

CONSULTATION PAPER

Consultation paper on the possible revision of Regulation 2299/89 on a Code of Conduct for computerised reservation systems

Please note that this consultation commits only the Commission's services in its preparation and that the text is prepared as a basis for comment and does not prejudge the final form of any decision taken by the Commission

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1. INTRODUCTION

1. Computerised Reservation Systems (CRSs)¹ provide customers with instantaneous information about the availability of air transport services and the fares for such services. They permit travel agents, whether brick and mortar or on-line, to make immediate confirmed reservations on behalf of the consumer.²
2. The Code of Conduct for Computerised Reservation Systems (“the Code of Conduct”) was first established in 1989 with the adoption of Regulation 2299/89 on 24 July³. Given that the vast majority of airline bookings were made through CRSs and that most CRSs were owned and controlled by airlines, it was felt that, in order to deal with the competition concerns arising in the supply chain of air transport products, it would be more efficient in terms of transport policy and market efficiency to develop an ad hoc regulatory framework than merely rely on the generally applicable provisions of competition law.
3. The Code of Conduct recognised that Computerised Reservation Systems required a certain degree of regulation in order to ensure that all airlines enjoy the same level of access to travel agents and consumers. It was established with the aim of improving transparency and preventing discriminatory behaviour both by the system vendors themselves and also by airlines, especially those which have a stake in the ownership and control of a CRS. On the one hand, system vendors were required to deal in an even-handed manner with all carriers and travel agents, while, on the other, carriers with a financial stake in a CRS were required not to favour that system over the others. The code also imposed obligations in terms of neutral display in order to avoid discriminatory treatment of airlines on the system’s principal display.
4. The Code of Conduct has been revised twice since 1989⁴. Each refinement of the Code has been intended to further clarify the principles contained in the original, to address problems that have arisen subsequently and to anticipate potential difficulties. The most recent revision also established rules for the treatment of rail transport in CRSs.

¹ Nowadays also often designated as Global Distribution Systems (GDS).

² The companies providing CRS services also provide an increasing number of other IT services, such as the management or "hosting" of the airlines' internal reservation systems when airlines decide to outsource this activity. But they are not the only companies providing these services. An air carrier uses an internal reservation system to manage its own reservation data which comes from various sources, such as its own website, call centres and travel agents connected to a CRS. The "hosting" of internal systems is a strictly separate and distinct service to the CRS services and is not covered by Regulation 2299/89. These services will not be discussed in this consultation paper.

³ OJ L220, 29.7.89, p.1 as amended by Council Regulation (EEC) No 3089/93 (OJ L278 11.11.93, p.1) and Council Regulation (EEC) No 323/99 (OJ L40 13.2.99, p.1)

⁴ It has been revised by Council Regulation 3089/93 (OJ L278 dated 11.11.1993, pages 1 to 9) and Council Regulation 323/99 (OJ L040 dated 13.02.1999, pages 1 to 8). Furthermore, Council regulations 83/91 (amended by Council regulations 3618/92 and 1618/93) and 3652/93 granted a block exemption to certain agreements establishing computerised reservation systems, given that the CRS market was such that few individual European undertakings could on their own make the investment and achieve the economies of scale required to compete with the more advanced systems and that therefore cooperation in this field should be permitted. The block exemption expired on 31 December 1998.

5. Since the last change to the Code of Conduct, the airline distribution market has known important developments: most airlines have divested from their participation in CRSs – although some airlines still hold minority ownerships - and alternative distribution channels are gaining ground, mainly due to the development of direct Internet sales.
6. In recent years, other regulatory authorities, namely Canada and the United States of America have reviewed their respective rules regarding Computerised Reservation Systems. Both had a regulatory framework applicable to CRSs quite similar to the EU Code of Conduct. The US opted for a total liberalisation, whilst Canada opted for a partial but still far-reaching de-regulation.

2. EARLIER CONSULTATIONS AND STUDY

7. Stakeholders and stakeholder groups from the airline industry, the railroad industry, the computerised reservation systems, the travel agency industry and the consumers of air transport services were consulted in 2002. These stakeholders were consulted throughout the year 2002 and in particular on four multilateral consultation meetings with all stakeholders. These were respectively organised on 16 April 2002, 10 July 2002, 10 September 2002 and 16 December 2002.
8. In December 2002, the services of the Commission commissioned an impact study of these proposals. That resulted in a further prolongation of bilateral consultations in that the consultant conducting the study – the Brattle group and Norton Rose - entered into a series of interviews and meetings with stakeholders.
9. The study was completed in October 2003. The full report of the consultants has been published on the Internet at the following address: http://europa.eu.int/comm/transport/air/rules/index_en.htm.
10. During this previous consultation process, a general consensus among stakeholders emerged that the existing Regulation is overly detailed, prescriptive and complex. Furthermore, it was felt that such a detailed regulatory framework was not appropriate and limited further development and adaptation to market needs in respect of a fast changing industry, undergoing important economic and technological evolutions. However, there were large differences of view on how the Regulation should be revised, especially with regard to the role of the "parent carriers" (air carriers that own or control a CRS).
11. The report by the Brattle group and Norton Rose concluded that there was scope for a gradual return to market mechanisms in the CRS market. But the report recommended to keep certain safeguards in the presence of vertical ownership relationships between airlines and CRS providers, especially in those markets in which the parent carrier and the CRS a) both have a large share of their respective markets and b) are in a position to maintain or gain market power in the airline market, the CRS market, or both. The consultants concluded that if these two conditions are fulfilled, the risk of competitive abuse would be too high to fully deregulate the market. The report mainly pointed to Amadeus and its owner-airlines - Air France, Iberia and Lufthansa – and their strong positions in their respective home markets.

12. The report by the Brattle group recommended an option of partial deregulation where greater price freedom with respect to booking fees is introduced, but where specific obligations with regard to the parent carriers – mandatory participation in all CRSs and non-discrimination requirements – are maintained.
13. The consultation revealed important differences of view between stakeholders concerning the revision of the Code of Conduct. There was no consensus on the option recommended by the Brattle and Norton Rose report. Therefore, the Commission did not immediately propose a revision of the Code of Conduct, but awaited that the rapidly changing market conditions would allow stakeholders to re-assess their positions under the new circumstances.

