ARE ALL ONLINE TRAVEL SITES GOOD FOR THE CONSUMER: AN EXAMINATION OF SUPPLIER-OWNED ONLINE TRAVEL SITES

HEARING

BEFORE THE

SUBCOMMITTEE ON
COMMERCE, TRADE, AND CONSUMER PROTECTION

OF THE

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ARE ALL ONLINE TRAVEL SITES GOOD FOR THE CONSUMER: AN EXAMINATION OF SUPPLIER-OWNED ONLINE TRAVEL SITES

THURSDAY, JULY 18, 2002

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30a.m., in room 2123, Rayburn House Office Building, Hon. Cliff Stearns (chairman) presiding.

Members present: Representatives Stearns, Deal, Bryant, Bass, Walden, Terry, Towns, DeGette, Markey, Rush, and Eshoo.

Also present: Representatives Boucher and Grucci.

Staff present: Ramsen Betfarhad, majority counsel; Mike O'Rielly, professional staff; Brendan Williams, legislative clerk; Jonathan Cordone, minority counsel; and Bruce Gwinn, minority professional staff.

Mr. STEARNS. Good morning. I would like to welcome all of you to this hearing of the Subcommittee on Commerce, Trade, and Consumer Protection, entitled, "Are All On-Line Travel Sites Good for the Consumer: An Examination of Supplier-Owned On-Line Travel Sites."

I would like to especially thank our witnesses on behalf of the committee for their appearance today and their testimony. Notwithstanding the hyper-enthusiasm for all things Internet and electronic commerce of the recent past, the fact remains that the Internet as an efficient ubiquitous communication tool has substantially transformed in fundamental ways commerce as we know it today.

Electronic commerce transversing the communications network that is the Internet is real, substantial, and rapidly becoming a key component of our economy. The hyperpredictions of not so long ago that e-commerce would reach between $3 and $4 trillion by the year 2003 may not have come true.

But by most estimates the value of business-to-business commercial transactions that transpire on-line is well over $1 trillion today. More significantly, the rate of growth of such business-to-business transactions is increasing unabated and it is far in excess of the growth rate for off-line commerce.

Business-to-consumer e-commerce may also have not met the glorious prediction of abundance who reigned during the .com bubble, but the fact, my colleagues, remains that it has grown substantially and it continues to grow at rates unmatched by off-line commerce.

One of the more stellar examples of business-to-consumer e-commerce growth is the on-line travel business. For example, in just over 3 years, 15 percent of all airline tickets are now being sold online, and the growth rate for such transactions is still accelerating.

More significantly, increasingly consumers are seeking and receiving more advanced travel services through on-line travel sites; such as arranging multi-city, or even country trips, involving a myriad of reservations for air travel, car, hotel reservations, and tours.

During the dot.com bubble, it seemed that any and all business models were tried as investors in their euphoric state, vis-a-vis anything Internet, had the penchant to welcome and accept them all.

However, as the dust settled and we learned that while selling books on-line made sense, selling groceries didn't, a sort of new business model has gained in appeal among dominant suppliers, but only in certain industries.

That sort of new business model calls for the dominant firms within an industry to collectively create an on-line distribution network for their goods and services.

In practice, this business model has manifested itself in a number of supplier owned, on-line distribution joint ventures, where the participating companies tend to be the top 5 or 6 in that industry.

These supplier-owned on-line distribution joint ventures are now present across a number of industries, including air travel, lodging, cosmetics, music, and even foreign currency exchange.

Now, there is no question that such supplier-owned on-line distribution systems engender economic efficiency and also consumer benefits. At the same time there is also no question that any time competitors come together in collaborative efforts such as these joint ventures that there is a risk.

There is a risk for collusion activity that may impede commerce and harm consumers. This hearing is meant to create an educational forum simply to examine both the benefits and possible risks that supplier-owned on-line distribution systems hold for the American consumer.

As examining the supplier-owned on-line distribution system across a multitude of differing industries within which they appear is a tall order at this hearing to accomplish, but we are going to try to focus on the online tavel business only.

This hearing will focus only on on-line joint ventures in the air travel and lodging industries. We have before us some great expert witnesses on these issues. We had hoped to have Orbitz, and at least one of the five major airlines that are involved with and own Orbitz, to speak on Orbitz's behalf.

Unfortunately, it did not work out, and they are unable to attend. However, Gary Doernhoefer, Vice President and General Counsel of Orbitz, LLC, has provided the subcommittee with written testimony on behalf of Orbitz, which I now offer to be included as part of the record, and without objection, it is so ordered.

[The prepared statement of Gary Doernhoefer follows:]

PREPARED STATEMENT OF GARY R. DOERNHOEFER, VICE PRESIDENT AND GENERAL COUNSEL, ORBITZ LLC

Online distribution of travel is the Internet's greatest success story. Travel is the most successful sector of Internet commerce. The Internet has offered services to travelers that a great many of them find convenient and informative, and so consumers of travel have given the Internet their highest vote of confidence—they choose to use it, they like it, and they choose to use it again.

At the same time, we all have to recognize that leading up to the use of the Internet, the automated distribution of travel has long been a sector troubled by insufficient competition, and that has resulted, among other things, in the costs of selling through many of these systems being unreasonably high. Those costs are paid in the first instance by the airlines, but are ultimately paid for by consumers as part of the cost of air travel.

The purpose of Orbitz is to bring new competition to automated distribution: new price competition, new technology, competition in the quality and content of the information provided, and new customer service competition. We believe that the results to date speak for themselves. We launched just 13 months ago, and since our launch (and despite our relatively small size)

- price competition has increased (with several of our larger competitors for the first time engaging in price reductions on the cost of making a booking),
- technology and information quality has increased (with at least one of our larger competitors moving to new search technology), and
- customer service at many websites, both online agencies and individual airline websites, has improved considerably in competitive response to improvements in customer service first launched by Orbitz.

In short, as a result of new competition from Orbitz, competition has increased, and competition is doing what it is supposed to do, which is to reduce cost and improve products and services. The consumer is better off for Orbitz having entered the market, whether or not that consumer actually uses Orbitz.

Let me review each of these arenas of increased competition:

Price Competition

Automated distribution came to air travel two decades before the Internet did. It came in the form of Computer Reservations Systems (CRSs). These were enormous mainframe computer systems with terminals placed in travel agencies. Typically a travel agent was placed under contract by a CRS, that travel agent used only that one CRS, and there were very few CRSs (there are only four in the world today). That meant that any airline could only sell through the agents that used a particular CRS by agreeing to pay whatever that CRS decided to charge for each booking made. As every government agency that looked at the issue found,[1] that gave the CRSs the power to price their services at levels far above what would exist in the case of a competitive market.

Furthermore, what were excessive prices paid for CRS booking fees 15 years ago, have continued to climb every year since then, despite the fact that computing and telecommunications costs have declined dramatically over the years.

In 1984, federal rules were put in place to try to limit the monopoly powers of the CRSs. In some instances, those rules have been somewhat successful, as in limiting the display bias of the CRSs. But the rules have been completely ineffective with respect to monopoly pricing of CRS services, and so those excessive costs have been built in to air transportation ever since, and get worse with each passing year.

The coming of the Internet to air travel in the late 1990's brought hope that this anti-competitive bottleneck might be opened up, restoring competitive market forces. It was impossible to launch a new CRS competitor, since they operated under contract to travel agents and all the travel agents were locked up in existing contracts. But new Internet sites were being launched every day. Users don't have contracts with websites—they just use the website if they want to. The hope was that the new open competition model of the Internet would remedy the long-standing anti-competitive problems of the CRS business.

However, the biggest of the CRSs, Sabre, moved quickly to establish its own dominance of the Internet. It used its unusually large profits at Sabre to build the first major online agency, Travelocity. Every booking on Travelocity was a booking on Sabre and imposed the same CRS booking fee that Sabre charged off the Internet. Other online agencies that came along followed the same model—their bookings went through a CRS and charged the same CRS booking fee. Thus the Internet be-

[1] The federal agencies that so found were the Civil Aeronautics Board, the Department of Justice, the Department of Transportation, and the General Accounting Office.

came a branch office of the CRS oligopoly, rather than a competitive alternative to it. And the hope of the Internet acting as a new source of badly needed price competition was dashed.

That is where Orbitz came in. Orbitz was determined that the Internet could provide price competition, and Orbitz has done so, despite the fact that Orbitz also uses a CRS to make each booking.

Orbitz offers every airline two options;

- It can pay the standard CRS booking fee, and make available to Orbitz only the fares it makes available to all other websites and CRSs, in which case Orbitz will give it no-bias display of its schedules and services and will book its tickets, or
- It can get a rebate equal to about one-third of its booking fee, in return for an agreement that any fare the airline chooses to sell to the general public through any other outlet, it will also make available to Orbitz. If it accepts this latter proposition, it can put that same fare anywhere else it wants—Orbitz expressly does not limit what that airline may do with that fare anywhere else, because this is an expressly non-exclusive arrangement. And the airline also gets non-biased display and booking capability. This lower priced option is has been chosen not only by the 5 airlines who have invested in Orbitz, but by 37 other airlines as well.

That is the basic offer to encourage price competition: pay us the standard amount and give us only the standard fares to sell, or give us a few more fares to sell and we will give you a discount on the price of having your tickets sold by us. That is exactly what happens in any competitive distribution market. We have not previously had price competition in air travel distribution, so some of our competitors neither recognize it nor welcome it. A few of them would like you to help them get government to prohibit price competition in the distribution of air travel. But that would not be in the interest of competition or of consumers.

The results speak for themselves. The largest online agencies, Travelocity and Expedia, caterwauled for months, alleging that Orbitz had exclusive rights to webfares, or that we didn't, but the airlines individually refused to make webfares available to them. What was really going on was that these largest websites wanted to get the webfares without engaging in the price-cutting competition to get them. When government did not come to their rescue by requiring the airlines to have these websites sell their webfares without regard to what the websites charged for the selling of those fares, the websites did what any business would do, which is engaged in price competition. They made offers to airlines to charge less for selling tickets through their website in return for availability of webfares, and the airlines individually began accepting those deals. Travelocity and Expedia now have webfares and advertise that fact. But they got them by finally engaging in normal price competition.

Let there be no doubt or mistake. Orbitz' competitors are getting the websfares now that they have begun to compete for them. Statistics that Orbitz uses to track whether it can still substantiate the marketing claim of "the most low fares" shows the unmistakable trend toward common fare offerings by all of the major online travel agents. Expedia clearly leads Travelocity in this competitive battle, and their recent marketing proudly proclaims their access to webfares. But the point is the same. Our competitors allowed us an advantage in having better fares for about six months while they complained to Congress and the regulators. Then they began to do what they should—compete. The fact is that the complaints about Orbitz we have heard for nearly two years simply are not being proven by the online travel marketplace. Today it is increasingly apparent that the complaints are nothing more than the efforts of competitors who dominated a market to hold on to the past. Granting them their desires will unquestionably, immediately and perhaps irrevocably harm consumers and raise airlines' costs at the worst possible time.

Now the question is being replayed by the CRSs. They are caterwauling that Orbitz has exclusive fares, or that we do not but airlines are individually refusing to make webfares available to the CRSs. What is really going on is that the largest CRSs want to get the webfares without engaging in price competition to get them. The question again is whether you will call for government to require airlines to buy the distribution services of the CRSs without regard to what the CRSs charge for that service. If you do, you would be ending any hope of price competition in the automated distribution of air travel. You would be granting a government-protected monopoly pricing power to the CRSs.

When government requires party A to buy party B's service, without regard to the price party B chooses to charge, party B may now price with impunity. Why should that excessive cost be built into the price of air travel? What public purpose could that possibly serve? Wouldn't that, in this case, serve the interests of the largest CRSs at the expense of the travelling public?

A few more points need to be made here.

First, Orbitz did not invent webfares. They were invented long before Orbitz was even conceived. They came about because the CRSs had raised their booking fees so high, that the cost of selling tickets through a travel agent using a CRS became so high, that airlines could no longer afford to sell their lowest fares through that increasingly expensive channel. When the airlines developed their own individual airline websites, and found that those websites were by far the cheapest way to sell a ticket, they began putting their lowest fares only on their own website. And those fares became known as webfares. What Orbitz has done is take those webfares that were only available on the airline's own website, and made them more widely available by putting them also on Orbitz. And what the price competition brought by Orbitz has done is to also take those webfares and, by pushing Travelocity and Expedia to engage in price competition, made those webfares even more widely available by putting many of them on Travelocity and Expedia. And if competition is allowed to continue to work, we expect that the CRSs will sooner or later start to engage in price competition as well, and those webfares will show up on the CRSs also.

So webfares are spreading. They are becoming more and more widely available. But there is also the benefit of spreading price competition. It is a double benefit for consumers.

Second, not only are airlines and consumers being harmed by excessive CRS booking fees, but so are travel agents. The cost of selling through a travel agent went up over the past decade not because travel agents charged airlines more for their services, but because CRSs kept charging airlines more for selling through a travel agent. The travel agent was priced out of selling the lowest airline fares, not because of any cost imposed by the travel agent, but because of costs imposed by the CRSs, decisions over which travel agents had no control. To the extent travel agents have been harmed by the inability to sell the lowest fares through the CRS that has them under contract, that travel agent is the collateral damage of the CRSs having been allowed to excessively price their service for so many years. Travel agents would benefit from competitive pressure on CRSs to more reasonably price their services, because that would make travel agents a more price-competitive way to sell airline tickets.

The high CRS booking fees that have burdened airlines and their customers for years have now become a major problem for travel agents as well. Agents are being priced out of selling the lowest airline fares by costs that are decided by somebody else and are paid by somebody else to somebody else.

Third, Orbitz has in fact not only offered to reduce the costs of distribution as described above, but has also offered further cost reductions well into the future. Orbitz has agreed to a specified schedule of fees that are reduced every year for many years into the future. With CRSs the airlines have seen their costs going up every year. With Orbitz they see their costs going down every year. In addition, Orbitz has offered every airline the option of using new technology being developed by Orbitz to remove not only the search from the CRS (which Orbitz has already done), but also the booking itself. This would eliminate the CRS booking fee, rather than merely reduce it. Thus airlines can see substantially greater cost savings in the future.

And fourth, the importance of the CRS booking fee is easy to underestimate, and it is important not to. A typical CRS booking fee today is about $4.30 per segment. So for a single connection each way, round trip itinerary, the booking fee would be over $17. It doesn't sound like much. But that equates to over $2 billion per year for US airlines, and ultimately for their customers who pay for that in their ticket prices. Distribution costs are the third biggest cost category airlines have, after only labor and fuel. And that is in the context of a US airline industry that lost $7.7 billion last year, an all-time record worst year by far. So far this year airline losses have been equally disastrous. There is no question that the airlines have a vital interest in seeing price competition come to distribution costs.

Two numbers are particularly revealing: in the first quarter of this year, US airlines had an operating profit margin of *negative* 14%. Sabre, the largest CRS, had an operating profit margin of *positive* 26%, extraordinary for any industry, let alone one that is presumably suffering the consequences of post-9/11 downturn in the economy in general and travel in particular.

Technology and Information Quality Competition

The CRS's were built on technology that was cutting edge technology in its day. Unfortunately, that day was in the 1960's and 70's. CRSs are built on mainframe computing technology, and built around programming languages that few even know anymore. One of the characteristics of a monopoly is that it stifles innovation. CRSs have added features to their old platforms, but at a time when most of the world has moved from mainframes to server-based computing, the CRSs are the last bastion of the old mainframes.

Orbitz introduced to travel distribution the use of modern server-based technology to do searches. No online agency had done that before. It brought major new benefits to consumers in the form of improved and expanded information, and it substantially lowered the costs of building and operating the heart of the system.

The old mainframes were limited in the size of the search they could do in response to a customers request. The Orbitz search is unlimited. The websites that used CRS technology for their searches typically returned only 9 or 12 options for the consumer to choose from. Orbitz returns hundreds of options to choose from, and provides a handy matrix by which the consumer can readily organize those options by airline, by lowest fare, by elapsed time, and so on. The consumer on Orbitz gets more information and gets it in a more readily understandable and useable form—and that is good for competition in and of itself.

The positive consumer reaction to the Orbitz offer of more and better information produced what it should have produced, which is competitive pressure on others to improve their offerings. Expedia, for example, after Orbitz launched, took its search function off the old CRS mainframe and put it on modern servers. Furthermore, it borrowed the matrix idea in a somewhat simpler version. Travelocity has also said it intends to move off the mainframes, but has yet to do so.

This is technological competition doing exactly what it should do—pushing everybody to get better. Not only are Orbitz customers better off because Orbitz entered this market, but so are Expedia's customers.

However, while the technological innovations of Orbitz now look like obvious improvements, at the time they were considered very risky. No one had ever attempted to operate a CRS or an online agency using anything other than mainframe technology. Some predicted that anything other than mainframes would fail. In this environment, the only investors willing to take the risk of investing in Orbitz were airlines. They had both the knowledge of reservations systems to be able to evaluate the technological risk involved, and their vital interest as consumers of distribution services in increased competition. The combination propelled them to be willing investors when no one else was.

This is exactly the kind of situation the Department of Justice and the Federal Trade Commission had in mind when they stated, in their guidelines for business ventures that are collaborations of competitors, that such collaborations by competitors can be pro-competitive. In cases where it takes a collaboration of competitors to create a new competitor in a field sorely lacking in competition, that can be a very positive development both for competition and for consumers. That is certainly the case with Orbitz.

Orbitz, however, has no interest in remaining a company with only airline investors. We need to expand our pool of investors, and that means going outside the world of airlines to find additional investors. We have filed a registration with the SEC for a public offering. It is our intent to make that public offering, and bring in public investors and all the obligations that entails, as soon as market conditions permit.

One other innovation we have brought to information quality, which unfortunately has not been imitated by our competitors, is our no-bias displays. The typical practice of the largest online agencies is that they sell—or perhaps short-term rent would be more accurate—to airlines a commitment "to swing market share" to one particular airline at the expense of the others. What that means in practice is that a large online agency commits to a particular airline that it will get more consumers to buy that airline's tickets than would normally be the case, in return for extra payment from that airline. Orbitz, by contrast, has barred itself by contract from doing that. The Orbitz displays are strictly zero-bias. Our strategy is to present to consumers the most options, in the clearest format, with no bias among any carriers (and we offer the schedules and fares of over 450 airlines). This is an especially important benefit for small and low-fare airlines such as National Airlines and Midwest Express; as the DOT Inspector General has recognized, "their fares alone will define where they are featured in the Orbitz display."

On Orbitz any airline will get exactly the same display advantages as any other—no better and no worse. And they don't have to pay extra not to be biased against. And any consumer will get thorough and unbiased information, without efforts to push them to one airline or another. We believe that this approach offers a better deal both to airlines and to consumers.

Customer Service Competition

Our view was that online agency websites before Orbitz offered lots of schedules and lots of fares, but not much in the way of service after the consumer bought a ticket. We decided that was an area where consumers wanted more and we could deliver more. We built a series of features we call Customer Care, designed to provide consumers that follow-on service that was so lacking. When you book a ticket on Orbitz, you have the option of signing up for follow-up information about your flights. Orbitz will sent to you electronically continuous update information about your flight: a delay, a change of gates, a weather problem, congestion on the road to the airport, a delayed connecting flight, a local problem with air traffic control delays, alternative flights or hubs you might use to solve the problem, and a great deal more.

We find that many of our customers love this service. They tell us they often learn of problems from Orbitz before the airline informs them of those problems.

Again, competition did what it was supposed to do. Our competitors discovered that our customers loved this service, and they began working on up-grading their post-booking service as well. As a result, everybody has gotten better. In fact, many of the individual airline websites have significantly improved the follow-on service they provide. Competition works.

The Subcommittee

The Subcommittee needs to recognize that Orbitz is an issue not because it has reduced competition, but because it has increased it. And in particular, it has increased competition in an arena that has not been accustomed to price competition in particular in many years. The largest CRSs, Sabre in particular, are having a difficult time adjusting to the fact that they, like other businesses in America, are going to have to operate in a competitive marketplace. This is a new development for them, and some of them are not adjusting well.

Orbitz is not the cause of an anti-competitive situation, it is part of the remedy to an anti-competitive situation that has been allowed to perpetuate itself far too long. Orbitz is part of the process of the competitive marketplace returning to an arena from which competitive forces have long been excluded.

Some in their effort to persuade government to block new competition have alleged that Orbitz has such advantages that it will sweep all before it and thus ultimately reduce competition. That argument is as silly as it is self-serving.

Most fundamentally, Orbitz has no advantage that others cannot duplicate if they choose to.

- Orbitz got access to webfares, but only because it was willing to engage in reduction of booking costs to get those fares. To the extent others have been willing to do so (particularly Expedia, and to a lesser extent Travelocity) they have gotten webfares as well. CRSs have thus far not been willing to compete on the basis of the booking fees they charge. But it is clear that if they were willing to do so, they could get access to webfares as well. So far they would rather preserve their high booking fees. It is their choice.
- Orbitz has better search technology, performed by modern and far less expensive computers. The Orbitz approach of using the Internet and modern server-based computers is an approach with far lower costs of competitive entry than was the case with CRS technology, in which new entry was fundamentally impossible and never occurred. Orbitz has opened up the possibility of others entering this marketplace by demonstrating that new technology offers significantly lower barriers to entry. Any competitor could make the same upgrade in technology and enjoy not only better performance, but lower operating costs. It is their choice.
- Orbitz pushed the envelope in follow-on service to consumers, but others can do that as well, and some have. It is their choice.
- Orbitz has offered airlines commitments of further cost reductions going into the future, and has offered the option of making most of their bookings without use of the CRS. Any other competitor can offer that as well; they only have to make the technology investment to make those advances possible. It is their choice.
- Orbitz offers consumers a no-bias display, with no pressure or influence on the consumer to buy one airline over another. Orbitz loses a potential revenue source by adopting this approach, but in return it gains some customers who prefer the no-bias approach. Any other competitor can adopt the Orbitz no-bias approach as well, if they are willing to give up the extra revenues that come from selling bias. It is their choice.
- Where we are today is that CRSs sell about 70% of all airline tickets by dollar volume. Orbitz sells less than 2%.

- Orbitz launched in June, 2001, and quickly became the third largest online agency, after Travelocity and Expedia. One year later Orbitz's relative position to those two competitors is virtually unchanged. Among the three, Orbitz had slightly less than a third of that market a year ago, and that is what it has today. There is no trend line of Orbitz gobbling up all before it.

The Internet share of all air travel sold is growing, and is now at about 15% by value. But over half of that is individual airline websites, and those are growing faster than the online agency segment, including Orbitz. Following these numbers through, that means that Orbitz has less than 2 percent of the total distribution of airline tickets in the U.S. Hardly the dominant position that our critics have proclaimed.

Most basically, if, in some unforeseen and unlikely future, Orbitz did start eliminating competition, we have federal agencies with more than sufficient powers under the anti-trust laws and aviation statutes to step in and stop it. We do not need to stop a new competitor today, risking the elimination of clear consumer benefits, because someday, in somebody's fevered imagination, Orbitz might become so successful as to start eliminating competition itself.

