

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

In The Matter of))	Docket Nos.	OST-97-2881
))		OST-97-3014
))		OST-98-4775
Computer Reservations))		OST-99-5888
System (CRS) Regulations;))		
Statements of General Policy))		
))		

COMMENTS OF SABRE INC.

I. EXECUTIVE SUMMARY.

Sabre Inc. (“Sabre”)¹ urges total deregulation and termination of the CRS rules as scheduled on January 31, 2004. All CRSs are or soon will be free of airline ownership. The entry of on-line competitors and of direct booking on airline websites has radically expanded the channels for ticket booking. Passengers, travel agents and airlines now have many different ways of reaching each other. Thus, the original reason for the CRS rules – airlines ownership of all CRSs – no longer exists and there is no basis (or market failure) justifying continuing regulation.

This recommendation is subject to only one caveat: if Worldspan’s divestiture does not

¹ In preparing comments to the NPRM, Sabre has provided the Department with certain highly confidential commercial and/or financial information. Concurrently with this comment Sabre is filing a Motion for Confidential Treatment to withhold from public disclosure this information as it appears in both Sabre’s comments and the appendices attached hereto. Where indicated with “[CTR]”, Sabre has redacted the confidential information and has sought confidential treatment pursuant to 14 C.F.R. § 302.12.

Comments of Sabre Inc.
March 17, 2003

occur, or if Worldspan or any other CRS reestablishes airline control (either by ownership or contract), then the mandatory participation rule and the ban against a parent carrier linking commissions to the use of a particular CRS (tied selling) should be applied to that CRS (or any on-line entity performing CRS functions) until that relationship is terminated. However, all other CRS regulations should be allowed to lapse. Traditional antitrust enforcement should be relied on in this industry just as it is in virtually all others to ensure that consumers receive the benefits of competition.

A. Overview.

The Department of Transportation's ("the Department") Notice of Proposed Rulemaking ("NPRM")² regarding computer reservation systems ("CRSs") and statement of general policy issued on November 15, 2002 are fundamentally flawed and ought to be withdrawn in their entirety. The Department has proposed asymmetrical regulation that would favor major air carriers at the expense of low-cost carriers, consumers, travel agencies, and CRSs. Yet, low-cost carriers, travel agents (both online and brick-and-mortar), and CRSs are the ones that have revolutionized information and airline ticket distribution, permitting air carriers to lower the costs of reservations while virtually all other major carrier cost components have gone up far higher, and turned large carrier airline yield management (which tries to maximize revenue per passenger) on its head through the development of pro-consumer, transparent, low-fare search engines available at the click of a mouse.

Even as Orbitz, the major-airline-owned travel Web site, morphs into a CRS with its direct connect model, the Department proposes to keep regulations only for existing CRSs, while

² Notice of Proposed Rulemaking for the Computer Reservations System (CRS) Rules: "Computer Reservation System (CRS) Regulations; Statement of General Policy," 67 Fed. Reg. 69366 (Nov. 15, 2002).

Comments of Sabre Inc.
March 17, 2003

giving Orbitz a regulatory free pass. For the first time the Department proposes to directly regulate non-airline owned CRSs with a 63 page, triple-columned, single-spaced rule in the Federal Register covering every aspect of CRS relationships with air carriers and travel agents.

In doing so, the Department has relied on demonstrably antique and inaccurate data, ignored marketplace changes, and adopted a novel and strained interpretation of its authority to regulate CRSs as “ticket agents,” even though CRSs are not agents, and cannot “sell” or “arrange” air travel, but simply provide data processing services to “ticket agents.”

Compounding these problems is that the Department, after more than five years of studying this issue through numerous extensions of the sunset of its CRS rules,³ an Advanced Notice of Proposed Rulemaking (“ANPRM”),⁴ and a Supplemental Advanced Notice of Proposed Rulemaking (“SANPRM”),⁵ has proposed a rule that is almost incomprehensible in its length and complexity, replete with over 50 questions for commenter response, including whether the Department’s CRS rules should be allowed to completely expire. Transparent rulemaking edits between the Department and the Office of Management and Budget (“OMB”) on the CRS rules reflect fundamental policy differences within the Administration about key components (such as parent carrier mandatory participation and booking fee non-discrimination) of the rules, including their very existence, so that parties are not fairly put on notice about what rule or “no rule” is truly being proposed. This pervasive ambiguity about what really is being proposed likely will require the Department to go through another notice-and-comment period.