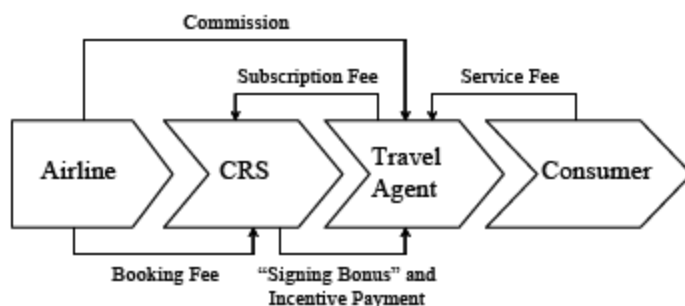
3. OBJECTIVE OF THE PRESENT CONSULTATION PAPER

14. As the present consultation paper will show, the CRS market has undergone important changes since the previous consultations and the publication of the Brattle and Norton Rose study. These changes have a growing impact on the competitiveness of European airlines and CRS providers.
15. These market changes call for a re-examination of the Code of Conduct with the aim to introduce more efficiency into the European airline distribution market. However, given the changed context since the previous consultations, a new consultation round seems appropriate to give stakeholders the opportunity to express their views with regard to the market developments and required changes to the regulatory framework.

4. MARKET CONTEXT AND LATEST DEVELOPMENTS

4.1. The flow of payments in the travel distribution market

16. CRSs act as intermediaries between the airlines and the travel agents. There are currently four major CRS providers active on the European market: Amadeus, Sabre, Galileo and Worldspan (the two latter recently announced their merger).
17. A few years ago, before the most recent changes to the market, the flow of payments in the CRS market could typically be represented as in this figure (source: Brattle and Norton Rose report).



18. The vast majority of the travel agencies rely on only one CRS. The major reason is efficiency: for an agency to use multiple reservation systems, it would have to incur

additional training costs and implement a costly accounting and recordkeeping system to consolidate transactions across systems. Travel agencies pay a subscription fee to rent equipment from the CRS to which they subscribe.

19. As travel agencies avoid the subscription to several CRSs, the CRS providers compete to attract the travel agencies to their system. Therefore, CRS incentive payments to travel agencies had risen over the years. For smaller agencies, the incentive payments could offset at least partially the subscription fee. But for larger travel agencies, which can generate substantial booking fee revenue, the CRSs effectively paid the travel agency to subscribe. However, travel agents claim that, under the pressure of changing market forces, incentive payments have stopped their upward trend and even have started to decrease in the last three to four years.
20. In order to capture all travel agencies, airlines need to participate in all CRSs. This may give the CRS providers significant negotiating power vis-à-vis the airlines. When a travel agency books a ticket using a CRS, the airline pays the CRS a booking fee. The booking fee is a flat charge per passenger per flight segment (the number of segments increases with the number of intermediate stops). Many airlines complain that high payments to the agencies were being compensated by high booking fees charged to the airlines.
21. In an effort to lower their distribution costs, most air carriers have reduced or even scrapped their commission payments to the travel agencies. To offset the loss of the commissions, many travel agencies have begun charging their customers a service fee for air travel transactions.

4.2. The Code of Conduct

22. In the context of air transport liberalisation in the 1980s, the vertical integration of airlines and CRSs gave airline-owned CRSs the incentive and ability to restrict competition in both the airline and the CRS markets. The most pervasive anti-competitive practice was display bias: each CRS could give priority on the display screen to flights operated by its parent carrier, and could give the flights of rival carriers less prominence. CRSs could also provide more reliable and up-to-date information on their respective owner-airlines, because the parent carrier's internal reservation system and the CRS were housed in the same computer ("architectural" bias). In addition, CRSs could impose highly discriminatory booking fees and other access terms on rival carriers, which would raise their direct costs.
23. Parent carriers may have used their own market power to restrict competition in the CRS market. For example, in markets in which a CRS owner-airline had a significant presence, the carrier could limit its participation in, or withhold information from, competing CRSs so as to make the systems unattractive to local travel agents.
24. In response to these competitive problems, the Code of Conduct was adopted in 1989. The Code required all CRSs to provide at least one unbiased display; give all carriers access to their system on non-discriminatory terms; and refrain from imposing certain highly restrictive contract terms on travel agents. The Code authorised CRSs to make booking and marketing data available, but only on a non-discriminatory basis.

25. Subsequent amendments to the Code imposed obligations on other groups, including “parent carriers” (airlines that owned or controlled a CRS) and travel agents. One provision requires parent carriers to give all CRSs the same information with the same timeliness. This “mandatory participation” requirement was designed to prevent parent carriers from restricting competition in the CRS market.
26. The Code of Conduct proved successful in preventing the most targeted exercises of market power. However, key provisions have had the unintended consequence of facilitating the non-targeted exercise of CRS market power. Most importantly, the Code’s non-discrimination requirement stifles price competition, because if CRS vendors provide a discount to one airline, they must provide it to all. Another example is the mandatory participation rule which effectively requires parent carriers to purchase the same level of service from all CRSs, and significantly limits these carriers’ leverage to negotiate better fees and terms from any individual CRS.
27. These unintended effects of the Code have gained more attention in recent years, as air carriers wish to lower their distribution costs. Many air carriers have labelled the booking fees “excessive”, and complained that the Code was doing more to impede competition than to encourage it. At the same time, changes in CRS ownership and technology are gradually eroding the key features of the competitive landscape for which the Code of Conduct was designed. First, many airlines have divested their CRS ownership. Three of the four CRSs (Galileo, Worldspan and Sabre) no longer have any airline ownership, and airlines only hold a minority share ownership in Amadeus. Second, the Internet, which allows airlines to sell seats directly, is decreasing the CRSs’ role as an essential intermediary.