In short, we do not engage in this country in anti-trust action based on future speculation. We act in response to evidence of an actual problem, not an imagined problem.

As the Department of Transportation recently concluded, "... government intervention in the marketplace should be designed to correct a failure of market forces, not to replace or pre-empt them in ways that could potentially stifle competition."

Federal and state regulators who are charged with enforcing the antitrust laws have reviewed Orbitz extensively, spanning more than two years. And despite this extensive review, nothing has come to light that has led any regulator to seek changes to the Orbitz business model, agreements or structures. In contrast, the most definitive conclusions the Department of Transportation has noted in its multiple reviews is that Orbitz entry has led to material pro-competitive advantages for consumers and the airlines.

In April, 2000, long before Orbitz launched, Orbitz went to the Department of Justice and suggested that they review our agreements, business plan, and the like. We provided to Justice all our agreements, contracts, and other relevant documents. Justice has reviewed our materials and continues to monitor our actual performance. In addition, they have sought information from airlines and from our competitors. If at any time before our launch or since they had concluded that our approach, or any aspect of our arrangements, was anti-competitive, they had full powers under the anti-trust laws to move to stop us or to force us to modify our approach. They have never done so.

Similarly, at approximately the same time, we made the same materials available to the Department of Transportation and to the Inspector General of the DOT. Both have thoroughly reviewed our agreements, contracts, business plans, and the like, and have sought information from airlines and our competitors. DOT concluded before our launch that there was no basis for using their authority to either prevent us from launching or to direct us to modify any aspect of our approach. They in fact found that on balance we offered both pro-competitive and pro-consumer effects. Like Justice, they have continued to monitor our actual performance. DOT recently issued a report on that monitoring and found no basis for changing their original view. It is clear that if they had found an anti-competitive problem, they have both the legal authority and the will to act to prevent it. But they did not.

Orbitz has been thoroughly scrutinized by both Justice and DOT, and continues to be. We have passed every test to date. This Subcommittee, if it wishes a careful review of Orbitz, need do nothing. That review has been underway for years and continues, despite the fact that it has found no anti-competitive problems.

Those agencies should be allowed to continue and complete their work in a thorough and balanced way. No public interest is served by one-sided calls for thorough scrutiny of Orbitz, and not of the CRS problem.

Automated distribution of air travel has long-standing problems with respect to adequate competition. We need to work toward a restoration of competitive market forces in this arena. Reactionary calls to artificially preserve an inadequately competitive status quo do not serve the public interest and in fact work against both competition and the consumer.

Mr. STEARNS. I want to also add that in a Washington Post article on June 19, I was quoted as saying that I intended to hold this hearing on this subject prior to the August recess.

I attempted to accommodate some folks on this, and I was willing to delay this hearing, but it did not work out. So we are proceeding with our witnesses, and I want to thank them, and I look forward, of course, to their testimony.

[The prepared statement of Hon. Cliff Stearns follows:]

PREPARED STATEMENT OF HON. CLIFF STEARNS, CHAIRMAN, SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION

Good morning. I would like to welcome you all to this oversight hearing of the subcommittee on Commerce, Trade and Consumer Protection entitled: "Are all Online Travel Sites Good for the Consumer: An Examination of Supplier-Owned Online Travel Sites." I would like to especially thank our witnesses on behalf of the Committee for their appearance and testimony.

Notwithstanding the hyper-enthusiasm for all things Internet and electronic commerce of the recent past, the fact remains that the Internet as an efficient, ubiquitous communications tool has substantially transformed, in fundamental ways, commerce as we have known it. Electronic commerce traversing the communications network that is the Internet is real, substantial and rapidly becoming a key component of our economy. The hyper-predictions of not so long ago that e-commerce will reach $3 to 4 trillion dollars by 2003 may not have come true, but by most estimates, the value of business-to-business commercial transactions that transpire online is well over $1 trillion today. More significantly, the rate of growth of such business-to-business transactions is increasing unabated and it is far in excess of the growth rate for offline commerce.

Business-to-consumer e-commerce may also have not meet the glorious predictions of the pundits who rained during the .com bubble, but the fact remains that it has grown substantially and it continues to grow at rates unmatched by offline commerce. One of the more stellar examples of business-to-consumer e-commerce growth is the online travel business. For example, in just over three years, 15% of all airline tickets are now being sold online and the growth rate for such transactions is still accelerating. More significantly, increasingly consumers are seeking and receiving more advanced travel services through online travel sites, such as arranging multicity or even country trips involving a myriad of reservations for air travel, car and hotel reservations and tours.

During the .com bubble it seemed that any and all business models were tried, as investors, in their euphoric state vis-à-vis "anything Internet" had the penchant to welcome and accept them all. As the dust settled and we learned that while selling books online made sense, selling groceries didn't, a "sort" of new business model has gained in appeal among dominant suppliers in certain industries. That "sort" of new business model calls for the dominant firms within an industry to collectively create an online distribution network for their goods and services. In practice this business model has manifested itself in a number of supplier-owned online distribution joint-ventures, where the participating companies tend to be the top five or six in the industry. These supplier-owned online distribution joint-ventures are now present across a number industries, including the air travel, lodging, cosmetics, music, and foreign currency exchange.

There is no question that such supplier-owned online distribution systems engender economic efficiencies and consumer benefits. At the same time, there is also no question that any time competitors come together in collaborative efforts, such as these joint-ventures, there exits the risk for collusive activity that may impede commerce and harm consumers. This hearing is meant to create an educational forum to examine both the benefits and possible risks that supplier-owned online distribution systems hold for the American consumer. As examining supplier-owned online distribution systems across the multitude of differing industries within which they appear would have been a tall order for one hearing. Therefore, this hearing will focus only on online joint-ventures in the air travel and lodging industries.

We have before us great expert witnesses on the issue. We had hoped to have Orbitz and at least one of the five major airlines that own it to speak to Orbitz's business model directly. Unfortunately, due scheduling conflicts they were unable to attend. However, Mr. Gary Doernhoefer, Vice President and General Counsel of Orbitz, L.L.C. has provided the subcommittee with written testimony on behalf of Orbitz, which I now offer to be included as part of the record.

I thank the witnesses and look forward to their testimony.

Mr. STEARNS. At this point, the ranking member is on his way, and so I will ask the vice chairman of the subcommittee, the distinguished member from Georgia, Nathan Deal.

Mr. DEAL. Thank you, Mr. Chairman. There is no admonition to trial lawyers that says that if the facts are on your side, argue the facts. If the law is on your side, argue the law. If neither the facts nor the law are on your side, pound on the table.

I find it highly regrettable that this hearing has been intentionally staged to provide a forum for parties who simply want to pound on the table, since they have neither the facts nor the law on their side.

It is even more regrettable that the company upon whom much of this hearing is focused, Orbitz, was not afforded the same respect and common courtesy with regard to notice and opportunity to testify as those who will testify against it here today.

It is not only regrettable in my opinion, but inexcusable, that those of us on the subcommittee who believe that all parties should be treated fairly and equally have likewise been regarded as second-class committee members by the staff and by some in leadership positions, and who apparently don't want anyone to interfere with this public lynching of Orbitz in absentia.

Since the pounding on the table will soon begin, let me first set forth some facts. Automated distribution of airline travel through large mainframe computers began two decades before the Internet.

These are known as computer reservation systems, CRSs, and there are only four of them in the world today. CRSs charge airlines booking fees that average over $17 for a single connection round-trip.

These booking fees cost U.S. airlines over $2 billion per year. The largest CRS is Sabre, which owns Travelocity, and today CRSs sell about 70 percent of all airline tickets, whereas Orbitz sells less than 2 percent.

CRSs were considered so monopolistic that in 1984 Federal rules were created to attempt to limit their powers. Even so, the booking fees charged by CRSs have continued to rise every year over the past 15 years, and since 1999 they have increased 4 to 7 percent every year, despite the falling costs of the information processing and computer systems.

And 75 percent of Sabre's revenues are from booking fees, which have increased an average of 5 percent per year for the past 10 years. Thirteen months ago, five major airlines created Orbitz in order to provide customers with better service and cheaper travel costs.

Last year U.S. airlines lost $7.7 billion, and are carrying debt burdens of $110 billion, and for the first quarter of this year have an operating profit margin of negative 14 percent.

Sabre, the largest CRS, and the parent company of Travelocity, had an operating net profit margin of positive 26 percent. Orbitz has been success by applying advance technology and making its products user friendly for those who want to book their flights online.

Travelocity, through its old CRS mainframes, are still using those old mainframes, but wants Congress to protect it. How can this subcommittee, which is charged with consumer protection, condemn those who have been innovative, and attempt to reward old monopolistic entities who refuse to modernize in an effort to try to eliminate their competition through this committee means.

Just as the facts are not on the side of those who criticize Orbitz, neither is the law. Before Orbitz was launched, it went to the Justice Department and asked them to review their business plan and agreements, and DOJ did so, and had they thought that Orbitz was anti-competitive, they had the power to stop them, but they have not done so.

The Department of Transportation and the Inspector General of the DOT have also monitored Orbitz and have likewise found their practices to be not anti-competitive.

The recently released DOT report to Congress on Orbitz that was engineered by some of the witnesses here today don't find any violations either, and contain this statement, and I quote:

"Government intervention in the market place should be designed to correct the failure of market forces, and not to replace or preempt them in ways that could potentially stifle innovation." That is good advice for this subcommittee.

Those are the facts and the law, and no amount of pounding on the table is going to change them. By taking financial risks and by employing innovative technology, Orbitz has lowered the cost of air travel, has made booking of flights over the Internet user friendly, and through the power of competition has rattled the cages of some of this monopolistic opponents.

That is what this subcommittee should encourage and not vilify. Thank you, Mr. Chairman.

Mr. STEARNS. I thank my colleague, and I think your robust testimony will provide advocacy for anyone who could not make it in a very, very confident and able way. The gentleman from Nebraska, Mr. Terry.

Mr. TERRY. Thank you, Mr. Chairman. I want to thank you for holding this hearing. My friend from Georgia is a trial lawyer, and the adage is that if the facts are not on your side, argue the law; and if the law is not on your side, settle and get out of the case as fast as possible.

Otherwise, the other part of the adage is attack their credibility, and I hope that is not what we are here to do today as may be suggested. But I am one of those people who signed the letter asking for this hearing, because I am worried about what appears to be an attempt for on-line anti-competitive behavior.

And I will submit my full statement for the record, only highlight the two points that concern me, and why I want to have this level of discussion here today. Any time you have an entity, when there is vertical integration, and you have the five major airlines that own this, the first thought can only be that they want to control every facet of booking airlines.

Fortunately, as Mr. Deal has pointed out in his statement, there is so much competition on-line anymore that it may just be commercially impossible to dominate at the level that probably they intended when they formed this.

The other issue that I think probably gives you credibility where you can argue facts, and can argue law in a case like this is the most favored nations clause that is in here that gives those people that participate, started up Orbitz, the self-serving lowest fares that others can't get.

So I want to talk about that. Now, fortunately, I think the fact that they haven't been able to dominate the market probably speaks well for the market. The fact that they intend to go out for an IPO certainly lessens my concerns of the vertical integration, that it is the five major airlines that own this entity of Orbitz.

Mr. Chairman, I have a more complete statement that I wish to enter into the record, but I am anxious to hear from the witnesses, and I know that their time is short as well. So I yield back.

[The prepared statement of Hon. Lee Terry follows:]

PREPARED STATEMENT OF HON. LEE TERRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Thank you, Mr. Chairman, and I thank you for holding this hearing on an issue of growing concern, not only in the airline industry, but other sectors as well. As I noted in a letter to you May 16th requesting this hearing, brick-and-mortar competitors in any industry joining forces for an e-commerce venture raises serious concerns. We have seen this trend extend past online travel and into the music and hospitality industries, and I commend you for holding this hearing to ensure members of your subcommittee are well informed on the issues surrounding supplier-owned online ventures.

In April, I joined more than 20 of my colleagues in a letter to Deputy Assistant Attorney General Hugh Pate, requesting the Justice Department fully investigate the practices of Orbitz, a supplier-owned online travel company. My concerns in this regard were twofold. First, the owners of Orbitz are the five largest airline companies: United, American, Northwest, Delta, and Continental. Moreover, representatives of these companies sit on the board of directors of Orbitz. These facts raise obvious concerns as to the completeness of information provided to consumers about competing airlines when surfing Orbitz.com. Is it coincidental these five airlines represent lowest fares on Orbitz searches more than 70% of the time, whereas other online travel sites return lowest fares for these same five airlines little more than 60% of the time? I understand Orbitz soon will be offering an IPO, which will diminish some of my concerns of it being owned by the five major carriers, but will do nothing to ease my apprehensions it is still being operated by the five largest air carriers.

My second concern is the so-called "most-favored nation" clause mandated by Orbitz for participating airlines. MFN requires participating airlines to produce lowest fares and make them available to Orbitz at all times. This clause provides a competitive advantage to Orbitz, and consequently its five owners. Worst of all, this clause makes consumers dependent on the company, rather than the company dependent on consumers, which is the essence of a free market and open competition. One question I would like answered at this hearing, Mr. Chairman, is why the MFN clause is even necessary? It would seem to me that a company engaging in ethical business practices with a solid business plan could gain success through innovation and capturing the attention of consumers, not artificially manufacturing its own market by trapping its competitors. Orbitz's own general counsel, Gary Doernhoefer, admitted in a July 12th CNET News interview that Orbitz's MFN clause is not necessary for the company to be profitable. Why not, then, let the market dictate survivability rather than contractual clauses?

I want to be clear that I wholeheartedly endorse increased competition. I also applaud Orbitz, Expedia, Travelocity, and a variety of other online ventures for using technology to expand our economy, and I'm pleased other sectors are doing the same. However, it is the responsibility of this subcommittee in general and a matter of specific concern to me that markets expand fairly; that consumer, not corporate, behavior drives profitably; and that above all, competition is preserved. I look forward to the testimony, and I yield back.

Mr. STEARNS. I thank the gentleman, and your complete statement will be part of the record, and the distinguished ranking member of the committee, Mr. Towns, is recognized.

Mr. TOWNS. Thank you very much, Mr. Chairman. Let me begin by thanking you for holding this hearing. I strongly believe that companies using the Internet to reach more consumers and to move their goods and services at inexpensive costs to consumers—and I have consistently voted with other members of this body to keep the Internet free from sales taxes and other regulations would stifle the growth of on-line commerce.

I think by and large we have accomplished that we set out to do, and that is to maintain competition in the on-line marketplace. Often times I think there is more competition on-line than off-line.

But I most admit to you, Mr. Chairman, that I have concerns that certain aspects of these supplier owned business models, the new controversy surrounds Orbitz, and which the carriers have placed a significant investment.

And while I have no problem with the airlines seeking to make more money, because that would preclude them from having to borrow money from the government, I do have some concerns regarding the competitive environment, or the perception of anti-competitive environment that exists on on-line travel sites.

Earlier this year, I signed on to a letter with my colleagues, Mr. Boucher, and Mr. Grucci, which asked the Justice Department to continue to monitor Orbitz and other on-line travel sites which may be using unseemly practices to squash competition.

It is my understanding that the airlines have a compelling story to tell, and I wish, I wish, that they were here today to discuss their side with us at this hearing. I say again, I regret that they are not here. So I will be asking questions of those assembled this morning, because it is my priority to ensure that the Internet continues to be a competitive marketplace, which benefits not only companies, but consumers as well.

Let me add, Mr. Chairman, that I am somewhat confused on why Orbitz is not here on their own accord today. I feel that as always that in this committee we have tried to put together a fair and balanced hearing, and don't understand why we have zero representation from Orbitz or the carriers.

However, I look forward to hearing the testimony before us today, Mr. Chairman, and hope to get more information on this complicated subject, and I yield back, because this is the most bipartisan committee in the U.S. Congress, and I want to let you know that is directly affecting upon your leadership. Thank you.

Mr. STEARNS. I thank our distinguished colleague. We have two members who do not serve on the subcommittee, and both of these individuals have approached me, and wish to have an opening statement, or to have an opportunity to comment.

Now, this cannot be done without unanimous consent of this committee. So if there is any objection, you can voice it now. The gentleman from Georgia.

Mr. DEAL. Mr. Chairman, reserving the right to object, and I will not object, certainly Mr. Boucher is an esteemed member of the overall committee, and I am well aware of his position, having also seen the letter that he and others have circulated back in April asking the Justice Department to continue to monitor Orbitz.

And I have no objection to Mr. Grucci also making a statement. I would have, of course, much preferred that they take the witness table so that they would be subject to being asked questions about their positions, which in opening statements first of all don't afford us that opportunity for that dialog and interchange.

And of course by the virtue of their positioning in their opening statements, they in effect have the last word. But I will not object, and I welcome both members to this committee.

Mr. STEARNS. I thank the gentleman, and by unanimous consent, both of them will be able to offer their opening statement, and at this point we will take Mr. Boucher, who is recognized.

Mr. BOUCHER. Well, thank you very much, Mr. Chairman. I appreciate the opportunity to participate in the hearing today, and I want to thank the Chairman for accommodating my presence here, as well as the presence of another member who also does not serve on the subcommittee.

I have a very strong interest in the matter that will be discussed today, and I want to comment you, mr. Chairman, for focusing the attention of the subcommittee on how consumers are affected by practices of supplier-owned on-line travel sites.

There is a growing and in my view disturbing trend of companies in a given industry banding together to create a website for distributing their products or services, and then favoring that website with information or other benefits not shared with other websites that compete with the industry owned site.

The denial of this information or other benefit by those exclusively in control of it to the web-based competitors of the industry-owned website, directly hinders competition in electronic commerce, by injuring the businesses of existing on-line competitors, and by discouraging new entrants into the market.

Consumers are hurt as the number of websites offering products or services to them are restricted. Today, we examine this practice as it exists in the airline reservations market. I would point out to the members that troubling examples of the same practice are also found elsewhere.

In the music industry, the five major record labels have created two websites for the delivery of their music inventories across the Internet. They have denied to the on-line competitors of those websites comparable licenses for the significant foreclosure of Internet-based competition and music delivery.

And incidentally, I have introduced legislation that is designed to address that practice by requiring non-discriminatory licensing in that instance. Elsewhere, we observe the creation of websites jointly owned by other suppliers, from a hotel distribution system that is owned by five major hotel groups, to Gloss.com, that is owned by three leading beauty products manufacturers.

To MovieLink, that is owned by the six major motion picture studios; to FX-All, for currency exchange, and that is owned by 17 leading international financial institutions. Now, while I am not aware of the particular practices of these supplier-owned ventures, I think that they may deserve this committee's inquiry and attention at some future time.

Their creation clearly marks a trend of suppliers in a broad range of industries participating in the creation of websites that hold the potential of injuring commerce and adversely affecting consumers, and I think they bear watching.

I am familiar with the practices of the industry that we are focusing on this morning. Orbitz, jointly owned by the largest air carries, in my view gets an unfair break. The carriers give Orbitz their best fairs.

These lowest fairs are not available to the non-industry affiliated websites, Expedia and Travelocity.com. The ability of these independent companies to offer vigorous on-line competition to Orbitz is injured by this practice.

Consumers of Internet-based travel sales are hurt as a result. Orbitz gets yet another break. Its contract with its carrier owners requires that all fares given by any carrier to its own website, or to a third-party site, such as Expedia or Travelocity, also be given to Orbitz.

So no carrier can enter into an exclusive promotion with a third-party site that would offer exceptional bargains to the public. Some of the best opportunities for inexpensive travel used to come from these exclusive promotions. Not anymore.

As my constituents frequently say to me when they are outraged about an obvious unfairness, there ought to be a law, and in the off-line world, there is a law. The Department of Transportation has a rule that airlines owning 5 percent or more of a computer reservations system must give other computer reservation system the same low fairs they give to the system they partially own.

A rule like that I think is badly needed to address the problems in the on-line world, about which we will learn more during the course of this morning. Mr. Chairman, I thank you for calling the committee's attention to what is an obvious problem.

Consumers, I think, will be benefited by the work that your subcommittee is undertaking, and I again thank you for the opportunity to take part in the hearing.

Mr. STEARNS. I thank my colleague. You can tell your constituents to be careful what he asks for when he said there ought to be a law. Mr. Grucci from New York is recognized.

Mr. GRUCCI. Thank you, Mr. Chairman. And let me thank you and the ranking member, and the esteemed members of this committee for giving me the opportunity to be here this morning.

I am not a member of this subcommittee, nor am I a member of the Commerce Committee, but I am a member of the Small Business Committee where we had a similar hearing that dealt with Orbitz, and airlines, and the issue dealt with the unilateral decision by the airline industries to stop making payments to the travel agents, while continuing to make payments to organizations like Orbitz, which is owned by the five major airlines.

This issue first came to my attention when a travel agent in my district, a small businessman, came to my office to explain the hardships that both on-line and traditional travel agencies were facing because of the policies of the major airlines.

He gave me examples of policies ranging from the recent elimination of commissions to U.S. travel agencies, to limited access to air fares. While many of his concerns were diverse in nature, each one of them shared a common theme; the policies were anti-competitive, anti-consumer, and anti-small business.

One need not look beyond the issue of Orbitz to highlight the very airline practices my constituents spoke of. Orbitz is a company that was started by the five major airlines; Delta, United, Northwest, American, and Continental.

While the purpose for its creation is of some concern, the greatest of problems lies within Orbitz's anti-competitive practices. Please allow me to review some of these practices with you. First, Orbitz receives airfares that are not available on any other travel site or through any other travel agency.

Orbitz refutes this claim by standing behind the technology they use called ITA. An informal study by the owner of OneTravel.com, which I would like to submit for the record, Orbitz not only receives better fares than the average travel site, but also the very technology it claims to receive these fares from.

For example, a flight from New York to Dallas costs $255 through ITA, but $249 on Orbitz. Second, Orbitz is clearly biased in favor of its own airlines. According to a report recently filed with the Department of Transportation, 71.6 percent of bookings on Orbitz between July 1, 2001 and February 28, 2002 was for its owner airlines, known as the big five.

During that same period, 51.3 percent, 61.4 percent, and 62.7 percent were reported big five bookings on OneTravel, Travelocity, and Expedia, respectively. Third, while the owner airlines of Orbitz have chosen to eliminate commissions to travel agencies in the United States, they continue to pay $6.37 to Orbitz for every ticket purchased.

I may add that the other group of companies that airlines have chosen to continue to pay commissions to, are travel agencies in foreign countries. In closing, I might add that it is greatly troubling that both Orbitz and the airlines are not represented here today.

In a Small Business Committee hearing on this issue on May 2, the airlines also turned down invitations to testify. Oddly enough, before Congress gave airlines $15 billion in financial assistance, it was difficult to leave your office without seeing airline executives and lobbyists.