³ The Civil Aeronautics Board (“CAB”) adopted its CRS rule in 1984 as one of its last official acts, with a 1990 sunset date. 49 Fed. Reg. 32540 (Aug. 15, 1984). The Department has proposed extending the current rules, in some form, through January 31, 2004. 68 Fed. Reg. 7325 (Feb. 13, 2003).

⁴ 62 Fed. Reg. 47606 (Sept. 10, 1997).

⁵ 65 Fed. Reg. 45551 (July 24, 2000).

Comments of Sabre Inc.
March 17, 2003

So that there can be no doubt: as the largest CRS, which also owns one of the most popular travel web sites, Travelocity.com – and therefore a company vitally affected by any CRS rules – Sabre’s position is that:

- The time has come to completely deregulate the Department’s CRS rules, with sunset on or shortly after January 31, 2004, as the Department has proposed.
- The only remaining concern the government ought to have about CRSs is the one that formed the original basis and purpose of the CRS rules – the ability and incentive of CRSs owned and controlled by major U.S. carriers to use their resultant market power derived from vertical integration to thwart competition. Without rules, such owner-carriers would have the economic incentive to withdraw from competing systems, degrade competing information channels, drive agents to one system with all content, extract monopoly rents from non-owner carriers, and slash booking fees for themselves. While this might be good for those owner-carriers, it would be bad for consumers. Unless the recently announced separation of Worldspan from its three owning carriers is actually “less than meets the eye,” this residual problem stemming from vertical integration will solve itself in mid-2003 when the sale of that CRS to independent investors is anticipated to close.
- For so long as any CRS remains owned or controlled by one or more major U.S. carriers⁶, the Department’s two core competition protection provisions of its CRS rules should still apply, continuing the requirement for parent-carrier mandatory participation rule and the ban against the owner-carrier tying travel agency commissions to the use of that airline’s own CRS. The bulk of the CRS rules, however, for both airline-owned or controlled and independent CRSs, should still sunset.
- Any remaining competitive issues could most efficiently be resolved under existing antitrust and consumer-protection laws, enforced by the Department of Justice and Federal Trade Commission.
- Under no circumstances should the Department finalize its flawed NRPM, which could not withstand judicial scrutiny. Indeed, no rule at all is far superior to the Department’s proposed rule.

All the CRSs that were once owned by U.S. airlines are now, or soon will be, independent entities. On-line travel service competitors, and direct booking on airline websites,

⁶ While Amadeus is owned by three foreign airlines, none of them has a sufficient presence in the U.S. to possess the power to distort airline or CRS competition here. Of course, in their home markets, the story is entirely different.

Comments of Sabre Inc.
March 17, 2003

have greatly amplified consumer options when booking air travel, bypassing CRSs. The original basis for the CRS rules (to prevent airline owners from misusing their control of CRSs) has therefore disappeared. There can be no valid reason for perpetuating – much less expanding – the Department’s regulation in this area.

Sabre’s comments assume that Worldspan’s airline owners will, in fact, divest their ownership. Should airlines retain, or reacquire, substantial control relationships in CRSs, however, the Department’s two core CRS competition-protection rules should apply to force owner-carriers to participate in each CRS and prevent them from tying travel agency commissions to the use of that airline’s own CRS.