4.3. The development of alternative distribution channels

4.3.1. The progress of direct bookings

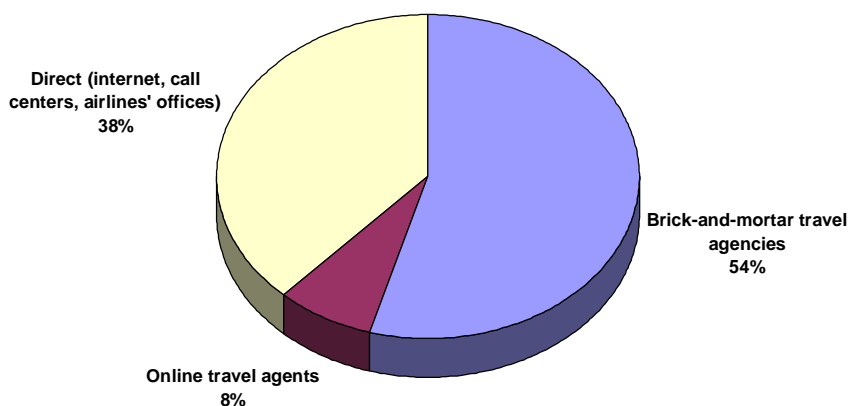
28. CRS services are an input to the retail sale of air travel. Three distinct entities sell air travel on a retail basis: (1) traditional “brick-and-mortar” travel agencies, including tour operators; (2) online travel agencies, including websites associated or not with brick-and-mortar agencies; and (3) airlines themselves, through their reservation offices, call centres and websites.⁵
29. Whereas travel agencies sell tickets for travel on many different air carriers, carriers sell tickets only for their own flights and those of their alliance partners. Brick-and-mortar and online travel agencies are highly dependent on CRSs - to search for flight and fare information, book reservations, and manage client records and agency accounts. Airline distribution channels do not use a CRS at all to sell or book tickets.
30. Thanks to the Internet, the direct selling of air tickets by the airlines via their websites has increased quickly in recent years. Low-fare airlines, that are taking a rapidly growing market share of air travel in Europe, almost exclusively rely on their

⁵ Recently, a number of internet search engines specialised in flight search appeared, especially in the USA. These websites, which search for fares on websites of airlines and travel agencies provide the consumer an alternative way to search for flights. But as these websites do not perform the booking, but rather re-direct the consumer to the chosen airline’s website, they should not be confused with online travel agencies.

website sales. At the same time, the "network carriers" have triggered a shift from their traditional distribution channels towards their websites in an effort to reduce their distribution costs in a context of high fuel prices and mounting competition from low-fare airlines. The Brattle and Norton Rose report already revealed a gradual shift away from brick-and-mortar travel agencies, and a surprisingly high level of supplier direct (*i.e.*, airline) bookings. As the latter do not use CRS, the role of the CRS in total bookings is decreasing.

31. Recent data confirm these market developments. It is generally expected that the shift from indirect channels (*i.e.* via CRS) towards direct channels will continue although at a slower pace: low-fare airlines' market shares are maturing at high levels and – in order to capture the "off-line" customers – may start selling more via indirect channels; but the network carriers still push to develop their direct selling channels.
32. Estimates show that in 2005, direct (non-CRS) sales already accounted for 38% of total bookings in the EU27.⁶

Market share of various distribution channels (% of number of bookings in EU27 in 2005)

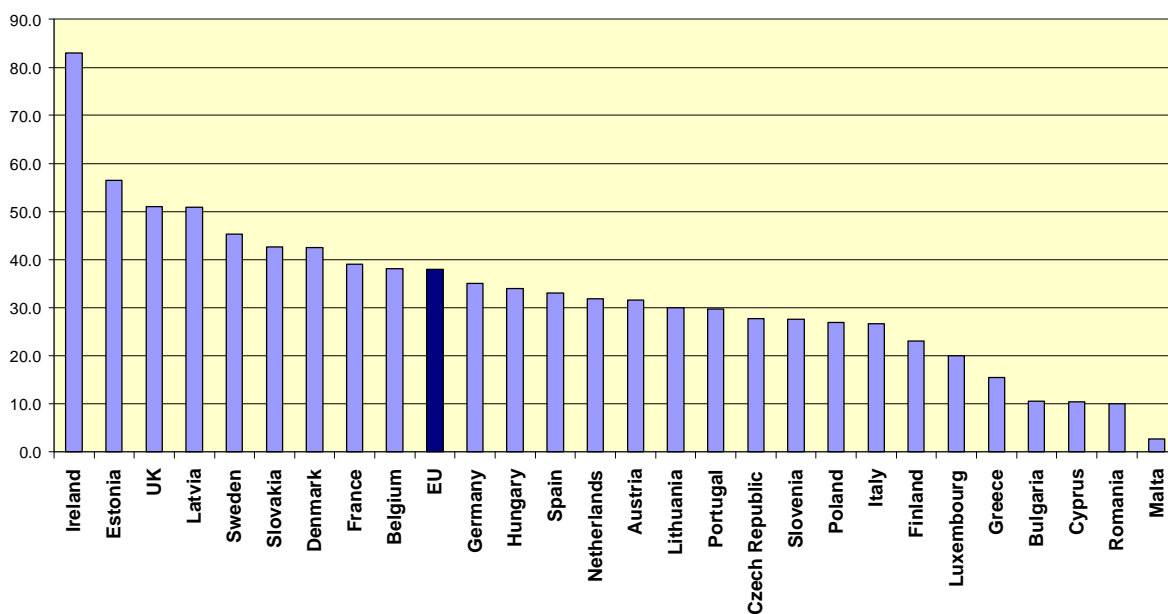


Source: Commission estimates

33. This figure varies quite a lot between Member States depending on the market share of the low-fare airlines and on the internet penetration rate in households and companies: direct distribution channels are best developed in Northern Europe, Ireland and the United Kingdom while in Malta not more than a few percentages of bookings are direct bookings.

⁶ "Bookings" are to be understood as bookings made within the EU irrespective of the place of travel. Estimates of the share of direct and indirect bookings have been calculated on the basis of partial industry data, Internet penetration rates per country, low-fare airlines' market shares in each country and the share of direct distribution for the most important airlines active in each country.

Direct bookings per market in 2005 (% of number of airline bookings)



Source: Commission estimates

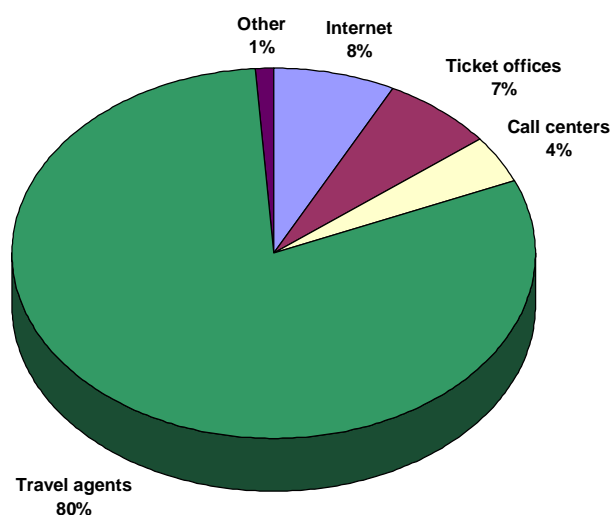
34. While the low-fare airlines distribute between 60 and 100% of their tickets via direct channels, this figure varies between 20% and 30% for most network carriers, although for some of them, the figure is above or below this bracket. The proportion of direct sales is sometimes higher in their home markets – where these companies are generally well known – than in other markets.