Now when their true practices are being highlighted, as travel agencies are forced to go out of business, these airlines seem to be hiding. Again, Mr. Chairman, I want to thank you for allowing me the opportunity to be here, and I would ask that my complete statement be submitted for the record, as well as the attachments.

Mr. STEARNS. Without objection, it is so ordered.

[The prepared statement and attachment of Hon. Felix J. Grucci follows:]

PREPARED STATEMENT OF HON. FELIX J. GRUCCI, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

First, I would like to thank Chairman Stearns for inviting me to today's hearing addressing the issue of supplier owned online travel sites. I appreciate the committee's generosity in allowing me to be here this morning.

This issue first came to my attention when a travel agent in my district—a small businessman—came to my office to explain the hardships that both on-line and traditional travel agencies were facing because of the policies of the major airlines. He gave me examples of policies ranging from the recent elimination of commission to U.S. travel agencies to limited access to airfares.

While many of his concerns were diverse in nature, each one of them shared a common theme: the policies were anti-competitive, anti-consumer and anti-small business. I might also add that his concerns were not specific to his company—since I have been involved in this issue, hundreds of travel agencies have contacted my office mirroring the very concerns expressed to me by my constituent.

One need not look beyond the issue of Orbitz to highlight the very airline practices my constituent spoke of. Orbitz is a company that was started by the five major airlines—Delta, United, Northwest, American and Continental.

While many would argue that Orbitz was launched in 2001 in order to drive Expedia and Travelocity out of the market, airlines claim that Orbitz was created because of the high cost of the travel agency industry. Despite the fact that they have eliminated commission to U.S. travel agencies, airlines claim that the costs associated with the Computer Reservation Systems—or CRSs—used by travel agencies are growing too expensive.

Gary Doernhoefer, the Vice President and General Counsel to Orbitz, recently stated in a Small Business Committee hearing that "the changes in the industry are bringing about needed relief to a distribution system that is broken; a system that for years has boasted leading edge technology—Computer Reservation Systems or CRSs—deployed in a tragically inefficient, unnecessarily costly structure." He also made reference to CRS costs later in his testimony, stating, "as these costs went up, fares had to go up as well."

The great irony of this argument rests in the fact that the airlines created, and until recently, owned each of the four computer reservation systems. One of the CRSs, Worldspan, is owned by three of the owners of Orbitz—Delta, American and Northwest. How can they argue that the CRS' are charging too much money, when the airlines are the ones responsible for setting rates for the CRS they own?

While the purpose for its creation is of some concern, the greatest of problems lies within Orbitz' anti-competitive practices. Please allow me to review some of these practices with you:

- First, Orbitz receives airfares that are not available on any other travel site or through any other travel agency. Orbitz refutes this claim by standing behind the technology they use called ITA. In an informal study by the owner of Onetravel.com, which I would like to submit for the record, Orbitz not only receives better fares than the average travel site, but also the very technology it claims to receive these fares from. For example, a flight from New York to Dallas costs $255 through ITA but $249 on Orbitz.
- Secondly, Orbitz is clearly biased in favor of its owner airlines. According to a report recently filed with the Department of Transportation, 71.6% of bookings on Orbitz between July 1, 2001 and February 28, 2002 was for its owner airlines—known as the big five. During that same period, 51.3%, 61.4% and 62.7% were reported big five bookings on Onetravel, Travelocity and Expedia respectively.
- Third, while the owner airlines of Orbitz have chosen to eliminate commission to travel agencies in the United States, they continue to pay $6.37 to Orbitz for every ticket purchased. I may add that the other group of companies that airlines have chosen to continue to pay commission to are travel agencies in foreign countries—at the same time that travel agencies are struggling to survive in the United States because of commission cuts.

Orbitz has a series of restrictive provisions in its contract with an airline that are heavily anti-competitive. Orbitz requires the airline to give all fares available through the airline's own website to Orbitz. It also requires airlines to give Orbitz any deal that the airline reaches with other travel sites. Lastly, it requires the airline to provide either marketing support valued at $14 million a year or access to exclusive fares.

Mr. Chairman, I believe Michael Thomas of Onetravel said it best when he said, "It is as if GM, Ford and Chrysler decided to form a super-dealership that would compete head-on with independently owned car dealers, and would withhold certain automobiles from the independents—the cars the public most desired."

In closing, I might add that it is greatly troubling that both Orbitz and the airlines are not represented here today. In a Small Business Committee Hearing on this issue on May 2, the airlines also turned down invitations to testify. Oddly enough, before Congress gave airlines $15 billion in financial assistance, it was difficult to leave your office without seeing airline executives and lobbyists. Now, when their true practices are being highlighted—as travel agencies are forced to go out of business—these airlines seem to be hiding.

Again, Mr. Chairman, thank you for allowing me to join you here this morning and I look forward to hearing the testimony of the witnesses and trying to find a way to eliminate the anti-competitive practices of both the airlines and Orbitz that are forcing hard working Americans with the travel agency industry—both on-line and off-line—to look for new jobs.

Thank you.

Mr. STEARNS. The gentlelady from Colorado.

Ms. DEGETTE. Thank you, Mr. Chairman. I just have a couple of thoughts that I would like to share, and I don't come into this hearing with a preconception about what I think we should do about the issue, but let me say last night I decided to see what Orbitz did for myself.

And so I went on to my computer, and I got some prices for flights from my hometown of Denver to Washington and back, and I went on some of the other travel sites and got comparable fares.

And I did find with some of the fares that Orbitz was cheaper, but I also found at the same time that Orbitz did not feature flights from Frontier Airlines, which is our big competitor in the Denver-Washington market.

So my question is that while Orbitz may be very helpful for consumers right now, and because of its structure may be able to really help consumers get low airfares, what happens in the long run in markets like my market, which is a hub for United, if sites like Orbitz don't feature some of the startup competitors.

What happens to overall airline ticket prices in the long run. On the other hand, does the availability of a supplier-owned distribution system like this turn the concept of anti-trust on its head, and do we really have anti-trust issues with a company like Orbitz, which is an Internet company, and only one of many Internet companies.

So I guess the question we need to ask is whether this model is inherently anti-consumer or pro-consumer. Are these businesses destined to inhibit competition in the long run, or is there some way they could enhance competition in the long run.

I think that from the consumer standpoint that this is critically important to answer, because over time given Orbitz's successful business model, this is not going to just affect the airline industry, but all kinds of different industries.

So I look forward to this hearing, and I thank the chairman for having it, and I yield back the balance of my time.

Mr. STEARNS. I thank the gentlelady. The gentleman from New Hampshire, Mr. Bass, is recognized.

Mr. BASS. Thank you, Mr. Chairman, and I appreciate you holding the hearing, and as a former member of the Aviation Subcommittee and a licensed pilot myself, and I have been an instrumented pilot now for 32 years, I would like to be back thinking about aviation issues just for a couple of hours.

We are all aware of the boom and bust cycle of most e-commerce enterprises over the past few years, but from the beginning travel planning was among the very limited number of industry sectors that could be profitable on-line. It could be because it makes sense.

And for better or for worse, instead of calling a travel agent for airline or hotel directly on the phone, you can now do it yourself, and we all do that, sometimes directly with airlines, and sometimes with intermediaries.

It has obvious consumer appeal, and you can check prices, and it has really made the business of understanding airline travel a lot easier. But more broadly, I think today's hearing will be an opportunity to consider the consumer benefits of moving outside proprietary networks into a more open architecture.

So this is like Orbitz and TravelWeb represent a shift in the technology S-curve, but interestingly enough, they are also joint ventures of the old economy firms, airlines, and hotels.

Nevertheless, there is a certain need for oversight to ensure that the issues of competitiveness and market power are not abused. As such, I welcome the FTC's disclosure requirements for websites that receive compensation from supplies, and although none of us spilt many tears for buggy whip manufacturers when the automobile arrived, small travel agents across the Nation are facing a change in industry model, and their significant power in small business America.

Nevertheless, I believe it is clear that the market consumers have not yet spoken on which model they prefer. The bottom line is that I appreciate this hearing, and I am wondering where the beef is.

And we will hopefully get both sides of the issue here, and let's stick up for the consumer, because I think it is a great opportunity for consumers to get good deals for travel, while at the same time maintaining a good strong economy hopefully in the air. Thanks a lot, Mr. Chairman.

Mr. STEARNS. And I thank the gentleman.

[Additional statement submitted for the record follows:]

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

Thank you, Mr. Chairman for calling this hearing. As a former Subcommittee chair, I spent a great deal of time examining e-commerce issues, particularly those impacting consumers and the long-term development of e-commerce. Additionally, it is refreshing to examine a segment of the economy that is growing and flourishing. Much of the Committee's time and energy recently has been spent examining failing industries or collapsing companies. While that is an important function, it is sad to have to focus on such events. And so, I think this is an important and beneficial hearing and look forward to the testimony of the witnesses.

The online travel industry has grown by leaps and bounds in a short amount of time. As one of the largest e-commerce success stories, it highlights the great possibilities of the Internet and e-commerce. Consumers have certainly found cause to take advantage of the myriad of web sites offered to improve their travel experiences. The Internet practically has turned each and every consumer into his or her own travel agent, with travel sites offering various business models to meet consumer demand and interest. From the bidding mechanisms of Priceline.com, to web auctions, to the new independent sites like Expedia and Travelocity, and to the supplier-owned site of Orbitz, we are seeing some refreshing developments. These results are being duplicated throughout the entire travel industry, including the lodging industry. This innovation isn't stopping with how the travel services are offered but extends to what is being offered as well. Online travel companies are developing some of the most creative consumer attentive services imaginable all with the goal of obtaining consumer loyalty and consumer attention.

However, this portrait is not completely rosy. As consumers continue to use the Internet for travel purposes and transparency continues to improve, some business approaches will fail. Furthermore, some traditional services, such as the old role of the travel agent, may no be longer necessary. It used to be that when a person wanted to travel to a distant city they called their local travel agent and booked the best plan for their needs. Such a function may be no longer applicable, forcing the travel agent of yesterday to adapt to a new role. I believe this is exactly what travel agents are preparing to do.

Technology advances eliminate old-style jobs all the time. We no longer have Blacksmiths and candle makers to name a few. This is the traditional debate captured in the children's tale of Paul Bunyan. We probably ought not try to protect jobs supplanted by new technologies or failed business models. However, there may be legitimate concern if such technology advances are coupled with creative relationships that could mask old-time trickery, funny business, or collusion.

Supplier-owned distribution systems in the online world within various industries have generated some heated debate in both the academic and practical worlds. As a group such sites, which go beyond just the travel industry, raise some interesting questions. I will admit that it is quite unusual to see the biggest industry players within an industry—longtime fierce competitors in the off-line world—come together in one happy family to jointly sell services or products online.

Orbitz and Travelweb hold out the many potentially positive benefits for their owners such as lowing the operating costs, creating a new avenue for unloading excess supply of travel services or products, creating new relationships with end-consumers, and promoting efficiency. There is legitimate concern when the controllers of supply also get a major role in distribution. A remaining question is whether the creation of these sites by the suppliers was done or is operating with malicious intent to block new entrants from getting their foot in the door. This remains the crux of this debate for which I will reserve judgment. I will say that I would be concerned if Orbitz and Travelweb are contemplating becoming the new OPEC of the online travel industry.

Mr. STEARNS. Now I welcome our panel. Mr. Sam Gilliland, President and Chief Executive Officer of Travelocity.com; Mr. Bruce Wolff, Chairman, of Travelweb, LLC; Jonathan Zuck, President, Association for Competitive Technologies; Dr. Mark N. Cooper, Research Director, Consumer Federal of America; and Mr. Paul M. Ruden, Senior Vice President for Legal and Industry Affairs, the American Society of Travel Agents.

I welcome all of you, and we will start with you, Mr. Gilliland, for your opening statement.

STATEMENTS OF SAM GILLILAND, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TRAVELOCITY.COM; BRUCE WOLFF, CHAIRMAN, TRAVELWEB, LLC; JONATHAN ZUCK, PRESIDENT, ASSOCIATION FOR COMPETITIVE TECHNOLOGY; MARK N. COOPER, RESEARCH DIRECTOR, CONSUMER FEDERAL OF AMERICA; AND PAUL M. RUDEN, SENIOR VICE PRESIDENT FOR LEGAL AND INDUSTRY AFFAIRS, AMERICAN SOCIETY OF TRAVEL AGENTS

Mr. GILLILAND. Chairman Stearns and Congressman Towns, I am Sam Gilliland, President and CEO of Travelocity.com, the Nation's most popular on-line travel site.

I want to thank you for the opportunity to testify. This hearing is an excellent opportunity for you to begin examining, and I hope reversing, a dangerous e-commerce trend across a growing number of industries.

Travelocity, along with many others, has been an outstanding critic of Orbitz, a joint venture owned by five of the Nation's largest airlines, which together account for 80 percent of the Nation's airlift.

It is very troubling from both an anti-trust and e-commerce perspective when the overwhelming majority of suppliers in an industry band together to coordinate distribution strategies.

Still, Travelocity has never argued that Orbitz should be restricted from entering the on-line travel market. There is certainly room for other competitors. We have instead focused on certain anti-competitive features of the Orbitz contract, the so-called most favored nations and exclusivity provisions.

These clauses, which provide Orbitz's long term contractual access to the full array of major airlines' fares and inventory threaten all independent travel retailers and consumers that we serve.

We believe that Orbitz should be required to compete on the merits of its technology, its customer service, and marketing ability, and not on contractual guarantees that deter airlines from offering their lowest fares to more consumers.

As Orbitz grows larger, consumers are being denied a choice in travel agents. They are required to pay increasing service fees on Orbitz that major independent on-line sites do not currently charge, and are losing the benefits of airline competition that the independent websites have fostered.

The on-line travel market is the fastest growing e-commerce category. With the rise of the Internet, independent travel agents are increasingly using this distribution channel to benefit consumers. I believe the role played by such independent agents is critical in maintaining and enhancing effective competition.

The travel sector of e-commerce has tremendous upside potential. The product that we sell is a virtual one, ideally suited to the Internet. Travelocity can help people dream about travel, and give them reliable tools to book their trips.

Even the paper ticket, the last physical product in travel distribution, has largely given way to the increasingly popular e-ticket. At Travelocity, we don't need to maintain warehouses or take return shipments.

However, independent travel agents can have the latest technology tools, but it makes little difference without the full array of fares and inventory to sell. The Orbitz strategy is about choking off the flow of critical content to independent travel distributors, a strategy that has a long checkered history in travel distribution, and one that led to the imposition of rules of fair play in the mid-1980's.

These so-called CRS rules, which have now been updated by the DOT for 10 years, do not apply to Internet sales, a loophole that Orbitz exploits every single day. And yet the very same conduct that the CRS rules restrain, where airline owners use their control to harm airline competition and consumers, is the exact conduct that Orbitz is engaging in today.

We believe that the rules should be updated to create regulatory parity. Orbitz and Orbitz alone has received wave after wave of web fares from its airline owners, often for discounts across their entire network of flights.

Our research shows that web fares account for a whopping 60 percent of Orbitz's total airfare sales, and those fares were generally denied to other travel retailers, to the detriment of consumers.

The data also shows that Orbitz is hardly a friendly site for most low fare and smaller airlines, which consistently sell a lower percentage of tickets in Orbitz than in the independent sites, a growing threat to their ability to compete.

On June 27, the DOT issued a report to Congress that raised the concerns about Orbitz, but was essentially inconclusive about what should be done, deferring instead to DOJ, which continues to pursue its own longstanding investigation.

Of course, consumers in competition are suffering while the agencies delay action. They fail to tackle these problems and it may be necessary for Congress to act. Now, the remedy is simple.

DOT and DOJ should remove the contract provisions that give Orbitz an unfair advantage and force Orbitz to compete on its own merits. Mr. Chairman, the rise of the Internet has initiated a true revolution in the travel industry. It holds the promise of greater efficiency and enhanced competition at all levels.

And as a policy matter and as a legal matter, we do not believe that suppliers should be able to engage in collective action to withhold information from independent distributors. This is an obstacle to consumer choice that this committee should strive to remove.

Thank you again for the opportunity to testify, and I look forward to your questions.

[The prepared statement of Sam Gilliland follows:]

PREPARED STATEMENT OF SAM GILLILAND, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TRAVELOCITY.COM

INTRODUCTION

Chairman Stearns, Ranking Member Towns, I am Sam Gilliland, President and CEO of Travelocity.com, the nation's most popular online travel site. I want to thank you for the opportunity to testify today. This Subcommittee has shown great leadership on many critical electronic commerce and consumer protection issues, ranging from privacy to cyber-crime to restraints on digital trade. We at Travelocity share your commitment to facilitating public policy that will create an online environment that is good for business and good for consumer welfare. The focus of this hearing on the consumer implications of online, supplier-owned travel agency joint ventures is an excellent opportunity for you to begin examining, and I hope reversing, a dangerous e-commerce trend across a growing number of industries.

Travelocity (along with other independent travel retailers, business travelers, consumer groups, several small and low cost airlines, a large and growing number of Members of Congress, and other government officials) has been an outspoken critic of Orbitz, the joint venture owned by five of the nations' largest airlines. Travelocity has never argued that Orbitz should be restricted from entering the market; to the contrary, there is room for more competition in online travel. Our concern has instead been focused on certain features of the Orbitz contract which we believe unnecessarily restrict the ability of airlines to provide consumers better access to the lowest fares in the marketplace. These features are the so-called "most favored nations" (MFN) provisions and exclusivity incentives. These clauses, which provide to Orbitz long-term contractual access to a full array of the major airlines' fares and inventory, threaten all independent travel retailers and the consumers we serve.

We hope that this hearing will help catalyze the continuing efforts of Congress, the Department of Justice, the Department of Transportation, and other government officials to find a workable solution to the Orbitz problem. We have called on them to remove these anticompetitive clauses and require Orbitz to do what all other travel retailers do everyday—compete on the merits of their technology, customer service and marketing ability—and not on contractual guarantees that insulate Orbitz from true competition and serve as a deterrent to airlines from offering their lowest fares to a greater number of consumers. We have also called on the DOT to update and modernize the CRS rules to address the Orbitz issues—for the sole reason that the rules were last revised 10 years ago and therefore do not apply to airline-owned online travel retailers, but only to traditional computer reservation systems marketed to travel agents.

Mr. Chairman, this hearing before this subcommittee is critical, because it is consumers and their welfare that this debate is all about. We believe that much is at stake for consumers now, and much more profound harm is in store for them if Orbitz' plan is executed without restraint. Consumers are increasingly being denied a choice in travel agents, both online and offline, as they are being forced to go to Orbitz, through the operation of Orbitz' MFN and exclusivity provisions, for full access to the major carriers' lowest fares. Consumers are required to pay an across the board service fee on Orbitz that the major independent online sites do not currently charge, and this fee will almost certainly rise as Orbitz accounts for an ever larger share of airline ticket sales. Orbitz and the Orbitz MFN are actually catalysts for transferring the costs of distribution directly to consumers—although it is highly unlikely that consumers will see equivalent reductions in airfares as Orbitz' service fees will undoubtedly increase. With the ascendancy of Orbitz, consumers are losing the benefits of airline competition that the independent travel web sites have until now fostered both by forcing the major carriers to compete with each other and by giving new entrant and low cost carriers—the major force for keeping airfares low—a better opportunity to compete with the majors. Left unchecked, the operation of the anti-competitive provisions of the Orbitz agreement will inevitably lead to less consumer choice, less airline competition and higher consumer prices for air travel.

The online travel market in which Travelocity.com participates is growing at a rapid pace and, according to the research firm PhoCusWright, "is the fastest growing e-commerce category." With the rise of the Internet, independent travel retailers—both brick-and-mortar and online—are increasingly using this distribution channel to expand the richness and reach of their product and service offerings to the ultimate benefit of consumers, who benefit from the more robust airline competition the independents foster.

A key component to the continued growth and consumer gains in the Internet travel market is fair access to information from travel suppliers and, in particular, access to travel suppliers' lowest fares and corresponding inventory. It is of no benefit to companies that distribute airline tickets if they develop the best low fare search technologies but are denied access to the full range of airfare inventory. At Travelocity, while we are focused on providing the best technology and customer service, we are also focused on giving our customers—both business and leisure—the most comprehensive access to the lowest fares and rates available. After all, that is what consumers demand and rightly so.

You will hear from Orbitz that it offers the carriers lower distribution costs in exchange for the guaranteed contractual access to their inventory that Orbitz alone enjoys. This is simply not true. Independent retailers, like Travelocity, have repeatedly offered to meet or beat Orbitz's economics, and yet have been denied equal access to the low fare inventory Orbitz receives. On July 11, American Express stated that for the last six months or so it had offered to pay a portion or all of the airlines' distribution costs relating to certain fares and inventory only provided to Orbitz, but thus far no airlines have accepted American Express' proposal.

We strongly believe that the denial of fair and open access to travel information to independent travel agents raises substantial public policy questions that Congress, the Department of Transportation, the Department of Justice and other government officials must address.

TRAVELOCITY.COM AND THE ONLINE TRAVEL DISTRIBUTION CHANNEL

Travelocity.com is an Internet commerce pioneer. Since our initial launch in March 1996, our customer base has grown to more than 34 million members. We have built this successful business and a solid brand by constantly innovating and creating new products that take advantage of Internet technologies to bring benefits to consumers and travel suppliers alike. We believe we are changing the way consumers can shop for and buy travel. Some of our web site's innovations and features include: (i) Alternate Airports—which provides alternative city fare information (often bypassing hub airports) in response to a given fare request; (ii) "Dream Maps"—which offers leisure travelers on a limited budget the ability to view "theme" vacations (i.e., beach, ski or national park packages) that compare and select among the best fares for multiple destinations, and (iii) Best Fare Finder—a revolutionary product that shows consumers calendar-based fare offerings, so that they know precisely when advertised low fares are really offered.

While travel suppliers are understandably focused on maximizing the amount of revenue they receive with each sale of inventory, at Travelocity.com we are focused not only on giving travel suppliers an excellent, low-cost selling channel but perhaps more importantly, on providing *consumers* with what they want, which, more often than not, is the **lowest** available fare. We have invested heavily to improve the speed and functionality of our site. As noted by one airline industry analyst, "the philosophy [of independent travel web sites] is to push the price lower—a complete reversal of the aims of an airline's own yield management team." [1]

Travelocity.com creates a global storefront for consumers to see, experience, research and buy their travel in one place. As such, Travelocity is the "front-end" or user interface through which consumers access a vast virtual warehouse of travel information, such as supplier inventory, prices and schedules.

Just like any other travel agency in the world, Travelocity contracts with one of four computer reservation systems (CRS) for access to this supplier information. Travelocity's agreement for these "back engine" services is with Sabre, the CRS owned by Sabre Holdings Corporation, Travelocity's parent. CRSs are closely regu-

[1] *Reuters Finance* (Feb. 23, 2000) at <www.biz.yahoo.com>.

lated by DOT (and also by DOT's counterparts in Canada and the European Union). One of the bedrock principles of these rules is the requirement that the airlines that own CRS's participate in the other CRS's to the same extent they participate in the systems they own, so long as the other CRS's offer the airlines commercially reasonable terms. These are rules of fair play designed to protect competition and consumers and they have stood the test of time.

