT's proposed rule with an exception that would permit parity provisions against carriers that own or market a CRS.

Respectfully submitted,

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<sup>7</sup> The Department of Justice understands a carrier that "markets" a CRS to be a carrier that receives consideration for selling or helping to sell that CRS to potential subscribers. For example, a carrier that receives some bonus or discount for every travel agent that switches CRSs is a marketer. Additionally, the Department of Justice understands that a carrier that is affiliated with an entity that markets a CRS is a marketer within the meaning of these provisions.

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