4.3.2. Travel purpose and booking complexity

35. Data on the number of bookings may overstate the importance of direct sales in terms of revenue as a higher proportion of high-value tickets are being sold via indirect channels (business travel and complex itineraries). Indeed, as ECTAA⁷ data indicate, the average value of airline tickets sold by the affiliated travel agencies is almost EUR 500. An AEA survey⁸ showed that while the network carriers in 2005 sold 16% of their tickets via their own websites, this only corresponded to 7.5% of overall sales revenue; 80.3% of sales revenue was still generated via travel agents.

⁷ The European Travel Agents' and Tour Operator's Association
⁸ Association of European Airlines (AEA), "Source", AEA market research Quarterly, issue 2/2006

Share of various distribution channels in AEA airlines' revenues



Source: Association of European Airlines

36. These figures show that the importance of the direct channels also depends on the type of traveller where a difference needs to be made between leisure travellers and business travellers. Data indicate that airlines more easily shift the simple itineraries and the leisure travellers to their websites. The same AEA survey showed that 85% of the tickets sold via the websites of the network carriers concerned point-to-point services while only 15% concerned connecting services. And 95% of the tickets sold on these websites were economy class tickets.
37. In contrast to business travellers, leisure travellers are more apt to vary their distribution channel based on the nature of the trip. European leisure travellers typically rely on a brick-and-mortar agency for package tours or complicated travel, because personalised service remains important for handling complex bookings or resolving questions regarding fare restrictions. However, leisure travellers with simple itineraries and ready Internet access more easily use online travel agencies or airline websites.
38. European businesses typically depend on a specific brick-and-mortar travel agency to manage their travel-related accounts. This allows easy tracking of expenses for corporate accounting purposes, and ensures automatic notification of any schedule changes or cancellations. Additionally, brick-and-mortar agencies help business travellers to book complex itineraries and secure special fares.
39. But as recent surveys⁹ show that a growing proportion of business travellers book their travel online, the importance of CRSs is slowly reduced for this type of travellers, too. A growing proportion of business travellers chooses to self-book their trips on the internet and the success of the low-fare airlines contributes to this evolution as more and more business travellers find their way to these airlines (a

⁹ American Express Business Survey 2006 – CWT Business Travel Indicator (January 2006)

recent study¹⁰ showed that business travellers make up to one fifth of their passengers). Still, the market power of CRSs in this market segment should not be understated as although more than half of European business travellers use online booking facilities, these are often bookings via the online facility of a specific travel agency and hence are indirect bookings (i.e. they are handled via a CRS).

40. Overall the figures indicate that airlines may be gaining market power vis-à-vis the CRSs. This is certainly true for the low-fare airlines which use the CRS services only for a small proportion of their bookings, although this might be increasing. Network carriers are more dependent on CRSs, especially for business travellers which make up almost half of their passengers. Still, the growing proportion of direct-booking business travellers and the higher proportion of direct-booking leisure travellers may give the network carriers more leverage in their negotiations with the CRSs although the situation varies a lot between carriers.

4.3.3. *The evolution of the CRS market shares*

41. These developments are of importance to assess the market power of the CRSs, generally and individually. Indeed, in terms of CRS bookings only, the dominant position of some CRS providers in some national markets has not eased since the adoption of the Code of Conduct: Amadeus has a large market share in important markets like Germany, France and Spain and in some smaller markets. Galileo/Worldspan has large market shares in the United Kingdom and in some smaller Member States¹¹.
42. When considering all airline bookings, including non-CRS bookings, these large market shares are reduced owing to the development of the airlines' web sales. Indeed, as shown in paragraphs 32 and 33, direct sales are gaining ground and are reducing the individual and collective market shares of CRSs in total bookings.

4.4. **The change of control at the CRS providers**

43. When the Code of Conduct was adopted, the major CRS providers were owned and controlled by airlines. Today, only one CRS provider – Amadeus – still has three airlines as minority shareholders (Air France/KLM, Iberia and Lufthansa).
44. Galileo became a public company in 1997, when its American and European airline-owners sold 37 percent of their equity in a public offering. They sold an additional 37 percent in 1999, leaving United Airlines as the sole airline-owner. In 2001, Cendant Corporation, which has no airline affiliation, purchased the entire company. In 2006, Travelport including Galileo was acquired by the Blackstone group.
45. Until 2003, Worldspan was 100 percent owned by three US airlines: Delta (40 percent), Northwest (34 percent), and American (26 percent). In 2003, Citigroup Venture Capital Equity Partners (CVC) and Teachers' Merchant Bank purchased Worldspan from its three airline-owners. In December 2006, the merger of Galileo's parent Travelport with Worldspan was announced.

¹⁰ No-Frills Airlines: Revolution or Evolution? A Study by the Civil Aviation Authority (UK), 2006

¹¹ Data on country-to-country market shares of the CRSs were provided to the Commission on a confidential basis and cannot be disclosed.

46. Sabre was developed and owned for many years by American Airlines. American sold close to 20 percent of its interest in Sabre in a 1996 public offering, and the remainder in 2000. Until December 2006, Sabre was a stock-listed company when the capital investors Silver Lake Partners and Texas Pacific Group announced their intention to acquire Sabre.
47. Until 2005, Amadeus was controlled by three of its founding airlines: Air France, Iberia and Lufthansa. This was still the situation when the Brattle report was produced. However, the control structure at Amadeus changed in 2005 with the entry of two capital investors – BC Partner and Cinven – in the capital of Amadeus.
48. Before the entry of BC Partner and Cinven, the three airlines owned together about 47% of Amadeus' capital but which gave them about 86% of the voting rights. Today, the three airlines hold 46.4% of the capital¹² (Air France/KLM 23.2%, Lufthansa, 11.6%, Iberia 11.6%), but the voting rights have been reduced in proportion to the share in capital. BC Partner and Cinven hold 52.7% of the capital and of the voting rights. The remainder of the capital is held by other investors (1%).
49. Hence today these airlines hold minority ownerships in Amadeus. Although they still hold financial interest in the company, their say over Amadeus has been significantly reduced.
50. In Europe, national flag carriers historically owned the national marketing company (NMC) that promoted the most prominent CRS in their home market. For example, Lufthansa owned Start Amadeus, the German distribution system for Amadeus, and Alitalia owned Galileo Sigma. Today, most European airlines have sold off their ownership of the NMC to the CRSs. However, a few flag carriers still have stakes in the NMC. Specifically, Finnair, Estonian Air and CSA Czech Airlines own a share of the Amadeus NMC in their home markets. Similarly, Austrian Airlines, Malev and Olympic Airways are part owners of the Galileo NMC in Austria, Hungary and Greece respectively.