Currently, the CRS rules in the United States, unlike the rules in Canada and the European Union, do not apply to the distribution of airline information directly to consumers via the Internet. The CRS rules were last amended in any significant way in 1992 (before the Internet became a major channel for e-commerce) and were scheduled to sunset in December 1997. It was over five years ago that DOT first solicited comments on how the rules should be updated to reflect the multitude of changes in the travel distribution landscape that had already occurred since the regulations were revised in 1992.

Ten years ago, all CRSs were owned and controlled by large airlines. Today, two of the four traditional CRSs, including Sabre, are free of all airline ownership. This structural change has effected substantial modifications in the fundamental incentives and business goals of those independent CRS enterprises. Further, in 1992, the Internet was in its embryonic stage as a tool for the distribution of airline products, with only a handful of airline sales made online. At present, roughly 15% of all airline tickets are sold through the Internet and the percentage is growing rapidly. If these rules are to remain in effect, these rules need to be modernized.

I understand that a draft of the rules has been completed and is under review at the Office of Management and Budget. The revised rules must sufficiently and appropriately address the most critical issues facing travel distributors today, including the ability of travel distributors to obtain access to the lowest fares of travel suppliers that own competing travel agent sites, as exemplified by the airline-owned site Orbitz (we are not seeking to have these rules apply to data that the carriers put only on their proprietary single carrier web sites). In revising these rules, DOT must strive for fairness. It makes no sense to have rules insuring fair competition and consumer protection for the offline environment that are not applicable to the online environment. For example, core antitrust principles are not solely applicable in the offline environment, but govern all commerce. Either the rules should apply to both, or not at all. Further, even after five years of delay, it makes no sense for DOT to attempt to regulate until it receives critical inputs from the Commission Congress chartered two years ago and DOT just recently formed to study the plight of travel agents, and until the Inspector General completes the separate study on Orbitz Congress required as part of last year's Appropriations bill. These exercises are directly relevant to how the rules should be modernized, as the DOT itself has acknowledged. In short, DOT should not put the regulatory cart before the horse.

HOW ORBITZ OPERATES—THOUGH MFN AND EXCLUSIVITY

Evidence of how Orbitz operates in the online travel channel may be found in its "Airline Charter Associate Agreement." Based on the most favored nations language in this agreement, airline participants may not undercut the prices they post on Orbitz, either by putting lower prices on their own web sites or by running promotions (even one day sales) with online competitors of Orbitz. The MFN specifically requires that any published fare posted on the airline's own web site or on any third party site be given immediately to Orbitz. Under the agreement, "published fares" are broadly defined and include the overwhelming majority of fares in a given airline's inventory.

In addition, the owners agreed among themselves to impose annual in-kind promotional support obligations on carriers, with one of the ways carriers could meet this obligation being to offer their lowest fares **exclusively** through Orbitz. It works this way: Each participating carrier is obligated to provide Orbitz with substantial "In-Kind Promotions," which can run into the millions of dollars. Among other things, these obligations can be satisfied by offering "exclusive promotions or fares available only on" Orbitz or the participating airline's own Internet travel site. Orbitz can withhold certain rebates if the carrier and Orbitz fail to develop a mutually acceptable promotional plan and/or if the carrier fails to adhere to the terms of that plan.[2] Moreover, Orbitz' requirement that all participants immediately provide to Orbitz all promotions and fares that are offered using alternative distribu-

[2] The non-equity owning carriers can also apparently satisfy these requirements by providing Orbitz with "passenger database information" and "competitive purchaser names" (e.g., e-mail addresses of passengers who booked travel through another online agency).

tion methods will undercut any incentive by Orbitz to innovate by developing and packaging special promotions from suppliers.

These very unusual contract provisions were the subject of much controversy in 2000 and early 2001 as the Department of Transportation and Department of Justice considered what safeguards might be required up front, before Orbitz' launch. DOT (and DOJ) nonetheless allowed Orbitz to launch without any limitations on its ability to enforce the MFN clauses and exclusivity incentives. An analysis of that DOT decision, and an examination of the events of the months since Orbitz began operation, leads only to the conclusion that if there were ever a basis for permitting Orbitz to enforce either of these provisions, it evaporated long ago.

In and of themselves, the terms of the Orbitz agreement with its participating carriers have impaired the ability of consumers to have broader access to lower airline fares. This harm to the competitive airline process has materialized with even more severe, long-term harm inevitable. In its April 13, 2001 letter to Orbitz, DOT acknowledged that "critics argue that the MFN clause undermines the ability of individual airlines to make clandestine deals with other Internet travel sites—deals that they rightly contend have a pro-competitive effect on pricing . . . Thus, there is some potential impact on the market dynamic." [3]

While "under the radar" sales by airlines on independent travel agents have slowed, the volume of immediately detectable web fares offered on Orbitz has exploded. Orbitz's strict most favored nations requirement, which it strongly polices, ensures that price discounts are immediately detectable by all carriers at the same time every working day. To the detriment of consumers, this environment acts to discourage discounting, because there is no way for carriers to create even a temporary advantage over competitors.

In its June 27, 2002 Report to Congress, DOT recited the concerns of those smaller low-fare carriers opposed to Orbitz because, among other things, "they do not want to lose their ability to selectively engage in deals with other online agencies and distribution channels without the obligation to also give these deals to Orbitz." Even more telling, one such carrier stated the in-kind advertising commitment was "designed to burden small low-fare carriers with higher distribution costs." [4]

EXCLUSIVITY AND WEB FARES

In the April 13, 2001 letter, DOT expressed its rationale for allowing Orbitz to launch with contractual incentives to provide content to Orbitz exclusively. The Department expressed strong misgivings, saying:

> *We have serious concerns about incentives toward exclusivity, however limited. While we are prepared to reserve judgment until we see how this provision operates in the marketplace, we will monitor these developments closely. Allowing a new entrant with no sales or market share to offer financial incentives to get exclusive access to a very limited portion of supplier inventory may be a legitimate means of overcoming entry barriers.* (emphasis added)

As predicted by many of its critics, in the months following its launch the owners of Orbitz made available to Orbitz—and Orbitz alone—wave after wave of web fares, often for discounts across all or much of their entire network of flights [5]. The representations made by Orbitz to induce DOT to allow it to commence operations unfettered by standard rules of fair play—namely, that web fares would represent only "1/10th of one percent" of the fares offered [6]—have proven to be completely false. To the contrary, our research indicates that web fares account for at least 60% of Orbitz' total airfare sales, and those fares were generally unavailable for negotiation (as American Express and others can attest) and therefore denied to other travel retailers to the ultimate detriment of consumers.

Importantly, these Orbitz web fares are not simply last-minute weekend travel fares on flights that have an unusually high number of empty seats; they are instead wide swaths of the airlines' fares on flights and available for more advanced booking. On February 26, 2002, Karl Peterson, CEO of Hotwire, a travel web site owned by four of the five Orbitz owners succinctly described the transformation of the uses of web fares by large airlines, noting:

[3] DOT Letter at 4.

[4] DOT Report at 13.

[5] Of course, Travelocity welcomes low fares and the more the better. However, because the largest carriers in the U.S. have withheld comparable low fares from any of the tens of thousands of offline and online travel agencies that compete with the agency they jointly own—Orbitz—they have distorted competition in the field of airline ticket distribution and have also injured those millions of consumers and businesses who, for all sorts of valid reasons, choose to deal with travel agencies that are independent of the big carriers.

[6] See DOT Letter at 7.

"[N]o longer are web fares surgical. They are closer to a published fare sale than they've ever been . . ."

Because of this guaranteed access to low web fares on the Big Five—and not because of any technological innovation or high level of customer service—Orbitz has become one of the top three online sellers of airline tickets.[7]

In recent months, *some* of the Orbitz carriers have started to provide limited access to some web fares to some independent retailers. This has not, however, solved the problems raised by the Orbitz MFN or leveled the playing field. For example, Orbitz has now confirmed publicly that it has *10 year contracts* with its owners that, among other things, guarantee Orbitz access to *all* these web fares.

A key premise of the DOT's decision allowing Orbitz to proceed was that a "very limited portion of supplier inventory" would be made available to Orbitz on an exclusive basis. In other forums, Orbitz executives had asserted that these special web fares to which it alone would have access would not account for any significant portion of the lowest fares it offered. In a May 22, 2001 speech to the Aero Club, Jeff Katz said:

"We estimate that about 99% of the time that Orbitz produces a lower fare, it will be [sic]not be because we had access to a fare others did not, but because we found a fare that everybody had access to, but not everybody could find. Or not everyone chose to display."

As any observer of Orbitz will know, this statement has not proven to be accurate. Instead, in the 13 months since Orbitz commenced operation it has offered numerous "web only" discounts that the five Orbitz owners made available on Orbitz, but denied to all of Orbitz's independent competitors, online and offline.

SMALLER CARRIERS HAVE CONSISTENTLY POORER SALES IN ORBITZ

There is more data that should concern consumers, evidence that has ominous overtones for the future of airline competition and e-commerce. A number of concerned parties predicted in 2000 and early 2001 that Orbitz would be designed and operated in ways that would neutralize the ability of the small, discount carriers to achieve a premium share of ticket sales in the independent web sites. For example, Orbitz's refusal to allow airline advertising in the airline displays was seen by many as an attempt to deprive smaller airlines of a very useful, point-of-sale technique that touted their bargain fares. Through banner ads promoting their fare specials, smaller carriers had been able in the independent sites to overcome their lack of name recognition and to attract needed incremental business.

In short, the data show that the small discount carriers do attract a substantially higher share of sales in the independent sites and that in Orbitz the major airlines have succeeded in nullifying that phenomenon.

As forecasted by many, the hard sales data for the months since Orbitz's launch show that smaller and low fare carriers do much more poorly in Orbitz than in the two largest independent web sites. These low-fare carriers achieve a percentage of total bookings that is 15% to more than 200% larger in the independent sites than in Orbitz.

Simply put, the data concerning how smaller airlines do in Orbitz are a bad omen of what the future holds for them and consumers. Moreover, they are a stark reminder of what the world was like for smaller carriers in traditional CRSs before the Civil Aeronautics Board adopted rules in 1984 to governing the operation of airline-controlled CRSs.

In response to this uneven competitive playing field, many travel retailers have responded by shifting their focus away from the sale of scheduled air, where they have long been positive forces for airline competition, to the sale of other products, such as hotels, package vacations and cruises. Lowestfares.com recently announced that it was discontinuing selling airline tickets entirely. In contrast, Orbitz's recently filed S-1 reveals that almost 90% of its 2001 revenues came from the sale of air transportation. As Orbitz becomes a larger seller of air transportation, this is not likely to be helpful for small and low-fare carriers (such as JetBlue and Southwest, neither of which participate in Orbitz), nor for the consumers who look to them to serve as a competitive spur for lower fares. As independents shift their focus away from the sale of scheduled air service, consumers lose choice as well as the competitive pressure that comes from agents who have historically provided them with tools to help them find the best deals. Orbitz, as an airline joint venture,

[7] Orbitz claims that it does not have "exclusive" fares because most of these fares are also available on the individual carriers' web sites. While Orbitz engages in such semantic games, this form of self-dealing is hardly the type of robust competition a free and fair marketplace would demand.

has little incentive to provide or improve upon these tools particularly as competition from independent, non-airline owned sites diminishes.

SHOULD ORBITZ BE PERMITTED TO OPERATE?

Travelocity has never asked that Orbitz be blocked from operating. Instead, we have expressed concern over the consumer harm and competitive implications of DOT not taking action while Orbitz implements a business plan predicated on exclusive access to the lowest fares of the five largest carriers in the U.S. Orbitz did not have to compete or negotiate for that access, but was simply given (and guaranteed) that access—which is not indicative of a competitive marketplace. We have urged the government to address this risk head-on, certainly allowing Orbitz to exist and engage in competition with the rest of us, but to be mindful of the "rules of the road" in any competitive marketplace and to consider the lessons learned from prior airline owned distribution ventures. This simply means removing the anticompetitive contract clauses and modernizing the CRS rules. These are surgical actions that can be taken and in no way constitute "regulating the Internet" as Orbitz has asserted.

WHAT SHOULD BE DONE?

We believe DOT or DOJ should act now to ban the use by Orbitz of the two contract provisions that require carriers to collectively provide "most-favored nations" treatment to Orbitz with respect to fares and inventory. The agencies should also void the provisions of the Orbitz Agreement that collectively give carriers financial incentives to confer fares and other content on Orbitz on an exclusive basis. DOT's June 27, 2002 Report to Congress raised concerns about Orbitz, but failed to reach conclusions on what should be done, deferring instead to DOJ, which continues to have open a long-standing investigation, which has no timetable for conclusion. If the agencies fail to tackle these problems, it may be necessary for Congress to step in and come up with a solution.

Unfortunately, DOT has not addressed the "sea changes" in the industry that have occurred over the past ten years. The limited scope of the U.S. CRS rules, which apply only to computer reservations systems to the extent these systems are used by travel agents, may have made sense in 1992. However, at a time when tickets sold online directly to consumers are approaching 15% of all sales, it is nonsensical to say that stringent rules banning the withholding by airline owners of key flight data are essential elements of public policy in the case of the four traditional CRSs (two of which are no longer airline owned), but that a ticket distribution system like Orbitz that is backed by the combined strength of the five biggest airlines, gets a free pass. This is bad public policy.

In fashioning the appropriate response to the competitive harm of Orbitz, DOT should be mindful of the policy underpinnings of the rules. In 1984, the CAB found that regulation of *airline owned or marketed* CRSs was necessary because, it concluded, airlines that owned the electronic distribution outlets for airline tickets had both the *means* and the *incentive* to use that control to advance their fortunes as airlines. DOT found a documented halo effect in terms of sale of tickets sold through the systems that favored major carriers that owned distribution outlets at the expense of smaller carriers.

In 1992, DOT affirmed that view and also found that airlines had an inherent incentive and power to favor the distribution outlets they owned over all others. No good reason exists today to believe that these fundamental dynamics in the airline industry have changed. In the face of those facts, it is difficult to see how rules designed to prevent abuses by even a single carrier owning a traditional CRSs offered to travel agencies are not applicable to this scenario where the five largest air suppliers form a joint venture to operate a distribution web site targeted at consumers.

DOT should promptly take the steps needed to apply with respect to Orbitz the same regulatory safeguards that it found long ago were necessary to protect competition in the case of traditional airline-owned CRSs.

CONCLUSION

Based on its MFN and exclusivity provisions that lead to exclusive access to web fares on the nation's five largest airlines—fares that predominate its listings despite its earlier representations to the contrary to DOT—Orbitz has gone from nowhere to become the one of the largest Internet travel agencies, and has achieved this position without having to compete for this favored access to fares and inventory. This is perhaps the most troubling aspect and key issue in supplier owned joint ventures—the danger of distorting competition and creating an uneven playing field which ultimately harms consumers and competition.

Action is needed now to prevent Orbitz from continuing to benefit from its supplier-owned structure and favored access to inventory—which it did not obtain through competition—and protect the competitive dynamic and promise of Internet distribution to bring lower prices and more innovative technology and tools into the reach of more consumers. If the MFN provisions were ever justifiable in April 2001 because Orbitz had "few sales and no market share" and if the exclusivity incentives might have been defended as a legitimate means to "overcome entry barriers," those reasons for DOT or DOJ to stay its hand have disappeared completely.

The rise of Internet commerce has initiated a true revolution in the travel distribution industry, and holds the promise of greater efficiency and enhanced competition at all levels. As a policy matter, and as a legal matter, we do not believe suppliers should be able to engage in collective action to withhold information from independent distributors. This is an obstacle to e-commerce that this committee should strive to remove.

In this country, laws and rules exist that prevent such boycotts from occurring—and it's time to enforce them now. Consumer choice, robust airline competition, and access to low fares are at stake here; broader issues of e-commerce and consumer harm hang in the balance as the Orbitz model is replicated by other suppliers in other industries.

Thank you for the opportunity to testify and I look forward to answering your questions.

Mr. STEARNS. Mr. Wolff, we welcome you.

STATEMENT OF BRUCE WOLFF

Mr. WOLFF. Chairman Stearns, thank you, too, for the opportunity to testify before this committee. First, in the interest of brevity, I have submitted a complete summary of this complex issue, and an attachment which I would like to include for the record.

Mr. STEARNS. By unanimous consent, it is so ordered.

Mr. WOLFF. My name is Bruce Wolff, and I am Chairman of the Board of Pegasus LLC, and I am also senior vice president of Marriott Intentional, and a member of the board of directors of Pegasus Solutions, two of the founding members of TravelWeb.

Today I am testifying on behalf of the Chairman of Travelweb. There is no doubt that TravelWeb sites can provide enormous benefit for American consumers. However, these websites should be viewed as one option among many for consumers.

Some consumers will find them absolutely right for their needs, and others will not. The increased use of travel websites and general customer satisfaction are evidence of the benefits that websites provide to some of America's busy and discerning customers.

In a few minutes, I would like to address the specific concerns that might be raised about the fact that TravelWeb is owned by hotel companies. For a moment, let me just say that owners of TravelWeb go toe-to-toe in the market every day trying to out-market each other and outsell each other.

We compete on price, location, frequent stay programs, travel agent incentive programs, and many other facets. TravelWeb will not change that powerful dynamic. However, TravelWeb allows us to achieve some economies of scale and some operational efficiencies for consumers without undermining in any way vigorous competition among the owners of TravelWeb, which drive down prices.

For that reason, we feel confident that TravelWeb is good for consumers. The initial owners of TravelWeb include five hotel chains; Hilton Hotels, Hyatt Corporation, Marriott International, Six Continents, Starwood Hotels and Resorts, and Pegasus Solutions, the leading technology provider to the hotel industry.

In the aggregate, these chains control only a small portion of hotel properties that carry their brand name. They are affiliated with many more properties that are independently owned, and although the hotel exchange and Pegasus are owners, TravelWeb is an entirely separate company, with its own board of directors and employees.

TravelWeb will specialize in on-line distribution of discount hotel rooms; that is, hotel rooms that are sold through what the industry calls their Merchant model. These rooms tend to be sold at prices below regular rates, primarily because of excess capacity.

We also operate TravelWeb sites to consumers called TravelWeb.com, which is accessible to the public. We view that as an important part of our business, but our primary effort is offering discounted rooms to TravelWeb site companies.

Let me now turn to some of the potential concerns about supplier-owned travel websites. I cannot address these concerns for other websites, but I can discuss them specifically for TravelWeb. First is privacy.

As with any website, concerns about privacy are legitimate and important. Travelweb is strongly committed to protecting private personal data collected in the process of a transaction, which may include customer's name, address, credit card information, and other important information.

TravelWeb is fully committed to adhering to all applicable Federal and State laws protecting privacy, and we are very sensitive to international laws on privacy. Now I would like to turn to the competition issue. One question is whether competition or whether competitors who own TravelWeb could collude to raise prices.

As I will discuss, this market makes it almost impossible to collude, and TravelWeb is carefully structured to prevent even the unlikely possibility of collusion. First, it is important to realize that only about 4 percent of hotel rooms are sold on-line.

In distributing rooms on-line, we compete with every other way of distributing hotel rooms. People can call directly, and they can call their travel agent, and various other ways.

Although we don't have hard numbers, we believe about 5 percent of rooms sold on-line are sold through the merchant model. Companies that sell through this channel are also in competition with rooms sold through other traditional channels.

On-line sales of rooms through the merchant model represent less than 1 percent of the rooms sold. TravelWeb's share of this market is tiny. We currently hope to grow it over time, but TravelWeb is really a latecomer to the market that is dominated by other large companies.

Even if two were to achieve a 10 percent market share that would mean that we would have less than one-tenth of 1 percent of approximately the $108 billion annual hotel market, hardly a prescription for market domination.

In addition, it is also important to focus on the structure of the hotel industry. Individual hotel properties are overwhelmingly independently owned. The combination or the combined share of all hotel rooms in the U.S. which carry the brand names of our owners is 29 percent.

However, about 80 percent of those properties that carry a national brand name are owned by franchisees, and therefore, they make their own business and pricing decisions.

I see that my time is up, and allow me to summarize by saying that we are an industry of very fierce competition. We are highly fragmented and unconcentrated. We are a non-homogeneous product. We entered into this venture to add choice to the consumers for on-line distribution of discount rooms.

We are very careful in structuring the organization so that care would be taken that even the appearance of collusion would be carefully monitored. I look forward to answering questions from all of you.

[The prepared statement of Bruce Wolff follows:]

PREPARED STATEMENT OF BRUCE WOLFF, CHAIRMAN OF THE BOARD, TRAVELWEB LLC

Mr. Chairman and members of the Subcommittee, thank you for holding this hearing and for giving me the opportunity to testify on supplier-owned travel websites. My name is Bruce Wolff, and I am Chairman of the Board of TravelWeb LLC ("TravelWeb"), a joint venture of six companies in the hotel industry, which distributes hotel room reservations online. I am also Senior Vice President of Marriott International and a Director of Pegasus Solutions, which are both founding members of TravelWeb. Today, I am testifying in my capacity as Chairman of TravelWeb.

There is no doubt that travel websites can provide enormous benefits for American consumers. However, these websites should be viewed as one option among many for consumers. Some consumers will find them absolutely right for their needs; others will not. But the fact that they have this choice is certainly a benefit. Travel websites offer incredible convenience by allowing consumers to obtain a wealth of travel-related information in minutes. They can see photos, learn about the nearby attractions, and compare prices from the comfort of their homes in minutes, often saving hours of effort. In addition, by achieving efficiencies in distribution, websites reduce costs and allow consumers to benefit from some of the most competitive rates available. The increasing use of travel websites and general customer satisfaction are evidence of the benefits that websites provide to some of America's busy, and discerning, consumers.

New, efficient methods of doing business sometimes mean that companies using traditional methods lose customers. That is a painful process, but it is the hallmark of a free enterprise system. The issue is not the effect of travel websites on other businesses that compete in distributing hotel rooms, however. It is the effect on consumers. Thus, it is perfectly appropriate for this Subcommittee to examine whether supplier ownership of TravelWebsites is good for consumers. In a few minutes, I want to address the specific concerns that might be raised by the fact that TravelWeb is owned by hotel companies. For the moment, let me just say that the owners of TravelWeb go toe to toe in the market every day, trying to outmarket and outsell each other. We compete on price, location, service, frequent stay programs, travel agent programs and many other factors. TravelWeb will not change that powerful dynamic. However, TravelWeb allows us to achieve some operational efficiencies for consumers, without undermining in any way the vigorous competition among the owners, which helps to drive down prices. For that reason, we feel very confident that TravelWeb is good for consumers.