The Department’s NPRM does not rely on the most recent and comprehensive sources of data for its rulemaking. It paints an inaccurate and outdated picture of the industry. No reference is made to the Department’s comprehensive review of CRS operations (as identified in the Department’s 1997 ANPRM and 2000 SANPRM), or the American Society of Travel Agents’ (“ASTA”) Automation Study of October 2002.⁷ And the NPRM was issued two days before the report of the National Commission to Ensure Consumer Information and Choice in the Airline Industry. For example, the NPRM mistakenly assumes that travel agents are “locked in” to CRSs because of long-term contracts; in fact, according to the ASTA Survey, subscriber contracts with five-year duration have declined from 84.7% in 1998 to 47.2% in 2002, and the number of subscribers with three year or shorter contracts has increased substantially (9.3% in 1998 to 39.2% in 2002). *Id.* at 35. Likewise, the number of travel agents providing their own

⁷ “The 2002 ASTA Agency Automation Report,” October 2002. Hereinafter referred to as the “ASTA Survey.”

**Comments of Sabre Inc.
March 17, 2003**

equipment to access the CRSs is estimated to reach approximately 70% by the end of 2003,⁸ further eroding the argument that travel agents are “locked in” to any particular CRS. And in the case of Sabre subscribers, 62% use their own hardware as of December 2002.

Had the Department used current information, it would also have recognized the substantial and continuing shift away from traditional travel agents to on-line ticket agencies and airline web sites. Once nearly 90% of all travel was booked through CRSs; CRSs, including bookings made by brick-and-mortar and on-line travel agencies (such as Travelocity, Expedia, and Orbitz) that use CRSs as booking engines, now account for about half of all bookings in the U.S. Airlines have accelerated this shift by offering special fares directly and not available through travel agents or CRSs, as well as frequent flyer incentives and conveniences like on-line advance check in on their web sites. In addition, almost all travel agents use the Internet to make some of their bookings and, contrary to the NPRM, those bookings are routinely made through the computer equipment leased to them by the CRSs themselves. The ASTA Survey found, in fact, that on average travel agencies booked more than 10% of their reservations on web sites. In other words, nothing prevents consumers or travel agents from substituting between distribution channels.

The airlines’ withdrawal of travel agent commissions has forced travel agencies to control costs, to find alternative sources of revenue, and to consolidate, thereby increasing their bargaining leverage against CRSs. As a result, large agencies book a major share of business travel for large companies and handle the vast majority of all air transportation reservations. The 117 agencies with over \$50 million ARC revenue had 57.2 % of all ARC revenue in 2001, and 12 agencies (less than 1/10 of 1 percent of the total number) received 36.5% of all ARC

⁸ Sabre estimate.

Comments of Sabre Inc.
March 17, 2003

revenue.⁹ In addition, CRSs now pay \$1.00 - \$1.50 per booking to travel agents to use CRS services rather than the other way around.¹⁰ As a consequence, there is no basis in the NPRM for “protecting” travel agencies from CRSs by proscribing particular contractual relations and conditioning compensation arrangements. If agencies need any protection it is against large airlines on whom they are dependent for overrides and product to sell, especially where those airlines are vertically integrated with CRSs.

Two CRSs, Sabre and Galileo, became independent of their airline owners and now compete vigorously for airline commitments to provide full data. Both publicly offer airlines discounted booking fees that will be frozen for several years in exchange for fixed term agreements, fares otherwise limited to airline web sites or select on-line agencies (like Orbitz), and for other commitments not to discriminate against their users. In short, price competition for the business of airlines by the two independent CRSs is alive and well. Despite the NPRM’s reliance on claims by major airlines (who themselves are owners of Worldspan) that CRS booking fees are “exorbitant” (67 Fed. Reg. at 69376, 69382), the data show that the all-in price for a ticket issued by a brick-and-mortar travel agency through a CRS in today’s zero commission environment is much cheaper than the cost the airlines absorb for *either* tickets issued through their own reservations offices or through their carrier web sites, if all the expense of operating the web site and servicing the customers who use it are taken into account.

Further, most airlines have not taken advantage of the discounts being offered by the two independent CRSs. Worldspan-owning carriers have continued to impose the same allegedly

⁹ National Commission to Ensure Consumer Information an choice in the Airline Industry, Upheaval in Travel Distribution: Impact on Consumers and Travel Agents, Report to Congress and the President (Nov. 13, 2002) (hereinafter “NCECIC Report”), app. G at 113.