4.5. The liberalisation of the CRS market in the USA

51. In 2004, the US Department of Transportation (DOT) decided to eliminate all the rules governing the computerised reservation systems. The rules were gradually phased out until 31 July 2004 when all remaining rules were lifted. The DOT justified this move first by the fact that the US system providers were no longer owned by airlines and that Amadeus' market share was too small in the US to present a risk of abuse. Second, the DOT referred to the development of alternative distribution channels and the availability of information and booking facilities over the Internet; the market would sanction any improper behaviour by the CRS systems.
52. The liberalisation of the CRS market in the USA is of importance for the European airline distribution market, at least for two reasons. First, it provides precious information about the behaviour of market actors in a liberalised environment, even if the market conditions in the US differ somewhat from those in the EU. Second, the change of market model observed in the US is having effects on the EU market, too.

¹² According to information provided on the Amadeus website (<http://www.amadeus.com/amadeus/x8150.html>).

4.5.1. *Change of the market model*

53. In 2006, the liberalisation started showing its full effects as transitional agreements signed in 2004, the so-called direct connect access three-years (DCA3) agreements between the airlines and the CRSs, came to expire. During the renewal talks that took place in the course of 2006, the CRS market model started to change in the USA.
54. Indeed, the traditional market model where the flow of payments goes from the airlines to the CRS and then to the travel agents (see paragraph 17) is being challenged by the most recent agreements. The lifting of the CRS rules has given the airlines the possibility to freely negotiate with the CRSs on the fares content they provide. This enhanced negotiating power allows the airlines to obtain booking fee reductions from the CRS providers.
55. The CRS providers offer full-content deals in exchange for reduced booking fees. For the CRSs, it is very important to secure access to the airlines' full content in order to remain competitive vis-à-vis other CRSs in securing travel agent adherence. On the other side of the market, the travel agents are then given the possibility to "opt-in" into these full content programmes by paying a charge for each booking (which is deducted from their possible incentive payments). By "opting in", the travel agent is assured access to the airline's full content and that the airline will not impose a surcharge on tickets issued by that travel agent.
56. In order to promote the full-content deals with the CRSs and the attached opt-in programmes for the travel agents, the airlines define these programmes as their "preferred booking channels". They impose a booking surcharge on travel agents that do not use these preferred channels and may reduce content accessible on the non-preferred channels.
57. In the face of reduced incentive payments, reduced or even lifted commission payments and higher booking charges, the travel agents may increase their service fees to the consumers. Indeed, travel agents (this is especially the case for SMEs), that have already seen their margins reduced by the change of remuneration model (from airlines' commissions to service fees charged on customers) may not be able to adapt to further increases of their costs and may have to pass on to customers the extra cost for the access to full content.
58. This market evolution has led to a reduction of the CRS booking fees in the US. Press comments point to a reduction in the range of 20 to 30%. Although the introduction of per-segment charges on the travel agents indicates a transfer of the booking costs from the airlines to the travel agents, we do not have evidence whether the full costs have been passed on by the CRS.
59. The changes in the market also encouraged some of the bigger travel agencies to develop direct booking tools. New technologies allow them to establish direct links to airlines and to by-pass the CRS. While these developments are still in the

beginning, they may provide more market power to the travel agents in the long term, at least to the bigger ones.¹³

60. So far, the feared "content fragmentation" has not been observed on a general scale. Indeed, it was feared that the CRS deregulation would lead to airlines not offering the same content on each of the CRS in which they participate. In that case, travel agents - and their customers - would not have had access to all the fares of all the airlines and may have been compelled to use more than one booking channel. But the development of the full-content programmes rather indicates that the deregulation may predominantly have been translated into lower booking fees and incentive payments instead of content fragmentation.

4.5.2. *Impact on the EU market*

61. The liberalisation of the CRS market in North America seems to have affected the EU market in two ways. First, it may have improved the competitive situation of US airlines vis-à-vis their European counterparts. Second, there is growing pressure from the airlines to obtain similar "deals" in the EU as in the USA.
62. Almost by definition, US airlines have their largest market share in the US. Therefore, the reduction in booking fees in the US reduces these airlines' distribution costs compared to those of their European competitors.
63. The liberalisation of the US CRS market may have provided a competitive advantage to the American CRS providers, too. CRS providers tend to enter into "global" deals with the airlines, covering the whole of the world. Thereby, American CRS providers may have given large discounts for bookings on the US market – where they have large market shares - to compensate for the fact the EU Code of Conduct does not allow discounts on bookings in the EU. A CRS provider with a small market share in the USA may not be able to provide the same deal as he cannot compensate the higher fee on EU bookings by a lower fee on the limited number of US bookings it handles.
64. The market changes across the Atlantic may have affected the way airlines negotiate with CRS providers, even in Europe. There are signs that airlines are putting more pressure on the CRS providers to lower the booking fees in Europe, but the Code of Conduct's ban on individual discounts limits their ability to obtain these reductions. Some airlines may increase the pressure by considering to define preferred CRSs and to introduce surcharges on travel agents for bookings via other CRSs.¹⁴

5. **THE SPECIFIC SITUATION OF THE TRAVEL AGENTS**

65. While the previous chapters mainly deal with the relations between the airlines and the CRS providers, the following two chapters pay more attention to the situation of the travel agents and, last but not least, the consumers of travel services.

¹³ It must be noted that the specificities of each EU country and the small size of the markets in Europe may render such systems economically unfeasible in Europe.

¹⁴ Article 8 of the Code of Conduct prohibits this practice for parent carriers.