TRAVELWEB

TravelWeb is an independent company created in February 2002 to provide online marketing of hotel rooms and is only now ramping up operations. The initial owners of TravelWeb include five hotel chains—Hilton Hotels, Hyatt Corporation, Marriott International, Six Continents Hotels, and Starwood Hotels and Resorts—and Pegasus Solutions, a leading technology provider to the hotel industry. In the aggregate these chains own only a small portion of the hotel properties that carry their brand name, and they are affiliated with many more properties that are independently owned. Pegasus provides central reservation system and other services to many hotels in the U.S., and its Utell subsidiary provides marketing and reservation services to a network of hotel properties. I should note that, although these hotel chains and Pegasus are owners, TravelWeb is an entirely separate company, with its own board of directors and employees. While the board members set general policy, the management of TravelWeb makes independent business decisions focused on achieving success for TravelWeb. Under the agreement governing TravelWeb, the hotel company owners of TravelWeb, including myself, do not have access to certain information and cannot participate in certain decisions.

Hotel properties other than those of the founding members are invited to participate in TravelWeb by supplying room inventory for distribution. Many properties of other chains already participate in TravelWeb, and we expect increased participation by additional chains and independent properties as we become more established. In the long run, our customers will primarily be other travel website companies, not consumers themselves. We will specialize in the online distribution of discounted hotel rooms, that is hotel rooms that are sold through what the industry calls the "merchant channel." These are rooms that tend to be sold at prices below regular rates primarily because of excess capacity in the market.

TravelWeb will compensate participating hotels for inventory in an amount that is based on market conditions and negotiations between TravelWeb and the hotel property. TravelWeb in turn will add a markup to that base rate when it makes inventory available to other travel websites. The room will be offered to consumers at a rate determined by TravelWeb, and the travel website who "sells" the room will receive a commission.

We also operate a travel website for consumers called TravelWeb.com, which is accessible to the public. That site has been in operation for some time and provides another choice for consumers alongside many other travel websites. Through that website, TravelWeb operates as a retailer and deals directly with consumers. We view that as an important part of our business, but our primary effort is offering discounted rooms through other travel website companies.

POTENTIAL CONCERNS

Let me turn now to some of the potential concerns about supplier owned travel websites. I cannot address these concerns for all websites, but I can discuss them in connection with TravelWeb.

1. Consumer Privacy Protection

As with any website, consumers are legitimately concerned about privacy. TravelWeb is strongly committed to protecting the private personal data collected in processing a transaction, which may include a consumer's name, address, credit card information, and other important information. TravelWeb acts as both a "wholesaler," by selling through other travel websites and as a "retailer." Whenever TravelWeb is furnished personal information by consumers, it transmits only the information necessary to complete a transaction. In addition, TravelWeb may use other information voluntarily submitted by the consumer in order to evaluate his or her travel preferences and to make better recommendations. TravelWeb may also aggregate certain information, e.g., zip code data, for its own market research or for advertisers. Other than these uses, TravelWeb does not sell, lease, or share personal financial information with other parties and is fully committed to adhering to all applicable federal and state laws protecting the privacy of consumers. We are also sensitive to international privacy laws requirements.

2. Competition Issues

Now I want to turn to competition issues. Let me say at the outset that TravelWeb provided background material to both the Department of Justice and the Federal Trade Commission prior to our formation in February. We have offered to meet with and brief appropriate officials in both agencies regarding our structure and operations. We have not been contacted by either agency but we stand ready to cooperate with them.

POSSIBILITY OF COLLUSION

One question is whether the competitors who own TravelWeb could collude to raise prices. As I will discuss, the market makes it almost impossible to collude, and TravelWeb is carefully structured to prevent even that unlikely possibility.

First, it is important to realize that only about 4% of hotel rooms are sold online. In distributing rooms online, we compete with all other ways of distributing hotel rooms—directly from the hotel, through 800 numbers, through travel agents, and so on. Although we don't have hard numbers, we believe about 5% of rooms sold online are sold through the merchant channel. Companies that sell through this channel are also in competition with rooms sold through traditional channels. Online sales of rooms through the merchant channel represent less than 1% of all rooms sold.

TravelWeb's share of online merchant channel sales is tiny. We certainly hope it grows over time, but TravelWeb is really a "late-comer" to a market segment that is dominated by other, large companies. A recent industry analysis stated: "The hotel industry is too complex and unwieldy for [TravelWeb] to wrestle away the top spot" from our competitors.[1] But, even if we were to achieve 10% of this category, that would mean that we will sell less than .1% of the approximately $108 billion in annual hotel bookings in the U.S.—hardly a prescription for market domination.

In addition, it is also important to focus on the structure of the hotel industry. Individual hotel properties are overwhelmingly independently-owned. The combined share of all hotel rooms in the U.S. which carry the brand names of one of our owners is 29%. However, about 80% of the properties that carry a national brand name are owned by franchisees that make their own, independent business decisions and establishes its own prices. Neither TravelWeb nor our individual owners compel these properties to participate in TravelWeb or to comply with any centralized price-setting system. In other words, the hotel industry is highly fragmented, with literally thousands of independent actors. Even at the local level, there are usually hundreds of independent hotel properties in any large metropolitan area and dozens in small areas. Finally, hotel rooms are not homogeneous. Hotel rooms vary greatly in size, quality, amenities, and location. Consumers shop around for the combination of room rate, location, and amenities they want.

The combination of the highly unconcentrated industry structure, the large number of independent actors, and the lack of homogeneity make collusion extremely unlikely. In order to guard against even a remote possibility of collusion, TravelWeb was advised by antitrust counsel throughout the formation process and continues to be advised on an ongoing basis. TravelWeb has adopted a number of restrictions on our own operations to ensure its continuing compliance with the antitrust laws. The management of TravelWeb does not share pricing information with any participating hotel or chain, including the owner chains. For example, even though I am Chairman of the Board, TravelWeb does not provide me with the base rates charged to TravelWeb by any individual property. We do not discuss rooms rates or any other sensitive competitive terms offered by individual properties at any of our meetings or in any documents. In short, TravelWeb believes that collusion in this industry is exceedingly unlikely, and we have taken steps to ensure that it is impossible within the TravelWeb structure.

EXCLUSIVITY

Questions have been raised about the possibility that TravelWeb could have exclusive access to discounts offered by participating properties. That is not the case. Each participating property is free to offer discounted rooms through other websites or through any other channels. In fact, it is typically the case that the same room is made available simultaneously through multiple websites and is removed from the inventory only after it is sold. No independent property of a participating chain is required to participate with TravelWeb, and participating properties are not required to offer any particular portion of their inventory—either rooms offered at regular rates or "discount" rooms—through TravelWeb.

"MOST FAVORED NATIONS" CLAUSE

Another question concerns TravelWeb's "most favored nations" (MFN) clause. We have included a narrow MFN in our contracts with participating properties. Our MFN provides that, if hotel properties offer inventory to be sold through TravelWeb, they agree that they will make available to TravelWeb the lowest price that they make available to any other independent travel website for comparable inventory. However, hotel properties are free to offer even lower rates directly, through travel agents, through their own websites, or through any another outlet. There are no incentives to properties to induce them to offer discounted rooms only through TravelWeb or necessarily to offer their lowest rates through TravelWeb. Thus, the MFN gives us some assurance that we are competitive with other independent travel websites, but it does not mean that we have any "corner" on the lowest rates offered by hotel properties.

CONCLUSION

TravelWeb is a new entrant in a market with vigorous competition. The hotel industry is composed of thousands of participants that compete every day for con-

[1] Henry Harteveldt, *New Portal Leader Won't Dislodge Current Leaders,* Forrester Consumer Technographics North America Brief, Feb. 20, 2002.

sumers. TravelWeb is a very small participant in that large market. We believe that the merchant channel is a valuable part of this market because it adds yet another way that rooms are sold. Frankly, we felt that the merchant segment of the market was not as competitive as it could be, and that is the reason we, that is, the hotel companies that own TravelWeb, decided to enter. We don't have all the answers, and no doubt we will learn better how to serve consumers over time. However, we are confident that TravelWeb will be a valuable addition to the market, one which promotes competition, rather than limits it. Thank you again for the opportunity to testify and I would be pleased to answer any questions.

Mr. STEARNS. I thank the gentleman, and Mr. Zuck, we welcome you and your opening statement.

STATEMENT OF JONATHAN ZUCK

Mr. ZUCK. Thank you. One sure sign that consumers are seeing increased benefits is the presence of entrenched vendors on Capital Hill claiming that consumers need to be protected.

Mr. Chairman, and members of the subcommittee, it is a pleasure to be here again to help tell the electronic commerce story on behalf of the more than 3,000 members of ACT, including many who do business online, and most of whom are small businesses.

Thank you for holding these proceedings, and I am optimistic that the clear light of realism resulting from your efforts and scrutiny today will reveal the Whitford campaign for what it is, hypocritical, entrenched marketing incumbents looking for protection from real competition.

Improvements in technology and specifically the Internet, have proven a tremendous boon to consumers who are beginning to enjoy greater convenience, better selection of goods and services, and lower prices.

At the same time, these increased efficiencies represent a serious threat to a large segment of our economy, middle management. It is estimated that the cost to consumers of entrenched middle management is something close to $15 billion annually.

The situation as far as lobbying at the Federal and State level, and business practices designed to stifle competition has become so severe that the FTC has recently announced a workshop to look into this problem.

We see inefficient middlemen attempting to stifle innovation and consumer choice on the net from multiple sectors, including cars, auctions, contact lenses, real estate, and of course air travel.

Something that is really important is let's agree at the outset that if consumer choice brought about the end of third-party travel distribution that it wouldn't be the end of the world. There is only a market for distributors as long as there is value added to the suppliers and consumers.

This is not a guaranteed marketplace. Nothing could be worse for consumers or small businesses than a fourth distribution channel. That said, it is far more likely that multiple channels of distribution will remain for a long time to come.

Power fliers will buy directly off of airline sites based on hub and route knowledge. Knowledgeable fliers might use Orbitz, Expedia, or Travelocity, and still others will continue to value the hand-holding that a travel agency is able to provide.

In fact, the recent Forrester report found that the majority of travel booked through brick and mortar agencies is premium travel. Remember again that those bookings currently make up 70 percent of the market; whereas, Orbitz, by way of example, has 2 percent.

Value added travel agencies will be the No. 1 beneficiaries of the elimination of valueless simple resellers and pressure on CRS rates. The Department of Transportation has found that there is no evidence that consumers can be herded into a single channel. The switching costs are simply far too low.

Throughout the economy distribution channels have created a secondary market with its own pitfalls, latencies, and costs to both suppliers and consumers. The evolution of the Internet has provided an alternative to these inefficiencies and an opportunity for suppliers to cut costs and to pass at least some of these savings on to their customers.

The obvious at first blush is to sell direct and the second is to combine suppliers and reintermediate in a more efficient manner. This is pro-competitive activity for which specific guidelines exist from the Department of Justice, and it has nothing to do with price competition between suppliers.

Ironically, the No. 1 recommendation of consumer groups during the fiasco brought about by the likes of Sabre before was that an industry-wide CRS system be created, and perhaps one like Orbitz, which serves over 40 airlines, is part of the answer.

Third-party distribution generally does not promote surprise competition between suppliers, but instead simply increases costs to consumers. That's fine if there is additional value being provided, and silly if there isn't.

The experiments with supplier initiated re-intermediation on the web today are good for e-commerce and good for consumers, and they will succeed or fail on their own merits.

Orbitz, like so many e-commerce sites before it, has delivered to the consumer better information, better services and lower prices, while at the same time saving the suppliers money, which in-turn benefits consumers.

They went to the Department of Justice and the Department of Transportation before even starting to get a review of their business plan. They have been under constant scrutiny by both agencies for the past 2 years, and in both chambers of the Congress, and at no time has there been any hint of a problem with their business model.

To the contrary, the Department of Transportation has concluded that they have helped competition in the travel booking market by following the DOJ guidelines. So-called web fares are now more widely available and more competition exists in the distribution channel.

The notion that the deals that exist are in fact exclusivity deals is a ridiculous one as we see advertising from many sites now saying that they have web fares. I hope the question gets asked what kind of deals are being cut to get them.

The notion that there has been any additional exclusive deals, or fare bias, is ridiculous. Those were already in place with folks like Travelocity, who were paid off to bias their listing.

Instead, there has been marketing increases and transparency with the Orbitz entry. The presence of Orbitz in the marketplace has been a boon to consumers, period. As a local theater owner, I am compelled to use a movie metaphor.

In the movie, Minority Report, we see the pitfalls associated with preemptive enforcement, such as might be suggested by some of the folks here at this table today, and it is very important that we don't engage in this kind of psychic behavior, but instead allow the market to work itself out.

So while I may seem to be providing the minority report here at this table, I, for sure, represent the majority view. Thank you, Mr. Chairman, and I look forward to questions.

[The prepared statement of Jonathan Zuck follows:]

PREPARED STATEMENT OF JONATHAN ZUCK, PRESIDENT, ASSOCIATION FOR COMPETITIVE TECHNOLOGY

The issue before this committee today transcends the air travel industry. The current situation in this industry is part of the natural struggle between entrenched business models and the ongoing drive toward greater efficiencies and consumer benefits through innovation in the marketplace and on the Internet. The Association for Competitive Technology (ACT) has always supported the creation of innovative e-commerce technologies and business models such as the one developed by its member company Orbitz. In the online travel space, Orbitz has created a new, lower-cost technology platform that provides consumers with easy access to a broader selection of low fares in a guaranteed unbiased display. The fastest growing IT organization in Washington, ACT represents over 3,000 technology companies and professionals. The bulk of our membership is comprised of small and mid-size companies and their executives

Following a worldwide trend, Orbitz represents a move away from inefficient proprietary networks toward more open and cost effective, open, Internet-based networks. Orbitz uses superior server-based technology to provide consumers with more information about all available fares. Their technology is better than first generation search engines, thus it can search billions of flight-options to find more choices. Moreover, the server technology can handle the huge volume needed to search billions of airline routings at a much lower cost, allowing Orbitz to charge the airlines less to distribute their tickets.

Since the launch of Orbitz, consumers have been given a much larger set of choices when searching for fares. In addition, there has been significant distribution cost savings for airlines and other travel suppliers at a most critical time for them. Orbitz is providing the first real downward pressure on one element of distribution costs in particular; booking fees charged by the dominant Computer Reservation Systems (CRS), which average nearly $14.00 per ticket. These CRS's have thus far refused to invest in Internet-based technologies that could help bring these costs down.

BEYOND THE INVESTIGATIONS

It is time to move past the seemingly interminable investigative process. By way of background, Orbitz has been scrutinized by more government agencies and congressional committees than any other online venture. Not one of these reviews has asked for any change in the Orbitz business model. Moreover, each review has noted the pro-competitive impact that Orbitz brings to travel consumers. The Department of Transportation report released last month found Orbitz implementation has been consistent with plans and that current evidence shows that no Orbitz charter associate airline has provided exclusive fares to Orbitz. The Department of Justice review has been "open" for more than two years. We are confident if there were any problems with Orbitz structure or joint ownership, the DOJ would have acted. Despite the results of the investigations, the chorus of Orbitz detractors continues the "Most Favored Nation (MFN) Indignation" refrain. Simply put, the MFN is a necessary part of the Orbitz business model that benefits consumers. James DeLong, senior fellow with the Competitive Enterprise Institute's Project on Technology and Innovation, noted in a paper prepared for the CATO Institute, that:

> "if good information [regarding airfares] is to exist, each participant must bind itself to provide Orbitz with its lowest fare. That is why the Orbitz charter con-

tains, and must contain, a [MFN] clause whereby each participant makes available to Orbitz all fares that are made to the general public." [1]

Despite this logic and without regard to the fact that Orbitz charter is consistent with the DOJ collaboration guidelines,[2] some of Orbitz's protectionist competitors continue to insist that the DOT and DOJ pursue investigations without demonstrating in any way that competition would be hindered or that consumers would not benefit. Indeed, these same competitors continue to complain about their lack of access to special deals and fares while making public announcements about airline fare deals they havle negotiated, including deals for web-only fares, and specially negotiated fares that give those two sites exclusive fares that Orbitz does not have.

STATE OF COMPETITION IN THE ONLINE TRAVEL SPACE

Despite the wild claims that Orbitz means the end of all other online travel services, the industry is healthy and competition alive and well. The travel market is $140 billion annually. Online travel bookings are on the rise. Online bookings comprise 13% of total bookings. Forrester Research estimates that online travel spending will grow to $60 billion in 2006. Currently, there are over 25 independent online travel sites vying for consumer dollars and eyeballs.

It is difficult to overestimate the challenges facing the travel market. Forrester estimates that 60% of consumers have *no* loyalty to any one travel site and often choose among several. Clearly it's a case of "what have you done for me lately?" This fact means that the online travel space can, and does, support multiple competitors with varying business models and value propositions. Indeed, Neilsen/Net Ratings noted that the consumer's ability to easily comparison shop for fares means that there can be several tiers of contenders.

Turning to the stories of these "contenders," you can see the promise of the online travel market for producing consumer value. SideStep.com, a Santa Clara, California company has produced a web application that is devoid of graphics and rich content. The premise is that SideStep.com can deliver a consumer a list of fares faster than Orbitz or the individual airline web site. Consumers with dial-up Internet access would be particularly well served by this approach. SideStep.com was launched in 2000 and produced a profit in April of 2002. Following the natural evolution of e-commerce, Qixo, a San Francisco company, has developed an application that searches across numerous sites including online travel, carrier and specialty sites. This application takes advantage of the fact that the carriers time to send the data to sites like Orbitz from their servers. This data can be mined before it can be posted to Orbitz. The goal is to find the cheapest fare no matter where it may be hiding. Finally, AgentWare, based in Atlanta, provides travel agents with all fares from online and offline sties. AgentWare is a $40 per month alternative to Sabre. At a recent meeting of the National Commission to Ensure Consumer Information and Choice in the Airline Industry in San Francisco, Commissioner Patrick Murphy stated that government intervention, in the face of technological innovation, is "very challenging indeed." Without question, this level of innovation and competition has produced manifold benefits for consumers.

THE CONSUMER'S ENDGAME: EFFICIENT INTERMEDIATION

The Orbitz machinations are part of a larger issue. This is what is to become of intermediaries or "middlemen" who provide little or no added value. The Progressive Policy Institute (PPI) has studied this issue and published the seminal paper in this field." [3] In the paper, PPI estimates that American consumers pay a minimum of $15 billion more annually for goods and services as a result of such e-commerce protectionism by middlemen. The CRS's and many of the "brick and mortar" travel agents fall squarely into this category. Rather than adapting to a changing marketplace, they have mounted a campaign to stifle the growth of online travel services.

Without a doubt, traditional travel agents have provided consumers value by serving as a buffer between them and the airlines. However, as more and more consumers book their travel through online travel sites and directly through the carriers' sites, travel agents fear the elimination of their business model. For online

[1] James V. DeLong,, "Online Travel Services: The Antitrust Assault on Orbitz—and on Consumers, CATO Policy Analysis, June 6, 2002 at p.10. The full paper is attached to this testimony as Appendix A.

[2] Department of Justice, "Antitrust Guidelines for Collaborations Among Competitors." April, 2000.

[3] Robert D. Atkinson, "Revenge of the Disintermediated: How the Middleman is Fighting E-Commerce and Hurting Consumers.," Progressive Policy Institute Policy Paper, January 2001. This paper is attached to this testimony as Appendix B.

buyers, it's not just about saving a few dollars per ticket. It's more about the control, information, and convenience consumers get by online searches for schedules, routes, and fares, then buying an e-ticket—in the middle of the night, when all the travel agents are asleep.

Technology has repeatedly enabled new information distribution that takes market power away from existing middlemen. (e.g., real estate, books, stock brokers, and car dealers).

"Survival of the fittest" favors those travel agents who find ways to charge consumers for the value they provide in counseling consumers and booking their travel. And many travel agents are learning how to survive—even thrive. In 2001, travel agents accounted for $63 billion in sales an increase of 40%. These travel agents account for nearly 70% of all airfares, as compared to 2% for Orbitz. This does not take into account the fact that traditional travel agents still process 90% of cruises and 95% of tours. The American Society of Travel Agents has acknowledged that while consolidation has taken place, the total amount of business remains constant. Arguments of mass unemployment are specious indeed.

More important than the absence of erosion, travel agents who do embrace technological change can still add value to a consumers travel experience. For example, in areas underserved by the Internet, these agents could offer to search fares, research and build customized vacation packages, add some mark-up and hire a delivery person to bring a person their e-ticket print out (while including brochures on activities to do while on the trip). The possibilities are endless.

Traditional travel agents make baseless claims that the online distribution models are "anti-consumer" because they take away "truly independent choice." This completely misses the point. The fact of the matter is that airlines pay between $22 and $32 per ticket in distribution fees to travel agents. In 2001, this totaled $380 million. This cost is passed through to consumers. Online distribution models can cut this cost to $6-$8 per ticket. A simple equation follows: A cheaper distribution model equals a cheaper ticket. The disruption of costly and inefficient distribution channels is part of the "creative destruction" process of technology-driven innovation and must be acknowledged. It is now being applied to the travel space. Traditional travel agents who do not incorporate Internet distribution models risk being held hostage by the CRS. The CRS distribution model supported biased display and kept information away consumer. In fact, a Consumer Federation of America paper from 1999 complained that: "Traffic is diverted to the dominant incumbents through a number of marketing mechanisms that extends market power over travelers: . . . deals with travel agents to divert traffic, . . . and manipulation of computerized reservation systems." [4] This era is over. It is irrefutable that consumers enjoy the control, information and convenience achieved through booking online. Travel agents should shed the CRS shackle or they will sit idly by while consumers move further and further toward the near perfect choice model provided by the Internet.

CONCLUSION

ACT vigorously supports any competitor that invests in information technology to serve consumers better, faster, and cheaper. ACT is just as vigorous in opposing the use of government regulation to prohibit competition on the merits of investment and innovation. As you contemplate the issue of Internet-based distribution, I urge you to focus on promoting robust competition and meeting the needs of consumers, not the protection of business models that are threatened by new technology and changing consumer preferences.

Mr. STEARNS. I thank the gentleman.

Dr. Cooper, welcome.

STATEMENT OF MARK N. COOPER

Mr. COOPER. Thank you, Mr. Chairman. In my testimony, I describe two clear examples of what we consider to be restraints on trade in cyberspace. One deals with the sale of cheap seats on airlines, and the other with expensive products, new automobiles.

Now, I choose these two examples from the ends of the spectrum of what can be sold in cyberspace to underscore an important point,

[4] Freeing Public Policy from the Deregulation Debate: The Airline Industry Comes of Age (and should be held accountable for its anticompetitive behavior), at p.7. Http://www.consumerfed.org/abaair1.pdf.

and one that is the theme of this hearing. Anti-competitive practices from the old economy can rob consumers of the benefits of the Internet, just as surely as closed platforms and incompatible operating systems, and balkanized applications that we so frequently hear about.

We believe that Orbitz reduces the supply of cheap seats to independent merchants, a good word. It imposes and facilitates uniformity and diminishes the tendency to undercut price leadership, which is so clear in this oligopolistic industry.