¹⁰ See CRA, App. 1 p. 18 discussing incentive payments to travel agencies; EK, App. 2 at 4.

**Comments of Sabre Inc.
March 17, 2003**

high fees through their wholly-owned CRS, and the fee Worldspan charges carriers today for traditional travel agent bookings is 7% higher than the fee Sabre charges the three owners of Worldspan – even without taking into account the 10% discount Sabre has offered each of those three. Indeed, most of the booking fee increases to which the airlines object were imposed when the CRSs were owned and controlled by large airlines. Accordingly, many of the most vocal complainers about the level of booking fees today are, ironically, asking for regulatory intervention to correct the alleged abuses that they, and no one else, committed. Despite this bizarre complaint about booking fees by present and past CRS owners, the NPRM nonetheless relies heavily on such allegedly “supracompetitive” fees. The Department, however, made no attempt to determine whether booking fees are in fact “supracompetitive” or even verify the cost of distribution through other channels. The Department acknowledges that it has “made no finding that each system’s booking fees exceed the system’s cost of providing services to airlines.” 67 Fed. Reg. at 69400.

Moreover, booking fee increases have been under 5% per annum. On the other hand, CRS costs have increased substantially because of, among other things, high data processing costs per booking, driven by the pricing practices of airlines, the increasing sophistication of low-fare finding tools used by travel agents and consumers, the much higher “look-to-book” ratios created by consumer shopping (with less than 7% of all shoppers who use the on-line travel agents to look for low fares booking there), enhanced functionality demanded by airlines such as electronic ticketing and interactive pre-reserved seating, Y2K initiatives, which in the case of Sabre cost \$80 million, and intense competition for subscribers. And in the face of complaints that booking fees are too high by American, Delta, and Northwest, the system of which they are the sole owner announced it was increasing airline fees by 2.1%, undermining

Comments of Sabre Inc.
March 17, 2003

any credibility of their claim here that CRS fee increases are not cost justified. Clearly, this is a case of deeds speaking louder than words.

The NPRM's assertion of authority to regulate non-airline owned CRSs has no foundation in § 411 or past interpretations. The Department originally regulated CRSs because of its § 411 authority over air carriers. *See* 14 C.F.R. § 255.2 (rule applies to "air carriers and foreign air carriers that themselves or through an affiliate own, control, operate, or market computerized reservations systems for travel agents . . ."). The rationale offered by the CAB's original CRS rule was that "[n]on-airline CRSs do not have the same incentive or ability to engage" in anticompetitive conduct. 49 Fed. Reg. at 32548. The NPRM now ignores this fundamental rationale for regulation and seeks to include non-airline owned CRSs within the Department's jurisdiction with the argument that CRSs are "ticket agents" under § 411. This assertion has no support in law, reason, or fact. It is contrary to the statutory definition that "ticket agents" must be a "principal or agent"; pursuant to the explicit terms of the CRS contracts with travel agents and airlines, CRSs are neither. The plain meaning of the "ticket agents" term cannot apply to those who do not *sell* tickets (and who do not have "plating" authority through ARC to issue tickets as the agent of the airline). In short, CRSs are just providers of data processing services to airlines and ticket agents. In addition, the Department's arguments that it must regulate systems directly to ensure a level regulatory field and to be "consistent with" U.S. bilateral agreements are without merit because bilateral and multilateral air services agreements are executive and do not, by themselves, confer any authority on the Department. Even assuming they could provide a jurisdictional basis, the Department would first have to show that a provision in one of these agreements had been violated.