66. With the development of the Internet, the travel market is evolving quickly. The sale of all kinds of travel products (flights, hotels, package tours, car rentals, etc.) over the Internet is growing strongly: Internet sales increased by 34% in 2005 and represent 10.3% of the overall travel market¹⁵. There is also a trend among holiday makers to growingly self-book their holidays on the Internet, i.e. flight and hotel, especially as low-fare airlines fly to the most popular holiday destinations.
67. The traditional travel agencies need to adapt: they diversify their offer, they introduce more flexibility into travel packages, they search for niche markets, they develop their own websites and, above all, they strive to offer value-added compared to Internet services. This value-added basically translates into the consolidation of the travel information from several booking channels (e.g. CRS and Internet) in order to offer consumers a quick and wide range of options.
68. With regard to airline bookings, the travel agents have lost part of their traditional role as the preferred intermediary. As pointed out in chapter 4.3.1, the airlines' websites are very effective competitors when it comes to the booking of simple itineraries. Indeed, the competitiveness of the travel agents resides mainly in the booking of more complex itineraries and in the combination of airline bookings with other travel products.
69. Furthermore, the development of online agencies also attracts a growing number of travellers. Although the number of airline bookings made by online agencies is quite limited compared to the bookings on the airlines' websites, they are progressing quickly.
70. The CRS providers have also adapted to the new market situation and have invested in some of the most important online travel agencies: Amadeus with Opodo, Sabre with Travelocity and Lastminute, and Galileo with Orbitz and Ebookers. These online agencies represent almost half of the online market in Europe.
71. In summary, the market situation is such that the traditional travel agents are already under pressure to adapt. In this market, size matters: larger travel agents are in a better situation to negotiate with the airlines and with the CRS (e.g. incentive payments and commissions). Larger travel agents may also benefit from economies of scale in developing or acquiring information systems to consolidate the information from various booking channels. Therefore, it is not surprising to observe a consolidation in the travel market where the average size of the travel agencies increases over time and where the number of small and independent travel agencies diminishes.
72. The US experience of a liberalised CRS market seems to show that the reduction of commission payments by the airlines and of incentive payments by the CRS providers does not fundamentally alter the already on-going market evolution, but that it may enhance the consolidation process as bigger travel agents can negotiate better deals and are in a better financial situation to adapt their information systems to the changing market context.

¹⁵ Trends in European Internet Distribution of Travel and Tourism Services, Carl H. Marcussen, Centre for Regional and Tourism Research, April 2006 (<http://www.crt.dk/uk/staff/chm/trends.htm>)

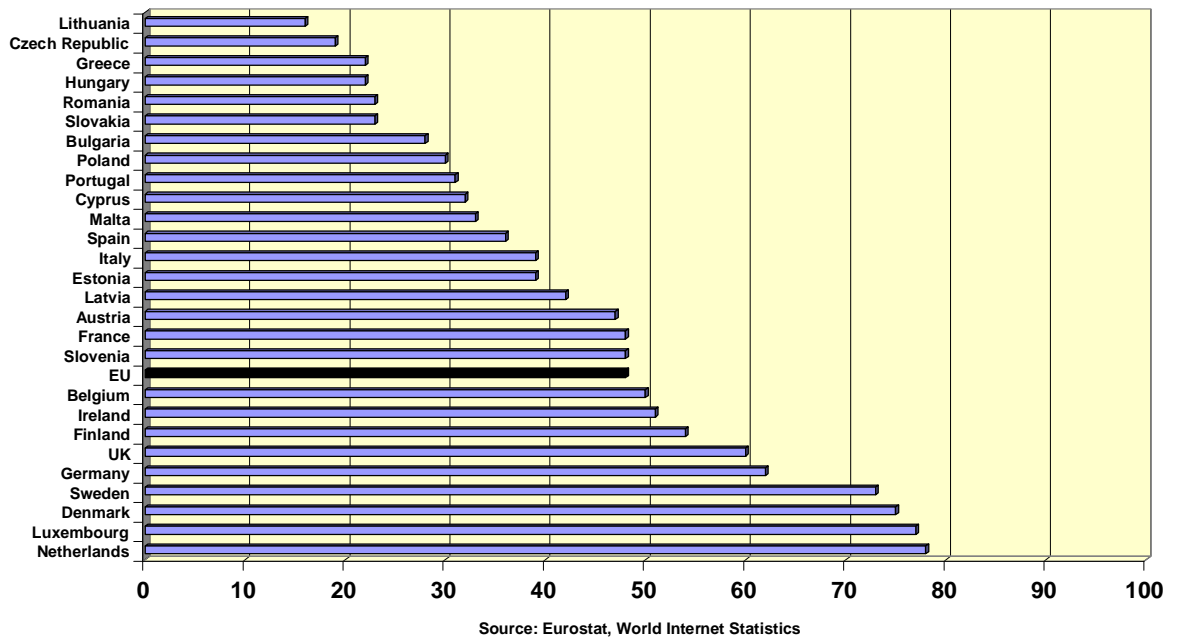
73. Competition between the CRS providers remains real: even if the incentive payments are reduced, the CRS will have to compete more on other aspects such as technology, functionality and especially content. Content or access to airlines' fares remains a central concern of the travel agents. If airlines chose to withdraw from some CRSs, it would reduce travel agents' choice of the CRS system and it may force them to use multiple booking channels with the higher operational costs involved. However, as the US experience shows, airlines seem reluctant to go this way as the CRS systems are still their main distribution channels. The airlines rather seem to use their increased market power to force down the booking fees for their lowest fares for which the Internet is a credible competitor and for which the booking fees are relatively higher compared to the value of the ticket. While complete CRS withdrawal looks very unlikely, travel agents' fears with regard to content fragmentation should rather be assessed with regard to the possibility of partial withdrawal (of low web fares).
74. The Brattle and Norton Rose report contained a specific chapter on **marketing information data tapes** (MIDT). CRS providers sell MIDT, principally to the larger participating airlines for use in marketing, route planning, yield management and other activities. Because the information is highly detailed, it allows an airline to monitor the demand for travel on rival carriers and maintain tight control over individual travel agents. The airline receives a complete breakdown of the travel agent's sales by destination, by airline and by fare class.
75. The possession of the commercial information of the travel agents enhances the airlines' bargaining power vis-à-vis the travel agents. It may even allow airlines to impose incentive schemes to travel agents. Payments are then based on the agency's ability to meet an agreed-upon target for bookings on a particular airline. The target is generally expressed as a share (say, 30 percent) of the agency's total bookings or as some increment (say, 10 percent) above last year's bookings for that airline. Because these incentives are voluntary payments that allow an airline to influence how much business a travel agent directs to it, they are more problematic from a competition standpoint than usual base commissions, which are independent of market share (and which tend to zero in recent years). Indeed, the incentives may transform a travel agent from a neutral seller's agent to a direct distribution agent for a particular airline - but with no disclosure to the consumer.
76. The Brattle and Norton Rose report discussed a policy option that would consist in eliminating travel agent identifiers from MIDT, so that airlines cannot pressure travel agents to reduce rival bookings. This option also would make it more difficult for carriers to implement the type of incentives schemes mentioned above.