There is a reason for that the cyber auction has become sort of the essential symbol of the Internet. The essence of the pro-competitive, consumer friendly, Internet is the ability to conduct many to many transactions. Many people interacting with many suppliers increases efficiency, and drives prices down.

When the five largest suppliers jointly commit to guaranteeing the lowest price on their website and nowhere else, they interdict that many-to-many characteristic. They drive the Internet back toward the few-to-many, which is the old economy model.

Two years ago, at an FTC roundtable, we identified a series of characteristics that we said should sound the alarm about potential anti-competitive effects. Orbitz trips every one of those wires. It has a large market share, 80 percent of the main suppliers; direct ownership, restriction on supply; coercive participation rules, and clear information exchange that creates uniformity.

These are characteristics that frustrate the Internet's ability, and I might briefly mention the other industry to Mr. Boucher, who said that there ought to be a law. As we pointed out in our testimony, it is illegal to sell cars directly to the public in virtually every State in this country, including Virginia.

It is illegal to sell comparison shopping even in some States, but that is considered a dealer function. It is illegal for auto manufacturers to use website hits to direct customers to their best dealers.

So unfortunately we have laws. We have State laws that are frustrating the benefits that the consumer could get from the Internet. The Internet is a revolutionary means of communications in commerce that can direct dramatically and directly enhance consumer soverignity and empower citizens, but only if public policy keeps it open.

A decade-and-a-half of our experience in the Internet and hi-tech software industries leads us to believe that the consumer and the economy are best served by open standards and unfettered commerce.

These afford consumers maximum choice and citizens maximum voice. They stimulate audacious competition, and encourage use and expression, and promote unfettered innovation.

The Internet is a disruptive technology and entrenched interests will seek to preserve their market niches and market power, no matter how high the cost to consumers. The most important antitrust case of the Internet century has its origins in the observation of a CEO that the Internet threatened to commoditize his product, the PC operating system.

Commoditization is the consumer's best friend, and empowerment with information and the ability to execute transactions directly turns products into commodities. Producers will resist by fair means or foul. I applaud you for holding these hearings that highlight this important aspect of the Internet that is so frequently overlooked here in Washington. Thank you.

[The prepared statement of Mark N. Cooper follows:]

PREPARED STATEMENT OF MARK COOPER ON BEHALF OF THE CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee, ny name is Dr. Mark Cooper. I am Director of Research of the Consumer Federation of America. The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, composed of two hundred and eighty state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than fifty million individual members. CFA is online at www.consumerfed.org.

I appreciate the opportunity to appear before you today to share our thoughts on the potential anticompetitive effects of joint ventures and other producer restraints on trade on the Internet. The Consumer Federation of America, founded over 30 years ago, was one of the first consumer groups to become involved in public policy affecting high-tech, consumer-oriented industries.

The Internet is a revolutionary means of communications and commerce that can dramatically enhance consumer sovereignty and empower citizens, but only if public policy keeps it open. A decade and a-half of experience in Internet and software industry policy reaffirms our belief that consumers and the economy are best served by open standards and networks. These afford the consumer maximum choice and the citizen maximum voice, stimulate audacious competition, encourage use and expression, and promote unfettered innovation by both consumers and producers.

A TECHNICAL AND CONSUMER POLICY MAP OF CYBERSPACE

I believe that the Internet can best be understood by seeing it as a communications platform consisting of four layers—the physical layer, the logic layer, the applications layer and the content layer. It is a platform because the layers are strong complements; they need to be tightly integrated and coordinated. In each layer there are "digital economy" issues that stem from its unique characteristics.

We hear a great deal about the physical layer, which is the medium over which Internet messages are transmitted. In this layer the primary concern is with owners of facilities—like cable operators and telephone companies—who refuse to allow service to have nondiscriminatory access to their telecommunications networks.

We hear a great deal about the logic layer, which is where code and protocols allow communications equipment, computers and display devices to interconnect and interoperate. In this layer the concern is with dominant software firms—like Microsoft—who can undermine the compatibility of competing code and lock out competition.

We hear a lot about the applications layer, where programs execute a sequence of steps to solve a problem or perform a task for the user. Here the concern is with applications—like instant messaging or identity verification—that refuse to interoperate, undermining universal availability and creating walls in cyberspace.

The issue before the Committee today deals with the content layer—the specific products or services delivered through the platform—but it is not the usual content debate we hear about. We frequently hear about this layer as a debate over digital content—digital rights management demands by content owners, on one side, who treat all consumers as thieves and want to hardwire antitheft devices into the fabric of cyberspace, and consumers on the other side, who demand fair use rights to enjoy the content they purchase when, where and how they desire.

The issue the Committee raises today is different.

OLD ECONOMY PROBLEMS MIGRATING INTO CYBERSPACE

This hearing highlights a very familiar old economy problem with very real implications for the new economy of the Internet. Traditional commercial restraints on trade can rob consumers of the benefits of the Internet, just as surely as do closed proprietary networks, incompatible operating systems, or balkanized applications. Classic restraints on trade, unilateral or collusive, can limit the availability of products, restrain price competition, or negate the beneficial effects of the Internet in enhancing consumer search.

The ability to gather and process information that is greatly facilitated by the Internet is a two edged sword. It can strengthen the ability of producers to control and manipulate the markets, just as easily as it can enhance the ability of consumers to shop and open distribution channels that increase competition.

This hearing makes it clear that we must be vigilant to prevent plain old dirty business practices from migrating into cyberspace, if we are to preserve the procompetitive, consumer-friendly promise of the Internet. To demonstrate how important this view of the content layer is, I will make the point with reference to two very different examples. The first involves highly perishable, low costs services—cheap seats on airplanes. The second involves very durable, expensive products—new automobiles.

CHEAP SEATS

A couple of years ago, the airlines showed a willingness to make low value, high margin seats available to online discounters. These are low value seats in the sense that they involve unsold seats close to the time of departure. They are like overripe fruit on the grocery shelf that cannot be sold at full price. Since the incremental cost of that unsold seat is virtually zero, any incremental revenue is pure profit.

Acting independently, the airlines cannot resist making them available at a low, "name your own price" level. The information exchange about these tickets in a cyber auction increases the likelihood of their being sold and allows supply to meet demand in a more efficient manner. Only the Internet (or an equally ubiquitous. accessible information environment) could bring this immense real time market into existence on a massive scale for consumers to directly choose what to buy in the way of discount tickets.

The side effects were not to the liking of the airlines collectively, however. As long as William Shatner was able to make people think they could name their own price, he was creating price resistance on the demand-side. As long as these tickets pop up in the chaos of this new cyberspace type of auction, he creates uncertainty on the supply-side. It is more difficult for airlines to know how many seats are being offered at what prices with this sort of arrangement. It is easy to make secret deals with the discounters to fill your planes at the expense of rivals. In an oligopolistic industry that has developed the most precise mechanisms of price discrimination in memory and an intricate systems of fortress hubs to exercise market power over increasingly captive traffic, this web-based discounting sound suspiciously like competition.

The response by the industry as a whole is to try to control this unruly behavior. By organizing their own online broker over which they have greater control, they may still sell many of the seats, but eliminate the price disciplining effect of unaffiliated discounters. At a minimum, they could reduce the supply of discount seats the discounter can offer. Diminishing their ability to make the "name your own price" promise, or even the lowest price available claim, will eventually degrade their ability to discipline price.

Depending on how they organize the site, the airlines can guarantee a reduction in supply of discounted seats by requiring members to make seats available. Airlines may have better information about the availability and price of seats when they control their own site.

They may also have rules—formal, or more likely informal—about making seats available on multiple sites.

I use the "name your own price" model as an example, because it exploits the information environment most intensively and has the cheapest seats. Orbitz may not be directly targeted at it, but it is certainly targeted at the next tier of cheap seats that are offered by Travelocity, Expedia and travel agents and it certainly has an effect on all discounters.

Obviously, we are skeptical of the proconsumer intent and impact of this sort of coordinated industry activity, especially when an independent undertaking came first. In more general terms, these types of producer joint ventures raise the fundamental problems of horizontal concentration and vertical integration disguised as consumer friendly e-commerce applications.

- Every time firms that are supposed to compete in the marketplaces have a meeting in cyberspace or physical space, it enhances the chances of collusion.
- Every time firms exchange information about input prices or the price and quality mix of their product line, they can increase the likelihood of anticompetitive parallelism.
- Every time they create ventures that diminish the availability of inputs, they may raise barriers to entry for potential competitors and raise the costs of the actual rivals.
- Every time they create ventures that coordinate their sales to the public, they reduce the likelihood that independent action will lower prices.

In other words, the efficiency that these ventures promise by lowering input costs is only in the public interest if it does not have any of these anticompetitive side effects. Of course, the industry insists this is not the purpose, nor would it engage in such activity, but it is the job of the antitrust and consumer protection agencies to prevent the anticompetitive outcomes. The problem could be massive in cyberspace and the ability of enforcement authorities to detect and prevent it is limited. As the chances of being caught are diminished, the likelihood of the violation increases.

One possibility is to have a huge increase in the funding for the regulatory agencies charged with policing this type of potentially anticompetitive activity. There is little chance that will happen. In the alternative, we need clear measures to prevent anticompetitive arrangements before they are executed. An ounce of prevention is worth a pound of cure. The antitrust authorities are familiar with such mechanisms. A rule of reason should apply with heightened scrutiny and consent decrees that ban specific practices.

Market Share thresholds: Arrangements that account for a significant share of the suppliers in a market should be subject to specific investigation.

Ownership Matters: Profit sharing between firms should be discouraged, since this diminishes the incentive to compete. Firms should not generally appear on both sides of a transaction, since this aids in the manipulation of the availability of a product or its price.

Restriction of supply: Restriction of supply either by requiring certain quantities to be offered or preventing participants from selling outside of the arrangement at attractive prices may restrict supply to the market and have the effect of undermining rivals or reducing competition for consumers. Such arrangements should not be allowed.

Participation Rules: If the ventures that invite the public to participate as buyers or sellers, then rules about who can make product available to or purchase product from the venture should not be unduly discriminatory or exclusionary.

Information exchange: Joint venture participants should not gain access to information on competitors' costs (of inputs) or quantities and prices of output sold through the venture. This requires anonymous transactions executed by a site administrator.

Oversight of informal behavior and compliance with conditions: Joint venture operations provide significant opportunity for exchange of competitively sensitive information in informal ways. These joint ventures should be required to have an Ombudsman to be present at all official functions and to monitor operations. A finding by the Ombudsman that anticompetitive activity has occurred should become a rebuttable presumption of a violation of the antitrust law.

EXPENSIVE PRODUCTS

At the start of what has been called the "Internet Century," there can be no better symbol of the transformation of the economy than a battle over automobile sales on the Internet. The automobile is not only the quintessential symbol of the industrial economy of the twentieth century; it is also the second largest expense on a consumer durable that most households make. Moreover, the distribution network that typifies the industry has important and unique elements that make it a potentially intense battleground when the new economy meets the old. The automobile is an expensive, long-lived commodity that requires post-purchase maintenance. Historically, this created a unique relationship between the dealer and the consumer. The dealerships have traditionally involved substantial investment. Automobile dealers are the quintessential old economy middlemen.

Some believed that these unique characteristics would prevent or slow Internet-based transactions from penetrating the distribution chain. The automobile was believed to be a type of commodity that is not well suited to Internet sales. Cars were not considered a good candidate because consumers needed to "kick the tires" before buying a car.

In fact it was not consumers who resisted the Internet when it comes to new auto sales. Consumers are perfectly willing to turn to the Internet for information about autos and tell the salesman exactly what they want based on online research. They would probably buy direct over the Internet, without going to a show room in many cases, if they could. Unfortunately, they have not been able to test this distribution chain because state laws protecting dealers will not let them. Direct sales over the Internet are illegal in virtually all states.

The cost of distribution of new automobiles approaches $100 billion per year. The distribution chain is ripe with inefficiencies and local monopolies that are perpetuated by state laws. Instead of the build-to-inventory system of the 20th century, which causes new cars to sit on lots for two or three months, a 21st century build-to-order system could get exactly the car the consumer wants into his or her driveway in two or three weeks. The savings for consumers and the economy would be immense. But this would dramatically reduce the role of the dealers as middlemen. The acres and acres of inventory by which they defined their very being would be irrelevant and uneconomic.

As the capability to deliver information expands and access to multimedia, interactive information applications improves, an environment in which producers and consumers can interact directly for automobiles could be created, just as it was for the "name your own price tickets." These changes would result in more effective shopping by consumers, better targeting of marketing efforts, personalized design of products, and reduced inventory/holding times for the delivery of goods.

- Higher and higher quality visual and video images that can be tailored and modified during the transaction, promise a quantum leap in the quality of marketing and consumer information gathering.
- Increasing integration of production with consumer preferences identified through on-line transactions can both dramatically reduce marketing and inventory costs and increase customer satisfaction.
- Personalized selling and flexible production can combine with interactive scheduling to reduce the amount of time that goods must be held in storage or spend in transit, sharply reducing delivered costs on big ticket items like automobiles.

To achieve these potential gains, however, major institutional changes must come about. Not only is it illegal to sell a car on the Internet, it is even illegal for manufacturers to distribute the hits on their home pages to the best dealers in the consumers' area. In some states it is illegal to sell comparison-shopping information to the public. These anticompetitive barriers to use of the Internet may be costing consumers $20 to $40 billion in the cost of new autos. Moreover, once the sale of autos is pulled out of the showroom and put into the competitive context of the Internet, financing, warranty work, and after market services would become much more competitive, potentially saving consumers tens of billions of dollars more.

Congress was quick to prevent the states from taxing the Internet, but much more harm is being done to consumers by these anticompetitive statutes that prevent them from utilizing the Internet for full effect. Congress needs to require states to allow the direct sale of cars over the Internet.

CONCLUSION

These two examples from the opposite ends of the spectrum of consumer goods and services that could be sold over the Internet remind us how vigilant we must be if we are to ensure that the Internet continues to operate in a procompetitive, consumer-friendly fashion. The Internet is a disruptive technology and entrenched interests will seek to preserve their market niches and market power, no matter how high a cost that imposes on the public. I applaud you for holding these hearings that highlight this important but overlooked aspect of public policy for the Internet.

Mr. STEARNS. I thank the gentleman.

Mr. Ruden.

STATEMENT OF PAUL M. RUDEN

Mr. RUDEN. Thank you, Mr. Chairman. The short answer to the question posed in the title of this hearing is no. E-commerce in fact in travel is in grave danger of being dominated by the joint market power of the largest airlines.

Perhaps uniquely the Internet has penetrated and influences the travel market place more than any other line of commerce. The potentials of this technology has been actively exploited by several non-airline entities, the most prominent of which are Travelocity and Expedia, but there are many others.

These firms are examples of the much maligned middleman, a firm that operates between the producer and the end-consumer, living off the value delivered to both the ultimate seller and the ultimate user of the product or service.

Many smaller firms have also entered the Internet space, using it to transmit information and to communicate with consumers.

The variety of approaches by retailers to the use of the Internet is imposing. The latest buzz word is convergence, signifying the merging of Internet and traditional business methods by parties at all points along the spectrum between what were once seen as pure Internet firms, and pure brick and mortar business models.

We refer to the middleman as much maligned because it is an article of faith among Internet proponents that the technology as Dr. Cooper said is disruptive, a disruptive force that eliminates what are described as wasteful middlemen by enabling more efficient transactions directly between producers and consumers.

The premise is that e-commerce meets all relevant consumer needs for access to information, and enables consumers to make decisions and act on them without assistance from anyone.

While there is no doubt that technology works fine for many consumers, the inference that it can meet all needs simply is not supported by the available facts. The truth is that for most consumers most of the time direct contact with a human being, with knowledge and expertise in travel, remains essential.

The consumer either lacks the credit or the information, or the wherewithal, or the comfort, to do his business on the Internet. You have heard about Orbitz, and I am not going to go on at great length about Orbitz.

They claim to have the greatest array of low fares available anywhere. They can make that claim because of preferential arrangements with the five largest airlines in the world, and 38 other airlines that give them preferential access to fares that other competitors on-line and off-line do not receive.

When Orbitz testified before a Congressional committee not long ago, they described themselves as just another startup travel agency. That, of course, was just testimonial snake oil. In reality, Orbitz was given a promotion budget unmatched in the history of retailing.

The Orbitz campaign reinforced in the minds of many consumers the concept that the Internet always delivers lower prices. Yet, virtually everyone who has tested Orbitz's actual performance in a systematic way, including Consumer Report's travel letter, has found that a substantial part of the time the on-line agencies produce better prices.

And the so-called traditional agents are still out there, showing consumers how to get better value for their money through alternate routings and other tactics known only to the professionals, and overlooked entirely by consumers working on their own.

Information and knowledge are very different concepts, and the information delivery potential of the Internet, while great, cannot replace the knowledge and experience of humans acquainted with the tricks and traps oft his complicated network.

The airlines would have the consumer believe that the on-line marketplace, through that marketplace, they mean to give consumers the lowest possible prices for air travel. Can that be so? Are the airlines, which constantly remind us of their slim to none profit margins over the years, and their staggering current losses, really in the business of selling their service for the lowest possible price. We think not.

The goal and the strategy of the airlines on the Internet is to dominate that space to such an extent that the flow of information will essentially be in their control, rather than under the control of the independent firms, and in that way their yield management systems will cease to run interference from neutral third-party retailers, whose first priority must always be to serve their customers.

Then the price discounts that Orbitz touts today will be entirely in the airlines' control, and largely non-existent. Orbitz's offer to be the next computer reservation system for travel agents, jointly owned and jointly managed by airlines, but uncontrolled by government regulation, is like a dinner invitation from Don Corleone, an offer everyone should refuse.

The small travel agencies of this country, on whose services the airlines relied for decades, and upon whom the majority of air travelers still depend, are being crushed by the market power of the airlines. Orbitz is the fighting ship that they are using to lead that charge.

The Federal Government, Mr. Chairman, bears a large part of the responsibility for the problem the agency industry now faces. Travel agents are still largely locked into long term contracts with severe penalties for failing to achieve book air segment thresholds.

Their ability to efficiently adapt to Internet technology is impaired by those contracts, and those contracts are permitted by the CRS regulations last adopted in 1992, and scheduled for review 5 years thereafter.

For 5 more years, the Department of Transportation has failed to address those regulations, leaving agents trapped between the CRS vendors and the airlines, the CRS's former and present owners, and the owners of Orbitz.

In addition to the elimination of commissions, the launch of Orbitz, the withholding of Internet fares from CRS displays, there is now even talk of the shifting of segment booking fees to travel agents, as well as credit card merchant fees.

The Internet could have and perhaps still can be a vibrant place in which all manner of travel commerce is conducted by firms large and small, as opposed to the path which the airlines have set out.

But that result will not emerge by itself. The government is going to have to take some swift and strong action to stop the trend toward airline domination of this space. So the question then of whether airline ownership of all on-line travel sites is in the interest of consumers, ASTA says no, not when the airlines are permitted to collectively own and control sites, such as Orbitz.

And do not be mislead by the effort Orbitz has put forth to have a public offering. If you read the public offering statement, it makes absolutely clear that the five airline owners intend to indefinitely maintain complete, 100 percent control of the management of Orbitz.

We have no objection, no objection, to individual airlines operating independently of each other, and doing on their own websites what their marketing philosophies and attitudes warrant.

Traditional travel agents and the new on-line agents, and all of the hybrids in between will find their way with consumers, in a marketplace where each firm is making independent decisions about how and where to sell its services.

Orbitz is the antithesis of independent decisionmaking, and consumers, like travel agents, can expect no good to come of it. Thank you very much.

[The prepared statement of Paul M. Ruden follows:]

PREPARED STATEMENT OF PAUL M. RUDEN, SENIOR VICE PRESIDENT FOR LEGAL & INDUSTRY AFFAIRS, AMERICAN SOCIETY OF TRAVEL AGENTS, INC.

The American Society of Travel Agents ("ASTA") offers this testimony on the Subcommittee's deliberations on the question whether all supplier-owned online travel sites are good for the consumer.[1]

The short answer is "no." ASTA believes that e-commerce in travel is in grave danger of being dominated by the joint market power of the largest airlines, with the result that the short term "deals" and so-called unbiased information that are now promised to consumers will be replaced with higher prices and restricted or distorted information that will make it more difficult for consumers to make optimum purchases of travel either online and offline.

Perhaps uniquely, the Internet has penetrated and influences the travel marketplace more than any other line of commerce. By expanding drastically and at low unit cost the "reach" of any information provider or seller, the Internet creates the potential for significant market expansion by many players of all sizes and configurations. By enabling consumers to cheaply and relatively quickly find and compare information, the Internet potentially increases the competitiveness of the marketplace along with possible stimulation of demand.

The potential of this technology has been actively exploited by several non-airline entities, the most prominent of which are Travelocity and Expedia. These firms are examples of the much maligned "middleman," a firm that operates between the producer and the end-consumer, living off the value delivered to both the ultimate seller and the ultimate user of the product or service.

Many firms that did not have the investment capital available to the major name players have also entered the Internet space, using it to transmit information and to communicate with consumers. Typically these firms do not provide transaction capability on their Internet sites, but use them as advertisement, information and communication tools.

The variety of approaches by retailers to the use of Internet technology is imposing and defies most attempts to categorize. The latest buzz word is "convergence," signifying the merging of Internet and traditional business methods by parties at points all along the spectrum between what were once seen as "pure Internet" firms and "pure brick-and-mortar" business models.

We refer to the middleman as "much maligned" because it is an article of faith among Internet proponents that the technology is a "disruptive" and "disintermediating" force that eliminates "wasteful" middlemen by enabling more efficient communication and business transactions directly between producers and consumers. The premise of this view is that e-commerce meets all relevant consumer needs for access to information and enables consumers to make decisions, and act on them, without assistance from anyone.

There can be no argument for that some consumers, some of the time, this is true. There is no denying the rapid growth of travel purchasing on the Internet. ASTA believes that virtually all of the growth in air travel sales by travel agencies nationwide is accounted for by sales on the Internet. Air travel sales by travel agencies, collectively considered, have been essentially flat for several years and no change in that pattern can be foreseen. To that extent, consumers are speaking with their hands, choosing the Internet to buy a substantial amount of air travel through direct access to the producer or through an online travel agency.[2] Recent reports indi-

[1] The presenter, Paul M. Ruden, is a Commissioner on the National Commission to Ensure Consumer Information and Choice in the Airline Industry, created by HR 1000 in the 106th Congress. This testimony is presented in his capacity as a representative of the American Society of Travel Agents and not in his capacity as Commissioner. This testimony does not reflect any position of the Commission which is still holding public hearings and will file its report in November, 2002.

[2] A major qualification to that point is that travel agents have for some time been buying air travel on the Internet for their clients. We are aware of no reliable way to measure the extent to which Internet sales growth is a product of that shift of booking from traditional computer reservations systems by travel agents.

cate that airline websites are now growing even more rapidly than the online agencies.