The Department's antitrust and economic analyses similarly misinterpret basic antitrust

Comments of Sabre Inc.
March 17, 2003

law, recognized economic principles, and sound policy. It specifically *condemns* CRS services as efficiency enhancing (and incorrectly cites the Supreme Court's *Aspen Skiing v. Aspen Highlands Skiing Corp.* 472 U.S. 585 (1985) decision, which recognized efficiency justifications for business conduct as a complete defense to a monopolization charge¹¹), even though the antitrust laws are designed to protect consumer welfare by encouraging market-driven lower prices, innovations and improved services. The Department's argument also relies on an erroneous view of two faltering doctrines of antitrust – one that requires a monopolist to share its “essential facilities” with others who could not replicate them and another that condemns “monopoly leveraging” of power from one market into another. Indeed, the NPRM extends these doctrines, even as the federal antitrust agencies question them. Twenty years of antitrust law have narrowly limited each theory to situations where anticompetitive effects are clearly shown, something the Department acknowledges that it cannot demonstrate. The NPRM similarly vitiates basic principles of administrative law: its fact assumptions are not based on substantial evidence and thus are “arbitrary and capricious”; its assertion of authority over non-airline CRSs is without foundation in its enabling law and thus is in “excess of statutory jurisdiction”; its policy conclusions are not adequately explained or justified and thus are “arbitrary and capricious”; and its change of long-standing Department policy of regulating only airline-owned CRSs is not justified.

The public, their travel agent representatives, and airlines are protected against any misuse of alleged market power by robust current competition among the four CRSs and

¹¹ At the eleventh hour, in a notice actually published in the Federal Register on March 17, 2003, (68 Fed. Reg. 12662) Department staff attempted to repair their “language errors” by changing the proposition in the NPRM – without, however, changing any of the analysis or conclusions that rely on their erroneously stated proposition. See Section IV.E.1, below.

Comments of Sabre Inc.
March 17, 2003

between CRSs and other distribution channels.¹² The NPRM identifies no market failure in airline ticket distribution or among CRSs warranting government regulation. The asserted travel agent lock-in concerns which may have justified the Department's 1992 rulemaking, have been dissipated by heated competition among CRSs and by a plethora of alternative providers of booking information to agents and their passenger customers. Thus, there no longer is any case for CRS regulation and the airline ticket distribution industry should be deregulated, subject to the caveats stated above.

One CRS (Worldspan) is still (for now) controlled by three major U.S. airlines, which account collectively for over 40% of all passengers carried in the U.S., and which (if their proposed sale of Worldspan does not go through) will be in a position in a deregulated marketplace to distort competition by coercing travel agents to use their system exclusively, thereby excluding CRS competitors and non-airline online agencies from the market. The competitive concern that originally motivated the CRS rules in 1984 – the vertical integration of airlines and CRSs – remains in Worldspan's case. That is, the airline owners of Worldspan, if freed from the rules, could favor Worldspan with low fare and other special content, and other special tools to buy their services, such as advance on-line check in, unavailable anywhere else, and use their dominant position in hub markets to drive travel agents and consumers to that CRS.

Likewise, Worldspan's owners could make it harder for other airlines to compete with them at their hub cities by lowering the charges they pay Worldspan for bookings on their service to zero, or near zero, while doubling or tripling the charge they assess to other airlines to be bookable through Worldspan, which in turn could dominate the hub cities of each of the three owners. In addition, unless restrained by some rules, these three carriers could force Worldspan

¹² KeyPoint, App. 4, pp. 30-40.

Comments of Sabre Inc.
March 17, 2003

to bias its displays to direct incremental traffic to Worldspan's owners' flights rather than to the flights of their competitors, even if such a reordering of displays otherwise made no economic sense for Worldspan or its subscribers. (Independent CRSs have no inherent incentive to take any of these actions.). This conduct would reinforce the dominance of these airlines in their hubs to the detriment of airlines seeking to enter those markets.

The Department should deregulate the relationships between CRSs and subscribers, and between CRSs and airlines, recognizing that vertical integration between certain major airlines and the CRS they own continues to present risks of anticompetitive effects. To achieve this deregulatory end while protecting consumers and travel agents from the abuses that first led to the promulgation of the Rules, the Department and OMB should consider the following options, either separately or in combination:

1. *Complete and final sunset* of all CRS Rules on January 31, 2004; this should allow all contractual relationships to be renegotiated or terminated but, if the Worldspan carriers do not end their control of that system by that date, with appropriate minimum regulatory safeguards put in place (specifically the retention of the mandatory participation rule and the ban on tied selling) to assure that the three large carriers owning Worldspan do not collectively or individually engage in unfair or anti-competitive conduct that would severely damage competition in the airline or airline distribution market;
2. *Forced divestiture* of CRS interests held by major U.S. domestic airline owners to prevent harm to competition through vertical integration (the historic justification for CRS regulation);
3. *Opt-out deregulation with voluntary divestiture*, whereby CRS rules regulating subscriber contracts would be dropped because no lock-in exists and CRS bypass is occurring at a rapid rate; but to prevent a repeat of the competitive abuses of airline-owned CRSs, the Department should retain its core pro-consumer rules (mandatory participation, no tying); under this scenario, CRSs owned by airlines and their airline owners could "opt out" of the remaining CRS regulations by terminating such arrangements.

**Comments of Sabre Inc.
March 17, 2003**

Under any of these approaches, the Department, the Department of Justice (“DOJ”), and the Federal Trade Commission (“FTC”) would retain jurisdiction to prevent violations of the antitrust and unfair and deceptive trade practices laws. Air carriers and ticket agents would be subject to the Department’s oversight for violations of the Federal Aviation Act (“FAA Act”) § 411; DOJ would retain its separate, albeit overlapping authority to proceed against any airline, ticket agent, or CRS for violation of the antitrust laws; and the FTC could enforce § 5 of the FTC Act against unfair or deceptive trade practices committed by non-air carriers (i.e., CRSs or ticket agents).

In this comment, Sabre sets out a history of the CRS rules and the industry practices that gave rise to them. Next, Sabre describes facts about the current air travel distribution market that the Department ignores or misunderstands in formulating its proposed rule. Sabre then shows that the Department lacks the statutory authority to regulate non-airline owned or controlled systems. Sabre next explains how the Department’s antitrust paradigm is outdated and its analysis flawed in analyzing the air travel distribution industry. Then, the Department’s fact finding is shown to have been flawed and indefensible under the Administrative Procedure Act. Finally, Sabre provides specific comments, and numerous requests for clarification to the proposed rules. In support of its position, Sabre has also engaged experts in the field of economics, statistics, and law to provide detailed analysis and explanation of points Sabre raises in these comments. These experts are:

- Steven C. Salop and John Woodbury, Charles River Associates (“CRA”) (examining CRS bargaining leverage);
- R. Preston McAfee and Kenneth Hendricks, KeyPoint Consulting (“KeyPoint”) (examining the evolving market for air travel distribution);

**Comments of Sabre Inc.
March 17, 2003**

- Douglas Wilson, Edwards & Kelcey (“EK”) (examining booking fees); and
- Richard Fahy (“Fahy”) (surveying the background and history of the CRS industry and rules).

II. THE NPRM IGNORES OR MISINTERPRETS CRITICAL FACTS ABOUT AIR TRAVEL DISTRIBUTION.

The NPRM makes numerous incorrect assertions of fact. As pointed out in Sabre’s Petition for Fact Hearing, filed in this docket on December 23, 2002, much of the information on which the Department’s proposals rest is stale or erroneous. In contrast, significant facts about air travel distribution as it operates today have been entirely omitted or brushed aside after cursory acknowledgement. Of particular relevance are facts about the relations between independent CRSs and participating airlines, and between independent CRSs and subscribing travel agencies.

A. Airline Booking Fees.

The NPRM, while admitting it has no factual basis to make such a finding, repeatedly emphasizes its belief that CRS booking fees are excessive. At the same time, with a nudge and a wink, it explicitly acknowledges that it has “made no findings” that CRS fees exceed costs. 67 Fed. Reg. at 69400. The assumption that fees are excessive is entirely wrong.

Sabre’s effective booking fee for its top-of-the-line service package was \$4.38 in 2002, 2.4% of the average airline ticket price for tickets sold through Sabre. Moreover, CRSs’ interest in obtaining access to airlines’ webfares has triggered significant price-cutting. In October 2002, Sabre began to offer a 10% reduction in booking fees and a three-year price freeze in exchange for giving Sabre and its subscribers (and their passenger clients) a three-year fixed term, additional and/or confirmed access to all content, and providing other forms of non-