6. THE CONSUMER OF TRAVEL SERVICES IN THE NEW MARKET CONTEXT

77. The discussion concerning the competing booking channels should not divert the attention from the ultimate beneficiary of the services: the consumer, be it the individual citizen or the business traveller. Whatever booking channel is chosen, its sole reason of existence is to offer airlines' transport services to the consumer. And the latter is the one who ultimately pays for the services offered, including the distribution cost.

78. The citizen wishing to travel by air basically wants to be able to find the most adequate travel option at the best price. The criteria of choice may be different between the two categories of consumers: while leisure travellers pay more attention to the price than travel time, the business travellers typically look first at the fastest connection and then at the price. But in both cases, the costs of the distribution of the air tickets - which are ultimately charged to the consumer - should not be excessive and the consumer should have access to a neutral and transparent choice of travel options.
79. Until the development of direct distribution channels, the travel agent was the obliged intermediate for acquiring air transport services. The Code of Conduct imposes on the CRSs to provide the travel agents with a neutral and unbiased principal display. It also forbids travel agents "*to manipulate the information provided by a CRS in a manner that leads to inaccurate, misleading or discriminatory presentation of that information to the consumer*" (article 9a).
80. This way, the Code of Conduct ensured that the neutral information received by the travel agents was adequately relayed to the consumers and that the latter received a comprehensive and neutral view of their travel options. However, the present market context may have changed the efficiency and adequacy of this measure:
81. First, the low-fare airlines – which now represent a significant proportion of air bookings – often do not participate in the CRS and if they do, they often do so at a low level of service. The travel agent that would only rely on his CRS display may not inform the consumer of the perhaps more interesting low-fare offer for the trip under consideration. Furthermore, traditional network carriers may also opt to offer promotional fares only via their Internet website as the CRS fees are proportionally highest for low fares. Given the competition in the travel market, numerous travel agents do inform the consumer of the low-fare options (and may book on his behalf via the Internet, but by charging an additional service fee). But it is the competition and not the Code of Conduct that pushes travel agents to offer these options.
82. Second, a quickly growing proportion of consumers and businessmen are aware that a search via the Internet may provide precious information on their travel options, especially for simple itineraries. Even if the Internet search may still result in a booking via any of the existing booking channels (airline website, on-line travel agent, brick-and-mortar travel agent), the Internet has become a powerful tool in the hands of consumers and businessmen in order to obtain information on their best travel options.
83. There are limitations. Not all consumers have access to the Internet. Only half of the EU households currently have Internet access (compared to 69% in the USA). This proportion varies strongly between Member States, ranging from only 16% in Lithuania to 78% in the Netherlands. Furthermore, in terms of fast Internet connection, only 23% of EU households had a broadband Internet access in 2005.

Proportion of households with Internet access (2005)



84. It must be noted that the internet penetration in households is increasing at a high pace: it has trebled over the last five years. Therefore, it can be expected that a growing number of households will have the opportunity to use the Internet when searching for the best air travel options. But these figures also indicate that there is still a significant proportion of consumers, especially in Southern Europe and in the new Member States, that depends on the brick-and-mortar travel agent for the purchase of travel services and that have a direct interest in ensuring the travel agents' neutral and unbiased advice.
85. The distinction between business travellers and leisure travellers (see chapter 4.3.2) is also of importance at this stage. The internet penetration for businesses is significantly higher than for households. Indeed, 91% of European companies have access to the Internet (63% broadband). Between Member States, the range goes from 75% (Latvia) to 98% (Finland). These figures indicate that, despite businesses' tendency to use the services of travel agents (see §43 and 44), the Internet does provide a viable (even if under-used) alternative booking channel, especially for simple itineraries. The growing number of business travellers on low-fare airlines seems to show that Internet booking may not be an obstacle for businessmen.
86. Does the Internet provide neutral and unbiased information on air travel opportunities? On the one hand, it may be argued that competition will ensure neutral information as consumers will avoid providers of biased information (be it websites or travel agents) as soon as they become conscious of the bias by comparing with other providers. On the other hand, experience shows that consumers of travel services typically consult only a limited number of Internet websites before making up their mind and they may not be aware of possible bias. For example, the new breed of Internet travel search engines may charge the airlines for a favourable display once they become established brands among Internet users.

87. It is open to debate whether the absence of neutral display prescriptions would not result in a similar behaviour by the CRS providers where favourable display positions would be offered to the highest bidder. Following the CRS deregulation in the United States, there have been cases where CRS providers have biased their principal displays against a particular airline in order to force access to its entire fare content. The question is whether competition between the different booking channels is sufficient to contain this kind of behaviour to an acceptable minimum.
88. While increased competition throughout the distribution chain should reduce the ultimate cost to the consumer, the latter may not be aware of it as he is unable to tell in how far this has been translated into lower air fares that compensate for higher service fees. Still, these service fees will raise the consumer's awareness of the distribution cost and favour bookings via the Internet where the service fees are mostly lower.
89. It is also important to be noted that greater price freedom for CRS services would allow reducing the booking fees for the lowest fares and thereby attracting "web fares" back to the CRS displays. If this would lead to an increased offer by low-fare airlines on the CRS, it would also benefit those consumers that do not have access to the Internet or who are less acquainted with its use.

7. THE FUTURE EVOLUTION OF THE AIRLINE DISTRIBUTION MARKET

90. Any change to the regulatory environment of the airline distribution market needs to take account of the likely future evolution of the market. Therefore, the major trends in the industry are briefly discussed.
91. Although the dominance of CRS in airline bookings has been reduced by the development of direct distribution channels, especially via the Internet, it seems they will remain the main providers of travel distribution services.
- Low-fare airlines, after their tremendous growth over recent years, have matured in their new point-to-point markets and are gradually moving into the "traditional" market of the network carriers by trying to attract more business passengers and flying to major airports in addition to the regional ones. Some of them are starting to offer connecting flights. In order to tap into the market of the costumers of traditional travel agents, the low-fare airlines may be increasingly interested in the participation in the CRS.
 - At the same time, a growing proportion of the bookings of network carriers will move to their websites. Today, the network carriers typically sell between 10 and 30% of their tickets via direct distribution channels. Within the next few years, this figure could increase for most of the network carriers.
 - On-line travel agencies represent currently between 7 and 10% of all air ticket bookings. However, their strong growth rates may lead to a doubling of their market share over the next five years. They represent serious competitors to the airline websites. As they are mostly "CRS-powered", they will help the CRS to partially offset the loss of market share of the traditional brick-and-mortar travel agencies.