The problem is that the foregoing facts lead many observers to conclude that the Internet is the complete answer to virtually all travel consumers' needs for convenient, low cost, trustworthy access to the national air transportation system. While there is no doubt that the technology works fine for many consumers, the inference that it can meet all needs simply is not supported by the available facts.

The truth is that for most consumers, most of the time, direct contact with a human being with knowledge and expertise in travel remains essential. Many air travel transactions are simply too complex for a consumer to successfully negotiate them over the Internet. Some transactions that seem simple on their face have complex aspects in the fare conditions and in the existence of alternative purchasing choices that will not be known to the average buyer. Many consumers of air travel do not have practical access to the Internet, do not have credit cards that are essential to buying online, or simply lack the wherewithal or comfort level necessary to buy online successfully. These people either need or strongly desire to continue using traditional travel retailers for the purchase of air tickets and ancillary travel services.

Normally, one might say this is a fine and proper division of supply and demand. The Internet, one might say, has simply added a new alternative for consumers and now each consumer can decide for himself which channel he wants to use.

But that is not what is happening. In ASTA's view the e-commerce marketplace for travel services is being distorted and misused by airlines who seek collectively to dominate the Internet space, and indeed all distribution channels, while throwing roadblocks in the way of competitors, actual and potential, who would challenge their hegemony.[3] The airlines have seen the power of retailers on the Internet, in contravention of the conventional wisdom, and now seek to lock them out of that competitive space with collective action that can only harm consumers in the long run.

We speak, of course, of Orbitz, the joint airline-owned website, owned by five of the largest airlines in the world. Orbitz claims to display the largest array of the lowest fares available anywhere, a claim they make because of preferential arrangements with the five owners and thirty-eight other airlines that give Orbitz access to low Internet fares that are denied to other retailers through the computer reservation systems on which they are dependent for access to fare and schedule information. That dependency was fostered, indeed virtually insisted upon by the very airlines that now own and control Orbitz.

When Orbitz first testified before a Congressional committee not too long ago, its president described it as Ajust another travel agency." But of course that humility was just testimonial snake oil.

In reality Orbitz was given a promotion budget probably unmatched in the history of travel retailing. It managed to lose $153 million in its first year and a half of operations but rose in less time than that to a very close third in business volume behind the two larger and theretofore better known online agencies.

The Orbitz campaign reinforced in the minds of many consumers the concept that the Internet always delivers lower prices. It also reinforced the idea that buying air travel is as simple as inputting a few simple pieces of information and getting a result that is always right, always the best price. Yet virtually everyone who has tested Orbitz' actual performance in a systematic way, including Consumer Reports Travel Letter, has found that a substantial part of the time, the online agencies produce better prices. In reality, no one firm has a monopoly, yet, on the distribution of low priced air travel. Indeed some firms, among them Southwest Airlines, have refused to allow Orbitz to publish or use their schedules. The Department of Transportation, while giving Orbitz pretty much everything it wants in every other way, has admonished Orbitz that it cannot claim to have all the lowest fares.

And of course the so-called traditional travel agents are still out there, albeit in reduced numbers, showing consumers how to get better value for their money through alternative routings and other tactics known largely to the professionals and often overlooked by the consumer working on his own. Traditional travel agents often produce the lowest price for a consumer by applying knowledge of travel opportunities that consumers often never consider. Information and knowledge are two very different concepts and the information delivery potential of the Internet, while

[3] ASTA has detailed its views on this process in numerous fora, including testimony before the National Commission to Ensure Consumer Information and Choice in the Airline Industry. With the Subcommittee's approval, we will submit a copy of that document for the record in these hearings

very great indeed, cannot replace the knowledge and experience of humans well acquainted with the rules, tricks and traps of our very complicated air travel network.

The airlines would have the consumer believe that through the online marketplace they mean to give consumers the lowest possible prices for air travel. Can this be so? Are the airlines, which constantly remind this august body of their slim-to-none profit margins over the years and their staggering current losses, really in the business of selling their service for the lowest possible price? We think not.

The goal of the airlines' strategy on the Internet is to dominate that space to such an extent that the flow of information will essentially be in their control rather than the control of independent firms. In this way their yield management systems will cease to run into interference from neutral third party retailers whose absolutely mandatory first priority must be to serve their customers. Then the price discounts that Orbitz touts will be entirely in the airlines' control and largely non-existent.

Orbitz will tell you, of course, that it is actually the friend of travel agents and consumers. It will say that travel agents are free to book on Orbitz today and to charge a fee to their client for the service of finding them what Orbitz says is the lowest possible fare. And that statement would be true in one limited sense but false in most ways that matter. It is certainly the case that a travel agent can book on Orbitz, masquerading as his client. But the complete reality is that the agent then gives up management of the transaction thereafter, which is often one of the main reasons the client used the agent in the first place. To create a manageable record in his own back-office accounting system, all the data has to be reentered. Moreover, almost all travel agents have in their computer reservations systems contracts a clause specifying a minimum monthly air segment count that must be booked. Failure to achieve that booking level results in a financial penalty. Bookings on Orbitz do not count toward CRS segment count thresholds.

Orbitz goes one better, however. It has now announced that it intends to become a CRS in its own right, offering its services to travel agencies in a more robust, but unspecified, manner, provided, of course, that it is freed of the DOT regulations that apply to the four existing CRS's. Thus, Orbitz, owned by five airlines, all former owners of CRS's and three of whom own another CRS now (Worldspan), portends a return to the times prior to 1984 when there were no CRS regulations. In that environment the airlines biased the CRS displays to benefit the owners and their co-host partners and otherwise distorted air transportation competition so badly that the Civil Aeronautics Board, in the final throes of deregulation, was forced to enact regulations.

It is, we respectfully suggest, simply not plausible to believe that the joint operation of websites by the airlines are going to produce consumer benefits for the long run. The Orbitz offer to be the next CRS, jointly owned and managed by airlines but uncontrolled by government regulation, is, like a dinner invitation from Don Corleone, an offer everyone should decline.

The small travel agencies of this country, on whose services the airlines relied for decades, and upon whom the majority of air travelers still depend, are being crushed by the market power of the big airlines. In the space of seven years those airlines have eliminated travel agent base commissions and are clearly committed to diverting as many of the agency customer base as possible to their websites. Orbitz is the fighting ship they are using to lead the charge. Keep in mind that, among its other blessings, Orbitz is favored by the 43 participating airlines with guaranteed compensation that insulated Orbitz from the final rounds of airline commission cuts faced by Orbitz' competitors.

The federal government bears a large part of the responsibility for the problem that the travel agency industry now faces. Travel agents are largely still locked into long term contracts, with severe penalties for failing to achieve booked air segment thresholds. Their ability to efficiently adapt to Internet technology is impaired by those contracts that are permitted by the CRS regulations last adopted in 1992 and scheduled for review five years thereafter. For five more years the Department of Transportation has failed to address those regulations, leaving the agents trapped between the CRS vendors and the airlines (the CRS's former and/or present owners and the owners of Orbitz). In addition to the elimination of commissions, the launch of Orbitz, and the withholding of Internet fares from CRS displays agents need to conduct their businesses, there is now talk of the CRS's shifting segment booking fees to travel agents, as well as credit card merchant fees.

The Internet could have, and still could be, a vibrant place in which all manner of travel commerce is conducted by firms large and small, as opposed to the path on which the airlines have set out, which, if not halted, will leave the Internet, and all other retail air travel distribution, dominated by a handful of powerful producers. But that result will not emerge by itself. The government is going to have to take some swift and strong action to stop the trend toward airline domination of this space.

To the question, then, of whether all airline ownership of online travel sites is in the interest of consumers, ASTA says "no, not when the airlines are permitted to collectively own and control such sites as Orbitz." We have no objection to airlines' operating their own sites as extensions of whatever marketing policies they individually develop. Traditional and online agencies will find their way with consumers in a marketplace in which each firm, including each airline firm, is making independent decisions about how and where to sell its services. Orbitz is the antithesis of independent decision making and consumers, like travel agents, can expect no good to come of it.

There is another issue before the Subcommittee: the question is essentially whether the joint hotel website, now called Travelweb, is materially different than Orbitz in terms of issues raised for e-commerce. As it functions today, travelweb.com appears to operate quite differently from Orbitz. We have very little hard information about the internal arrangements, but viewing the website, there is little similarity. The only function that seems to work simply gives the inquirer a list of hotel chains to whose individual websites the inquirer must go, one at a time, to seek rates and dates. The "Click-It" function that claims to offer comparative prices for weekend stays does not seem to do anything. Hotels.com is a principal competitor of travelweb.com. We were unable to understand the manner in which this site displays properties and rates.

But in neither case are we aware that there is a "most favored nation" clause that entitles the websites to all the rates that the hotels publish elsewhere. If such arrangements exist, we are entirely opposed to them. We are also concerned about any situation in which large competitors engage in cooperative marketing that includes price setting. While the neutral operation of a "posting board" for hotel rates from different properties is unobjectionable in general, it would be far better for e-commerce, indeed for all commerce, and consumers if the opportunities for abuse in these sites were eliminated by having them operated by independent third parties.

ASTA appreciates the opportunity to have presented its views, and remains at the Subcommittee's disposal to assist in any way it can.

Mr. STEARNS. I thank the gentleman. I will start the questioning to the panel, and let me just say as an overview that as Mr. Boucher, from Virginia, mentioned that this is a broad understanding of what happens, and the implications for the consumers, and that our role in this Commerce, Trade, and Consumer Protection Subcommittee is to determine what nuances, what problems, would exist if five airlines, for example—you have United, American, Delta, Continental, and Northwestern—who own an online site such as Orbitz.

But then you have TravelWeb, which is Marriott, Hilton, Hyatt, Sheraton, and Holiday Inn. Now, they might have some holding company names, but those are the major chains. And when these five large companies get together and have a website, do they provide efficiency that benefits the consumer, or do they thwart competition, and that is what we are looking at in terms of this hearing, and trying to see whether this model is also applicable to other industries.

But I would like to start with Mr. Gilliland. The Department of Transportation reported last month that they did an investigation, and they found no Orbitz charter airline has provided exclusive fares to Orbitz. Please comment.

In other words, that report would collaborate what Orbitz is saying, which is that basically they are competitive, and they are providing a good service, and they are not doing anything wrong. So the Department of Transportation said that, and so the question would be to you to say why is the Department of Transportation wrong.

Mr. GILLILAND. Well, I think it comes back to the basic question of what we have been talking about here, which is this Orbitz MFN, or most favored nations, clause. And I might just describe that here briefly.

There are two important components of that MFN. First, the third-party MFN, where every fare given to a third-party site, like Travelocity, by an airline must also be given to Orbitz.

And then the airline website component of that MFN, where ever fare on the airlines' website must be given to Orbitz. Now, you must ask, okay, so what is the implication of that. Well, it is a serious deterrent to airlines offering price discounts to independent distributors like Travelocity.

And so prior to Orbitz's launch, airlines could and did post exclusive fares on their own websites and occasionally gave those same web fares——

Mr. STEARNS. But, Mr. Gilliland, would not the Department of Transportation in their study take that into account and actually look at that? I mean, they understand the clause just as well as you do, and not as well as I do, but it would seem that they looked at it and found that there wasn't a problem.

Mr. GILLILAND. I would suggest that they give it further and deeper examination.

Mr. STEARNS. Okay. Mr. Wolff, you stated that this most favored nations clause, "ensures that we are competitive with other independent travel websites." How is this intended to keep you competitive with others—you might explain that—with other independent travel sites.

And do other independent websites have such agreements with the member companies of TravelWeb? For example, as I understand it, Hilton has their own site, and Marriott has their own site.

And you have these other hotel companies having their own sites. So I could go to those websites, and for example, Marriott, and get a fare, or I could go to TravelWeb. So you might provide how that——

Mr. WOLFF. Okay. This is complex and I will try to be very careful in the answer. First of all——

Mr. STEARNS. Make it simple.

Mr. WOLFF. We all compete very fierciously, and we all have our own independent websites where we try to attract——

Mr. STEARNS. The obvious question for the consumers is that if Marriott has their own site, why do you have to have a site like TravelWeb, and it is just those five?

Mr. WOLFF. And on behalf of Marriott, we would like the consumer to go to Marriott.Com.

Mr. STEARNS. Okay.

Mr. WOLFF. However, what we have noticed is that there are consumers who would like to go to sites with multiple brands on it. That's why Travelocity, and that's why there are several sites—HRN, Hotels.com, et cetera.

So we are creating a site with various hotels on it, TravelWeb. Now, is it a site that will have a lot of hotels? I was very interested in Gentlewoman DeGette's concern about competitors.

Mr. STEARNS. Frontier Airlines.

Mr. WOLFF. Frontier Airlines, and having run a sales marketing customer service for a small startup airline competing through the CRS's and everything, I am very sensitive to that issue.

TravelWeb's position is that we are inviting all hotel companies to participate, and while we are founded by the TravelWeb members that you have mentioned, we are going to other hotel chains and independents, and encouraging them to participate in our website also, which will just be one additional manner in which a customer can get a fare.

They can go to Marriott.com, and if they feel more comfortable going to a site with multiple brands, they can go to this site, and they can go to Travelocity, Hotels.com, a variety of sites.

Mr. STEARNS. Thank you. My time has expired. The ranking member, Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman. Let me begin with you, Mr. Ruden. In the early 1980's, the Department of Transportation wrote CRS rules, forcing the carriers to produce the same low fares to travel agents that gave to customers who called the airlines directly.

I have heard that applying these rules to the on-line world is technically not feasible as a business model. Is this true, and should the rules be rewritten to apply to the on-line world, as well as the off-line world?

Mr. RUDEN. Well, Congressman, I don't think that the CRS regulations had anything to do with which prices airlines charge. The CRS regulations were a response to practices that the airlines jointly owned computer systems, an analogy somewhat to the current situation of an on-line market place where they jointly own Orbitz.

Their jointly owned information distribution systems, which were placed in the hands of travel agents, had displays which were designed through bias and programming tricks to favor the owners of those systems and other companies which entered into partnerships with them.

And the judgment of the government, which was in the throws of deregulation, of finishing the process of deregulation, and shifting the residual authority of CAB to DOT, and putting the CAB completely out of business at that moment in history, the problem was judged so severe for airline competition that the government was compelled to regulate those practices to eliminate the propensity of these airlines working together to bias the displays in favor of themselves and against their competition.

And that is the fundamental principle to which those rules were directed, a lesson we are suggesting that we should keep in mind now that Orbitz has acknowledged publicly and in its filing with the Securities Exchange Commission, that it wants to be ultimately the fifth CRS, but without being subjected to those same regulations.

There is nothing in the regulations that I am aware of that would inherently prevent their application to airline jointly owned on-line operations.

Mr. TOWNS. Thank you very much. I guess a question to Mr. Zuck and Mr. Gilliland, this morning I decided to do a little on-line homework, and went to Orbitz and looked up what a flight would be from National Airport to LaGuardia, because I go home a couple of times a week, and sometimes three times.

And I then went to Travelocity, and typed in the same details. Do you have any guesses to what I found? And being you can't guess, let me tell you. I found a flight on either U.S. Airways or Delta Shuttle, on Orbitz where it was $290. The same flight on Travelocity was $412.50. Could I get a response, Mr. Zuck, and Mr. Gilliland?

Mr. ZUCK. Sure, I will take first shot at that. I mean, obviously, speaking on behalf of the airlines is way above my pay grade, but it is amazing that some of the things that people are allowed to get away with saying up here.

For example, one of the things that is going unsaid is that the airlines are in fact customers, too, to the CRS system that sell their tickets. They are in fact paying those——

Mr. STEARNS. Mr. Zuck, do you have your microphone on?

Mr. ZUCK. No. Now it is. Okay. Thanks. The airlines in fact pay companies like Travelocity's owner, Sabre, in order to sell tickets, and those rates, as Congressman Deal mentioned, have gone up, and up, and up. In fact, airlines are losing business, and losing money, and the CRS is making money, which might be some indication of why the CRSs have time to be here today.

I don't know if that is an answer to that question which has been raised, but the bottom line is this. Orbitz put something in their contracts that said we are willing to discount the money you spend on us to book this travel in return for giving us these cheaper fares that obviously you make less money on.

The ones that were previously offered on their on-line sites are ones that they have a lower profit margin on, and therefore don't want to spend the exorbitant booking fees that are being paid to CRS systems. These nonexclusive parts of the so-call MFN agreement is just an inventory availability agreement that is the result of discounts that Orbitz offers to suppliers on those booking fees.

So they make it cheaper for airlines to sell their cheaper flights, and it is really that simple. What companies like Travelocity and Sabre, and other CRS systems would like you to propose is that they be granted access to those cheaper fares, while still charging the exorbitant booking fees that they charge for the more expensive fares.

What is happening today in the market place is that we are seeing web fares beginning to appear on Expedia and on other on-line sites, and the reason or the way that is happening is probably through price negotiation, although while the Orbitz system is totally transparent, negotiations between airlines and Travelocity and Expedia remain confidential.

So in fact some kind of competition is taking place, where before there was none, and I think you will start to see the same fares appear on both sites very shortly as the RS systems begin to give way on their monopolistic ways.

Mr. TOWNS. Mr. Chairman, I know that my time has expired, but I sure would like to hear Mr. Gilliland's answer as well.

Mr. STEARNS. Mr. Gilliland.

Mr. GILLILAND. I appreciate that, Chairman Stearns. First of all, let me answer your question directly and then I will come to the points that were raised in the answer before me. On the question of these fares that you looked at, it is very likely that we simply at Travelocity didn't have access to the same fares that were being made available to Orbitz, and again this is my point earlier.

If an airline puts a web fare on its own site, it is obligated to provide it to Orbitz. If it provides a special fare to Travelocity, it is obligated to provide it to Orbitz. And that is irrespective of any price competition that the other panelists talked about.

We have gone into the airlines time and time again, and asked to get the same fares at reduced costs. We provide the booking fees at lower costs to those airlines. American Express mentioned last month that they have gone in and done the same thing, and in fact they said that we will offer up free distribution.

We will pay all of those fees that you typically pay to the CRSs. And did they get access to the fares? No. So the question is whether is it a competitive marketplace or an anti-competitive marketplace, and I think that this really gets back to the crux of the issue for us.

We have competed at Travelocity in the past by getting the best fares that we could for consumers. We would get exclusive fare sales from those airlines, a very competitive market to get at those fares.

If we enter into an agreement like that today, automatically those fares are given to Orbitz. So we have no leg up, and we have no competitive benefit, and there is no motivation for the airlines to do a deal with us. So we are left in a position where our sales force is busting its hump engaging with airlines trying to do those deals at lower distribution costs to those airlines.

And when we get them done, the Maytag repair man in Chicago at the Orbitz headquarters gets those same fares. It doesn't seem like competition to me.

Mr. STEARNS. The gentleman's time has expired. The gentleman from Georgia, Mr. Deal.

Mr. DEAL. Thank you, Mr. Chairman. It seems rather inconsistent to me on the one hand that people are arguing that things are anti-competitive and the reason that they are anti-competitive is because the cost to consumers is going down.

That seems to be what competition is supposed to do, is to bring the costs down. The heart of this whole issue is as Mr. Zuck indicates, is the booking fees that are charged by the CRSs. Now, Travelocity is wholly owned by the largest CRS, Sabre.

Seventy-five percent of Sabre's revenues come from booking fees. Booking fees are the third largest expense, that is, distribution costs, and booking fees is the largest part of booking costs or distribution costs.

They are the third largest cost to airlines behind labor and fuel, and so we are talking about something here of protecting—if you want to talk about protecting the old mechanism, Dr. Cooper, it is designed to protect the old mechanism of preserving booking fees.

What Orbitz has done is to say to these airlines that if you will enter into agreements with us, we will rebate up to a third of the booking costs as an incentive to do that, and they promised over a series of years to continue to lower the booking fees.

Now, I can understand, Mr. Gilliland, why Travelocity, being owned by a CRS, doesn't like that. But you, your own company, has entered into agreements with Delta and other companies to do exactly that have you not?

Mr. GILLILAND. We have provided them with lower distribution costs in exchange for web fares, and in fact, we get dribs and drabs of web fares from those deals, and we do not get the contractual guarantees that are provided to Orbitz through this most favored nations clause.

Mr. DEAL. But you and Expedia have both entered into agreements for web fares from Delta if you would agree to cut some of your booking fee costs aren't you?

Mr. GILLILAND. And in fact we would like to see that same type of competition occur in the future. We enter into agreements with a single airline to distribute their fares at a low distribution cost.

We don't enter into an agreement with five airlines all at once on the same exact economic deal, a price that has been set by the airline owners of Orbitz and Orbitz itself.

Mr. DEAL. And part of that is that your system has a built-in bias if people will pay you for that bias, something that was alluded to by some of the others, and I believe you call it a preferred carrier.

In other words, if you have a preferred carrier who pays you a fee to be a preferred carrier, when someone uses your website, you give them preference, in terms of the pull-up of that site, do you not?

Mr. GILLILAND. In fact, a consumer can make a choice to show a preferred airline, and a preferred airline display, or they can choose not to.

Mr. DEAL. And you get paid a fee if the airline will pay you to put a preferred status on your website?

Mr. GILLILAND. We have promotional deals with the airlines. That's competition in this marketplace.

Mr. DEAL. And that is what Orbitz doesn't have isn't it?

Mr. GILLILAND. Our site is not biased. Let me explain.

Mr. DEAL. Okay. Go ahead.

Mr. GILLILAND. Our site is not biased. If you look at our slight displays today, you will see that Travelocity has adopted the same display ordering as the Sabre CRSs, and the Sabre CRSs whose displays are governed by the CRS rules. Do we offer special promotional fares on some airlines? You bet we do.

When we can get deals with those airlines, we offer special promotions, and we will sometimes send promotional e-mails to promote those deals. You will not, however, see inferior service presented before better service.

Mr. DEAL. Mr. Chairman, I am reclaiming my time. I think you have answered the question. Let me ask you this though. Isn't it true that you refused to enter into some of these agreements for cheaper fares because of your exclusive agreements?

In fact, it was reported in May of this year in Aviation Daily that Travelocity and Expedia both turned down a special offer of an online fare from Northwest Airlines from the U.S. to Frankfurt, which they offered lower rates, and the reason that you turned it down was because it would interfere with an already exclusive agreement that you had with another airline; isn't that correct?

Mr. GILLILAND. We promote Northwest fares when we do promotional deals with Northwest.

Mr. DEAL. And that is assuming that they don't interfere with these preferred contracts that you already have with somebody else that you are already getting paid for?

Mr. GILLILAND. Sir, competition in this business—and in competition in many marketplaces, and supermarkets as an example—is to go out and get the best supplier deal that you can get one at a time, and that is what I am talking about here.

We are going out one at a time and getting promotional deals and we are offering those deals in our supermarket. It sounds like commerce to me, and it sounds like e-commerce to me.