- The combination of these trends should result in a further progression of the direct booking channels, but their rate of progression may gradually slow down, especially if booking fees were reduced.
92. Internet penetration is likely to continue to increase. Indeed, the high growth rates of internet access in all countries show that a growing number of citizens will have access to this distribution channel.
 93. For some time, some market observers placed high hopes on the development of new distribution companies, the so-called GNEs (GDS New Entrants). Airlines hoped that these companies could offer via new technology a kind of "low-cost CRS" that would compete with the established CRS providers. Today, the GNEs still represent an insignificant part of the distribution market. But their advent is not without impact on the industry: by offering more flexible solutions to adapt to airlines' evolving sales strategies, the GNEs at least contributed to pushing the traditional CRSs in adapting and modernizing their tools. Today, these companies rather focus on competing in the market for IT services to airlines, such as the internal reservation systems, and on developing complementary systems that would coexist with the traditional CRSs.
 94. We are likely to witness further horizontal and vertical consolidation in the travel market. The number of CRS providers will be reduced from four to three by the merger of Galileo/Travelport and Worldspan. Consolidation may also take the form of agreements between existing CRS providers in order to reinforce their market power, for example by sharing fare content. Horizontal consolidation is also visible amongst online and brick-and-mortar travel agencies. The presence of the CRS providers in the online travel market illustrates the vertical consolidation between CRS and travel agents. Furthermore, vertical consolidation may lead to airlines, travel agents and CRS providers belonging to the same company groups. This phenomenon is not specific to this sector and is being dealt with by general competition rules.
 95. Furthermore, the development and the use of new technologies will give rise to new forms of distribution where the content of several airlines may be presented directly to the end user, such as for example common Internet websites developed by airlines that are members of a same alliance. While these will not be CRSs in the sense of today's Code of Conduct, there will have very similar features and may be owned by groupings of airlines.

8. RAIL SERVICES IN CRS DISPLAYS

96. The Commission is committed to the promotion of intermodal goods and passenger transport as a matter of priority. In its White Paper on the Common Transport Policy¹⁶, it identified information and ticketing systems as the first means to promote intermodal/multimodal passenger transport.

¹⁶ European transport policy for 2010: time to decide, 12 September 2001, COM(2001)370. The importance of inter-modality has been confirmed by the Commission Communication COM(2006)314 of 22 June 2006 (Keep Europe moving – Sustainable mobility for our continent – Mid-term review of the European Commission's 2001 Transport White Paper).

97. The existing provisions of Article 21b of the Code of Conduct already provide for the possibility to include rail services in the principal display of CRSs commonly used in aviation. In doing so, these provisions refer to the provisions applicable in respect of air transport. However, the existing provisions with respect to non-discriminatory fees significantly reduce the interest of CRSs for rail services. In practice, only a few high-speed services have found their way into the CRS displays, such as Eurostar services.
98. Although the revision of the Code of Conduct cannot provide for a global solution with regard to the numerous technical difficulties at stake, it may help to relax some of the regulatory constraints imposed on CRSs in respect of their relationship with railway operators. This would favour the development of innovation and market driven initiatives.
99. Greater pricing freedom, i.e. the alteration or abolition of the current rule of non-discriminatory fees that in practice imposes the same fees on railway bookings as on airline bookings, would allow the railway companies to negotiate fees with the CRSs that are better related to the price of the ticket. Indeed, as railway tickets are on average of less value than airline tickets, the rule of non-discriminatory fees imposes proportionately higher fees on railway tickets and renders the CRS bookings less interesting for rail services.

9. QUESTIONS TO STAKEHOLDERS

100. In view of a possible revision of the Code of Conduct, the Commission invites all stakeholders to give comments on the following issues:

On a general level:

Q1. In the light of the described market developments, is there still a need for the sector-specific competition rules imposed by the Code of Conduct? Or should the Code of Conduct be revised or abolished?

Q2. Given the described market developments, has the risk of market foreclosure not reduced and are general competition rules (Article 82 of the Treaty in particular) not a sufficient remedy/deterrent against these risks?

On a more specific level:

Q3. Would the air transport distribution market - including small and medium-sized companies involved in the market - be ready for the introduction of greater pricing freedom (such as through the removal of the rules of non-discriminatory fees given in article 10)?

Q4. Given the changes in the market and in the ownership and control structures of the CRS providers, are the specific obligations imposed on parent carriers still needed? Or should these obligations be reviewed or lifted?

Q5. Should airlines remain free to invest in CRS providers and control them or should there be rules that restrict the possibility for airlines or other sectors to control CRSs? Are specific transparency requirements needed for CRS providers that are not publicly listed on a stock exchange?

Q6. Are the provisions given by article 6 of the Code of Conduct to make the data from Marketing Information Data Tapes (MIDT) available to groups of airlines and subscribers still pertinent in the present market context?

Q7. Should travel agents' identity no longer be revealed in the MIDT?

Q8. Are the Code of Conduct's detailed prescriptions with regard to the principal display of a CRS still pertinent in the present market context? Are they still required to ensure a neutral choice? Or can they be simplified or removed? In case stakeholders favour a simplification or removal of these prescriptions, could they – where possible - quantify the reduction in administrative costs that such a regulatory change would induce?

Q9. Would greater pricing freedom with regard to booking fees allow more rail services to be offered on the CRS displays? Do we need additional measures to promote the sale of rail tickets via CRSs?

101. Stakeholders are invited to provide comments in writing to this Paper. They are requested to identify the questions to which they wish to reply and send their response to the services of the Commission by **27 April 2007** by regular mail to the following address:

European Commission

Directorate-General for Energy and Transport

Office DM24 5/98

B-1049 Brussels

Belgium

Reactions can also be sent by e-mail to:

TREN-CONSULTATION-CRS@ec.europa.eu

The responses by stakeholders and a summary of responses will be published on the Commission's website. Therefore, responses should clearly indicate whether they are confidential and therefore cannot be published.