Mr. DEAL. And you pay those booking fees back to your parent company, Sabre; is that correct?

Mr. GILLILAND. No, we don't pay booking fees back to the parent company.

Mr. DEAL. You don't pay booking fees?

Mr. GILLILAND. That is incorrect. We don't have a booking fee relationship with our parent company.

Mr. DEAL. You do not have any booking fee arrangements? Are you saying that you are not charging any booking fees at all in your——

Mr. GILLILAND. We don't charge booking fees. We charge distribution fees to the airlines that we have relationships with. They are not booking fees.

Mr. DEAL. Well, it is the same thing, but just called by a different name isn't it?

Mr. GILLILAND. No.

Mr. DEAL. All right. Let me ask you this. If this arrangement that you accuse Orbitz of being involved in is so bad, can you explain to me why you are entering into an arrangement in Asia, and I believe it is called Zugi, along with 18 major airlines there in which you are the exclusive booking agency for them?

Mr. GILLILAND. Yes, I can explain that. We are a technology service provider to them, and we have licensed our technology, and those airlines are running that business, and we simply provide the technology, similar to the technology that Orbitz has contracted with a company named ITH to provide to them.

Mr. DEAL. So what you have done then in Asia is to duplicate what you are complaining about somebody else doing in the United States?

Mr. GILLILAND. No, and in fact it is very different. It is a technology services relationship.

Mr. DEAL. I see.

Mr. GILLILAND. And we perform technology services with many different companies on the Internet today, and as an example, Yahoo and AOL.

Mr. DEAL. And when you talk about wanting regulatory parity, are you asking this committee to recommend that we regulate the Internet in terms of online travel services?

Mr. GILLILAND. What I am simply suggesting is that we apply a very common sense approach to the Internet. If I go down to the corner drug store and get a prescription, and get drugs, I need a prescription. If I go to Drug Store.com, I need a prescription.

And I am simply asking that we apply similar types of rules to the Internet, and it is not about new rules. It is simply about ensuring that there is effective competition, just as that same competition was affected by in the mid-1980's, and in 1992 with the CRS rule.

Mr. DEAL. Mr. Chairman, I would ask—I realize my time is up, but I would ask for unanimous consent to include in the record a statement by Mr. Scott Yohe, the Senior Vice President of Government Affairs for Delta Airlines, which was his testimony on June 26 of this year before the National Commission to Ensure Consumer Information Choice of Airline Industry.

Mr. STEARNS. By unanimous consent, it is so ordered.

[The statement follows:]

PREPARED STATEMENT OF D. SCOTT YOHE, SENIOR VICE PRESIDENT—GOVERNMENT AFFAIRS, DELTA AIR LINES, INC.

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

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

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

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

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

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

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

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

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

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

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

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

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

- Post 9/11 passenger security taxes: $266 million.
- Increased terrorism insurance premiums, assuming FAA support ends, and the airlines have to rely on the commercial market: $250 million.
- Security-related revenue losses from postal service and cargo restrictions, as well as unreimbursed security costs for cockpit door fortifications, ramp security, checkpoint document verification, screening of catering supplies and material, airport space occupied by TSA, security equipment, personnel training, and airline seating for Federal Air Marshals: $175 million.
- And revenue losses due to customers deterred from air travel by the hassle factor: an estimated $600 million.

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

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

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

For all of these reasons, the current financial crisis has forced Delta to seek ways to cut costs in almost every aspect of our operations. We have undergone the agonizing process of reducing our workforce by approximately 13,000 positions. Industry wide, some 100,000 airline employees have lost their jobs. Delta has cut its flight schedule back by approximately 15% from pre-September 11 levels, and many other U.S. carriers have similarly reduced their own networks. U.S. airlines parked or retired some 350 aircraft. Hundreds of aircraft orders have been canceled or reduced.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

These e-commerce alternatives provide a means of distributing airline tickets to the public that costs less than the traditional travel agency distribution channel. The Internet is a highly efficient means of selling airline tickets, just like it provides a highly efficient way to sell many other services. Perhaps the most direct analogy is online financial and investment services websites—where major financial services providers have given consumers the power to use the Internet to take control of their own finances. Consumers who prefer this convenience and control can now make their own stock trades on the Internet for less than $10 rather than paying the hundreds of dollars in commissions that traditional stock brokers charge.

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

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

C. Delta Web Fares Have Benefited Consumers

Like any other cost savings, these developments are good for consumers. They make it possible for airlines to offer lower fares and increased services. The lower costs associated with direct distribution via the Internet have led Delta and other airlines to offer lower prices to consumers in the form of "web fares"—special discounted fares that an airline offers on the Internet but does not publish through the traditional GDS system.

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

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

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

Finally, the bottom line is that low fares *benefit* the consumers who choose to take advantage of them. Any regulatory attempt to interfere with the free market by prohibiting airlines from offering special discounts on the Internet would harm these consumers. The fact that some consumers may choose not to shop online does not make it "unfair" to offer discounts to those who do. Many businesses offer discounts to consumers who shop through less expensive distribution channels, whether that is an Internet web site, a warehouse superstore, or a rural factory outlet. Airlines are no different. It is no more "unfair" to offer discount airline tickets on the Internet than it is to offer discount commissions for online stock trades or discount prices for consumer products in a warehouse superstore.

D. Orbitz Has Benefited Consumers

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

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

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

Top Three Travel Web Sites

(based on the number of visits made in March 2002)

Expedia	11.6 million
Travelocity	10.2 million
Orbitz	6.6 million

Source: Nielson/Net Ratings

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

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

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

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

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

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

CONCLUSION

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

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

Mr. STEARNS. And I would say to all of the members that we will have a second round. I don't think we are going to have votes until one o'clock. So we have the unique privilege of listening to our panelists without interruptions. The gentlelady from California, Ms. Eshoo, is recognized.

Ms. ESHOO. Thank you, Mr. Chairman. I really appreciate you holding this hearing, because I think that there are really a plethora of issues for us to examine. As each person at the table states their case to each one of us up here, you are looking at the ultimate commuters in the country, I think.

Each one of us is tied to the airlines and reservations in some way, shape, or form, regardless of where our district is. I mean, in my case, I commute to California every single week, and I have almost without exception for 9½ years.

So in my case, it is United Airlines. They are terrific to me. They are wonderful for my staff to work with, and the crews are terrific, and the reservation people take very good care of us.

We travel on what I think is called a Y-rate. It is a government rate, and for those of you that are listening in, yes, we get mileage, but I have to tell you that the last thing I feel like doing is getting on an airplane when I don't have to commute, in terms of earning any kind of mileage.

We don't get anything that anyone else doesn't get, but I guess it is good to have it because it helps us get some tickets that we don't have to pay for out of our budget. I don't—I say this not so much to state the obvious, whether it is United Airlines or Delta Airlines, whomever the airlines are that are involved in this, make no mistake about it.

The Congress in the wake of September 11, one of the first steps it took was to put up $20 billion for the airlines. We recognized that we had grounded them, and we recognized that we needed to step up to home plate.

We understand what they mean in terms of our Nation's economy, commerce, all of it. So it is not whether I fly United, or the next person has Delta in their district, or the next person has whatever airline.

It is how business is conducted. I am not a lawyer, but I have to tell you that I think that some of this really bumps up against some anti-trust. It is just my initial take on it.

Why? Because when you put major airlines together, in terms of a service that others cannot get, and that you are not only stepping on the consumer, but that you are essentially cutting them out, in terms of getting the best price.

So I recognize that computerization and computerization of reservation services are very important, but you know, if you can't get the list in order to put it out there for people to take advantage, you are putting a world of hurt on them. I am very curious about why Orbitz is not here today. They were invited, Mr. Chairman?

Mr. STEARNS. Absolutely. They were invited and the airlines were invited, too. And there has been other hearings on this in the Senate Commerce Committee.

Mr. DEAL. Would the gentlelady yield on that issue?

Ms. ESHOO. Well, I am not finished yet, and if I have time, I would be more than glad to, to my colleagues. I am troubled about what the current state of affairs is, and it is rooted in some other things that have troubled me, in terms of what has happened with travel agents.

You have the airlines saying—you know, I have never really understood why the airlines are always hanging on by a thread. I mean, management and whatever, and it may be very well a business that doesn't produce a lot of profit.

But having said that, I think that they have the right to have a service where they get a crack at reservations and the profits that come from that. But do I think they should be the elephant with the big hoof and consider everyone else an ant under that hoof?

Well, you don't have too much of a chance if you are in that position. So let me ask a question and whomever would like to take a stab at it. What is the niche that Orbitz in your view is trying to fill? When they decided to enter the market there were already a few big players, and many little ones providing on-line travel services. All of the airlines had and still have websites where a customer can buy tickets on-line.

It doesn't appear, at least to me, that there are cost savings, because it is my understanding that Orbitz is losing money overall. I mean, I am playing a little devil's advocate, but I think that given who is here today, and they are not, that maybe you take a stab at that, and whomever wishes to.

Mr. GILLILAND. If I might, I won't speak on behalf of Orbitz and would prefer that they, too——

Ms. ESHOO. Well, you can't.

Mr. GILLILAND. [continuing] could be here as well to speak their mind.

Ms. ESHOO. Yes. I think they are missing a real opportunity.

Mr. GILLILAND. Yes. However, I can say that I can talk a little bit to the broader market, and the broader market that we compete in. And that is to provide very low priced trips, whether that includes air, car, hotel, vacation cruise, to consumers.

And this part of the market is very, very price sensitive, and in fact a $5 or $10 change in price can often mean the difference between making a sale and losing the sale to someone else.

Ms. ESHOO. Sure.

Mr. GILLILAND. Simply because they are a mouse click away. Competitors are but a mouse click away. So the importance of what we are describing here is that we need to, because of that price sensitivity, have the opportunity to get at promotional fares.

And when we do, when we strike deals with airlines, and we have done that historically, that is what Expedia, and Travelocity, and a number of other independent sites were based upon, was competing to provide the consumer with that best deal.

When we get those deals, we would rather they not automatically then go to Orbitz.

Ms. ESHOO. I see.

Mr. GILLILAND. And we think, and we also think that it is not good for consumers, because Orbitz charges a $5 service fee, which the other independent sites do not charge.

Ms. ESHOO. That's interesting.

Mr. GILLILAND. And in addition to that, we think it is not good for the airlines, and when it ends up not being good for the airlines, it is not good for the industry. They are in fact——

Ms. ESHOO. Well, I don't know if they are going to pay attention to what you think is good for them or not, but I appreciate you answering the question. What is the purpose of—let me just ask this, because I don't think I have too much time left. What is the purpose of the most favored nations clause?

Mr. STEARNS. Your time has expired.

Ms. ESHOO. Can they answer that, Mr. Chairman?

Mr. STEARNS. Okay. Go ahead. Sure.

Ms. ESHOO. Because it might be constructive.

Mr. STEARNS. We are going to have a second round here, and so you are welcome to go ahead.

Ms. ESHOO. The most favored nations clause; can they just tell us what that is?

Mr. STEARNS. Yes.

Ms. ESHOO. What is the purpose of that?

Mr. ZUCK. Well, I think one way to address that question is to segue from your first question. I mean, as Congressman Deal mentioned, the third highest cost to airlines is distribution, and a lot of this is these booking fees, which were over $2 billion generally annually.

So when asked what their purpose was for trying to construct Orbitz, it was to cut down their distribution costs. So it has a built-in model that rebates back booking fees, and makes that distribution cost less so that they save money.

I mean, it is not—there was not an alteristic motive or anything like that. but that they were simply trying to cut distribution costs to getting tickets out to consumers. That most favored nation status was something that again is a bit of a misnomer—it is just sort of an inventory availability clause—was simply a guarantee that came as a result of those reduced booking fees.

I mean, in other words, Orbitz was taking a risk by taking less money for booking travel and in return asked to get the best fares. Those options are available, and we are seeing plenty of other sites making use of web fares, et cetera, and Orbitz is contractually obligated to show all fares, and not just some subset that a mainframe returned.

And it is contractually obligated to show them in an unbiased way. We get mislead a lot by talking about different kinds of fees. Well, there is a booking fee that they charge, and that another company doesn't, but at the same time, companies like Travelocity get paid volume booking rewards and things like that.

Everyone finds a way to get paid, and I think it is important that we keep that in mind as well. But the problem is that if the way that you are finding to get paid involves essentially biasing your display, or promoting one fare over another, that is less pro-consumer than actually just getting paid a flat fee.

Let's make sure that we talk about things in the same terms. Everybody is getting paid in this, and the airlines are simply trying to pay less to sell airline tickets, and in an environment in which they are losing money.

Mr. COOPER. Let me try the reverse of that. Jonathan and I have been on opposite sides on a lot of issues. The essential threat to cartel behavior is cheating, and now you have a guaranteed flaw that it disenchants cheating.

And you can tell me why you were doing this to induce people to put your tickets there, but the effect is to disenchant people from cheating, from cutting that individual one-on-one deal that gets somebody a better price.

And that leads me to your first question, which is why do they come to this? They came to this for a simple reason. All hell was breaking loose out there. I mean, people thought they could name their own price.

They were getting resistance, alternative means of distribution, and this is an industry that clearly engages in cartel behavior. And cartels need to discipline, and so the answer is that you discipline by establishing a joint venture, and that dampens down the ability of all these people popping up in cyberspace to cut a side deal and offer a lower price.

And I will tell you that the 12 bucks difference between the CRS and what Orbitz is charging is peanuts compared to the $200 and $300 differences that you heard here. So you are disciplining the hundreds of dollars by diminishing the likelihood for deals to pop up in cyberspace.

Mr. STEARNS. Mr. Wolff, you might want to reply to that and then we will close up the debate and go on to Mr. Terry. Mr. Wolff, you will get the last word here.

Mr. WOLFF. Okay. Since this subject is supplier owned on-line sites, and the hotel site is an important entity, when words like cartel are distributed out, I want to make sure that there is no misunderstanding about how we operate.

First of all, we have a very narrow MFN, and it only says that if you are going to deal on TravelWeb and give us a rate, we would like to make sure that our big competitors don't get a better rate. It does not restrict them in any way from giving better rates on their own site, or through other channels. It is a very narrow MFN.

And so that this does not discourage competition through any other channel, and we want to make sure that our process here is very clear to everyone, and that we don't see ourselves operating as a cartel in any way, shape, or form. This is just handling one small segment of distribution, less than 1 percent of our business.

Mr. STEARNS. Thank you, Mr. Wolff. The gentleman from Nebraska, Mr. Terry, is recognized.

Mr. TERRY. Thank you, Mr. Chairman. I will follow up on these comments though. Let me just quickly outline why I think this smacks or smells of anti-competitive behavior here. First of all, you have an entity that is started up by the airlines. Right away, that will catch my attention.

Then they agree amongst themselves that on this website, through this most favored nation clause, that they will make sure that on this site is the lowest fare. This ensures though as they market Orbitz that we as consumers are then trained to automatically go to Orbitz because that will automatically have the lowest fare.

Now, we can say in the immediate sense that that is good for consumers, because that means that they will have the $290 fare, and you are guarantee this cheap seat on the airlines, but then what happens when they become the 800 pound gorilla and there is no more Travelocity or others?

Then the only thing on Orbitz is the $490 seat or the $415 seat. That's why you have to be on top of this type of anti-competitive behavior at the beginning. At the beginning, it looks pro-consumer, but you have to look down the line.

So first of all, I want to ask Mr. Zuck. I am very curious about what the Association for Competitive Technology is, but I will ask it another time, because your passion for Orbitz makes you look less independent than the name of the organization.

Mr. ZUCK. Well, now I feel compelled to answer.

Mr. TERRY. Well, don't talk, because I am speaking, please, and I have only a few minutes here. In your industry speech that I was trying to interpret, and in Mr. Towns' great question and research between Travelocity's price and Orbitz's price, there is a difference of $122.50 that you—that I interpreted from your answer as blaming on the CRS, the computer reservation system, and their pricing.

Are you saying that there is $122.50 difference simply because of the type of reservation technology that they use, and their $5 or whatever, their $17 fee that they put on? I am at a loss of what you are really trying to tell us. So if you could further explain the $122.50 in layman's words?

Mr. ZUCK. Sure. Thank you, Congressman, and I look forward to the opportunity to talk to you about the Association for Competitive Technology, that is mostly made up of small businesses, who would like nothing worse than to see imposed distribution channels put in place where they are not necessary.

So I would love to have that conversation, but to try and clarify this issue. First of all, we hear all the time that you don't always find the cheapest fares on Orbitz. So to some extent, what Congressman Towns found could be an anomaly, and I can't seek to explain a single fare, or where that anomaly comes from.

And there is a number of different possible reasons that that occurred, but taking the worst case scenario, which is in fact that there was a fare that was offered to Orbitz that wasn't offered to Travelocity, if that is where the site was.

Let's say that it is that worst case scenario and how would I explain that. What I was trying to say is that the reason that the airlines started offering these so-called web fares, fares that they only offer on their sites, is that they had distress inventory that they were offering at reduced prices.

In other words, cutting their profit out of that seat in order to simply fill seats on an airplane. They wanted to try and eliminate the distribution costs or minimize the distribution costs of those cheaper seats.

Orbitz's business model is about lowering those distribution costs. It is not comparing $12 to $120. It is comparing what the profit on that seat would have been, and if that profit has gone away, and that $12, which adds up to $2 billion, makes an awful lot of difference.

So Orbitz's business model is about selling airline seats more cheaply, and that is why they are getting some of these lower fares. To address your other comment about our sort of psychic predictions about anti-competitive conduct, I would remind you that the Department of Justice has guidelines for companies to get together to create distribution competition that Orbitz has followed and is under perpetual scrutiny from both the Department of Justice and the Department of Transportation.

And I can't for a moment imagine that Dr. Cooper would stand silent the minute that suddenly they were raising fares because they were the only on-line travel site, which seems very unlikely to begin with.

Mr. STEARNS. The gentleman's time has expired. Mr. Rush is recognized for questions.

Mr. RUSH. Thank you so much, Mr. Chairman. Mr. Gilliland, from the standborne of size and market penetration, Sabre and the other computer reservation system companies are much larger and far more profitable than Orbitz. Do you share that conclusion?

Mr. GILLILAND. That is correct. Orbitz is unprofitable.

Mr. RUSH. In fact, Mr. Deal said in his opening statement that Orbitz sold only 2 percent of all tickets last year, why Sabre and the other computer reservation systems sold 70 percent of all tickets. Do you agree with Mr. Deal's figures?

Mr. GILLILAND. I don't know if that is the exact math. I would say that largely speaking most tickets are sold through computer reservation systems, and even Orbitz uses the computer reservation system for much of the work that it has to do in the booking process on behalf of the consumer.

Orbitz is, although it wants to be in the CRS business, and therefore we think, great, let them come into the CRS business, and let them be governed by the same rules that the CRSs are. They are relatively small compared to the CRSs. They have only been in operation for 6 months, and CRSs have been in business for 20 years.

So it is kind of a striking comparison, both in terms of time, and time in market, and capabilities.

Mr. RUSH. Well, now I am trying to understand what the—well, who is the elephant and who is the ant here? Is the Elephant Orbitz or is the elephant Sabre? Who is the elephant and who is the ant here?

Mr. GILLILAND. Well, I think the issue, and what we are laying out here for you, is that we are concerned about maybe not step No. 1 of what has occurred here, but step two. What does this mean in terms of the consumer, and what will happen to consumer pricing if all of these fares are available in one place.

It seems to me that in fact if all of these fares are available in one place, it will discourage airlines from actually discounting as they have in the past. They are in the business of doing selective discounting, promotional fares, and that is how they compete. That is how they attract and stimulate demand.

They can't do that across the broader market and if in fact Orbitz continues with the success that it has seen and in fact it is depending on what stats you see, the No. 2 or the No. 3 on-line travel agency in just 6 months, our concern is that over time the same discounts that you see today may simply not be available, and again, not good for the consumer.

Mr. RUSH. Should we use another kind of standard, or another type of measurement stick other than—well, let's look at the employees. I mean, Orbitz has less than 200 employees, and Sabre has about 11,000 employees.

Mr. GILLILAND. Yes.

Mr. RUSH. Is that wrong for us to draw some conclusions based on those kind of measurement sticks?

Mr. GILLILAND. Well, Orbitz operates in one country and Sabre operates in 112 countries, and so again I don't really see the comparison there. If you are going to make comparisons between Orbitz, you might talk about its direct competitors today, which are Travelocity and Expedia, which have very similar numbers of employees working there today.

Again, you know, if Orbitz—and certainly it is indicated that it wants to be in the CRS business, would like to compete in that business, we welcome them. We welcome them under the jurisdiction of the CRS rules, which we have to comply with and have for many years, simply because we found, and the government found back in the mid-1980's, and early 1990's, that it made sense to ensure that there was effective competition between the large carriers and the small carriers; small carriers being disadvantaged back in that time by the airline-owned CRSs.

Mr. RUSH. Let me ask you another question. What about the—well, we have gotten a report that Orbitz had a large operating loss last year, and expects to lose money for several years to come.

And on the other hand, Sabre had a large profit increase in their first quarter of this year, compared to the first quarter of last year. And Sabre's first operating profit increase this year, compared to last year's, was about 25 percent of an increase.

Mr. GILLILAND. Yes.

Mr. RUSH. So where is the problem at?

Mr. GILLILAND. Well, let me first talk to Travelocity, who we posted our earnings today at Sabre and Travelocity, and Travelocity posted a loss this quarter. So things aren't going really as they should be for Travelocity.

Sabre, I am not going to apologize for as well-managed business. We have seen our revenues decline. If you look at the first quarter, our revenues declined by almost 6 percent. Our expenses, we took expenses out, and it is a very painful process that involves our employees, and we took over 20 percent of our expenses out.

It is about managing the business and managing the business in the technology sector. Technology companies—and we have done the studies—typically get better margins than airlines. And again that is not something that we are going to apologize about.

I want the airlines to do well. They have to do well for our business to do well.

Mr. RUSH. Thank you, and I yield back the balance of my time.

Mr. STEARNS. The gentleman's time has expired, and the gentleman from New Hampshire, Mr. Bass, is recognized.

Mr. BASS. Thank you, Mr. Chairman, and I don't have a dog in this fight. I have been listening with interest to this testimony, and there are clearly some inconsistencies of logic.

I think it would be helpful if Mr. Towns sent the printouts of his inquiry to the Internet to Orbitz and asked them for an explanation so we could make it a part of the record.

Mr. TOWNS. Would the gentleman yield?

Mr. BASS. Yes, sir.

Mr. TOWNS. I think it would be more important if Orbitz would come here and become a witness, and I think they should come here. That would be the real way to do this.

Mr. BASS. Well, reclaiming my time, it is my understanding from the opening statement of Mr. Deal——

Mr. TERRY. Would the gentleman yield for a minute?

Mr. BASS. Certainly.

Mr. TERRY. I will submit what Mr. Towns provided me for the record, which is just a printout from Travelocity and Orbitz.

Mr. STEARNS. With unanimous consent, it is so ordered.

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