



**COMMENTS ON DG TRANSPORT AND ENERGY'S
CONSULTATION PAPER ON THE POSSIBLE REVISION OF
REGULATION 2299/89**

ON BEHALF OF:

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I. INTRODUCTION

This Paper sets out our comments on the DG Transport and Energy (“DG Tren”) Consultation Paper on the possible revision of Regulation 2299/89 on a Code of Conduct for computerised reservation systems (the “Code of Conduct”), published by the Commission on February 23, 2007 (the “Consultation Paper”). These comments are based on our extensive experience in the provision of computerised reservation systems or CRS services in Europe and worldwide. **[CONFIDENTIAL]**

Galileo welcomes the opportunity to comment on the Code of Conduct at this time. Following the publication of the last in-depth study on the travel distribution industry, the Brattle Report,¹ in October 2003 there has been considerable evolution both in the supply of travel information (following the merger of a number of important airlines) and in the distribution facilities with several emerging business models and new technologies. Traditional CRSs have seen their negotiating position eroded both with powerful airlines that supply vital content and with increasingly strong travel agent subscribers. However certain features of the industry are still present, most notably, the participation of a number of flag-carriers in the ownership of the dominant CRS in Europe giving rise to the phenomenon of “double dominance” identified in the Brattle Report in a number of territories. Accordingly, Galileo believes that key rules of the Code are still relevant to the maintenance of an “even playing field” for the industry and should be retained.

The Consultation Paper does not, at this stage, contain any substantive proposals. This shows a positive willingness on the part of the Commission to respond to calls for a review of the Code of Conduct. The following comments are therefore intended to be constructive and to facilitate a move towards sound, practical guidance for all travel distribution industry participants.

II. SUMMARY OF PRINCIPAL COMMENTS

The main points made in this submission are as follows:

- ***Market power of Amadeus.*** While CRSs remain an important distribution channel for travel services, CRSs do not exercise market power as a matter of course.² There is fierce competition between CRSs to recruit travel agents and to obtain content that airlines are increasingly distributing through non-CRS channels. The particular position of Amadeus is exceptional. As DG Tren observes, “*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*

¹ The Brattle Group and Norton Rose, “Study to assess the potential impact of proposed amendments to Council Regulation 2299/89 with regard to computerised reservation systems”, prepared for the European Commission’s Directorate-General for Energy and Transport, October 2003 (the “Brattle Report”).

² See Consultation Paper, paras. 39-40.

*market share in important markets like Germany, France and Spain and in some smaller markets.”*³ Unlike Worldspan, Galileo and Sabre, Amadeus continues to enjoy a dominant position in each country where its parent carriers are flag carriers. Airline ownership of a CRS produces significant network effects vis-à-vis travel agents subscribing to a CRS. Amadeus has maintained and grown its position in Germany, Spain and France, but other CRSs have lost ground to Amadeus in their former parent carriers’ “home markets”. Galileo strongly believes that as long as there is vertical integration between CRSs and airlines there are financial incentives to restrict competing CRSs’ access to content and functionality.⁴ This is why Galileo supports the retention of the rules on mandatory participation by parent carriers. Without the rule on mandatory participation set out in Article 3a of the Code, there is little incentive for Amadeus’ parent carriers to provide content to a competing CRS and no safeguard on the “double dominance” effect on competing CRSs.⁵

III. SPECIFIC COMMENTS

A. OBSERVATIONS ON THE BACKGROUND TO THE CONSULTATION

Galileo will first address a number of issues discussed in the Consultation Paper before replying to the specific questions raised by DG Tren.

The CRS business model in Europe should be evaluated in its own context. It should be underlined that while the situation in the U.S. (full liberalisation) and Canada (partial-deregulation) are useful benchmarks for the purposes of a regulatory review,⁶ the travel distribution industry in Europe should be evaluated in relation to its own specific features.

Unlike the situation prevailing in the U.S. prior to liberalisation, Amadeus continues to be the dominant CRS in the EEA.⁷ Contrary to the claims made at paragraph 49 of the Consultation Paper airline control of Amadeus has not “*significantly reduced*”. In fact, hosting services,

³ See Consultation Paper, para. 41.

⁴ Although the Consultation Paper excludes hosting services from the scope of the consultation (p.3, footnote 2), hosting services do confer significant benefits on Amadeus because it reinforces its vertical integration into its parent carriers and creates additional market barriers. As a result, hosting services are relevant to any review of the rule on mandatory participation.

⁵ See Executive Summary to the Brattle Report: “*Amadeus and its owner-airlines- Air France, Iberia and Lufthansa- have a market presence that borders on “double dominance” in ... France, Spain and Germany... Thus, the concerns raised about the potential for competitive abuse absent the mandatory participation and nondiscrimination requirements are not frivolous.*”

⁶ Consultation Paper, paras. 6, 51-64.

⁷ See Consultation Paper, para.51: “*Amadeus’ market share was too small in the US to present a risk of abuse.*” See too reply to Question 4 below.

special deals, and technological “partnering” are all examples that demonstrate that control over/integration of Amadeus into its parent carriers has increased rather than decreased.

On the other hand, the Commission should not limit itself to the U.S. and Canadian examples in framing its recommendations for CRSs operating in the EEA. An example of an unregulated CRS industry that the Commission might also consider is the Asia/Pacific market where incidents of display bias, architectural bias and discriminatory booking fees are frequent [CONFIDENTIAL]⁸.

The flow of payments has altered since the Brattle Report. As the Commission recognises, the payment model set out in paragraph 17 of the Consultation Paper does not wholly reflect commercial reality today. For example, present-day European carriers sometimes penalize travel agents for placing bookings through a CRS or for not “opting in” to a full content arrangement. Airlines also provide incentives for bookings made through their own distribution channels or their preferred CRS through lower fares or consumer-orientated benefits such as frequent flier miles.

In general, European carriers have ceased paying commission to travel agents. Conversely, CRS financial assistance or incentive payments to travel agents have steadily increased over time as a result of consolidation by travel agencies, dual CRS automation of large agencies and competitive pressures among CRSs for a decreasing number of travel agency customers that book via a CRS.

As noted above, CRSs today do not have “*significant negotiation power*” vis-à-vis airlines or travel agents.⁹ Travel agencies are consolidating, with fewer travel agencies accounting for a larger share of CRS bookings. In addition, there are a growing number of multi-automated travel agencies groups (*i.e.*, travel agencies that subscribe to more than one CRS).¹⁰ The fierce competition between CRSs for a decreasing number of bookings made through CRSs, and the emergence of the supplier.com channel, has further strengthened the bargaining power of travel agents and has led to higher incentive payments. The fees charged by CRSs to airlines are decreasing and do not compensate for rising CRS costs including incentive payments. To avoid paying higher booking fees airlines are actively seeking means to reduce the content supplied to CRSs and to ‘disintermediate’ travel agents.

Galileo anticipates that in the medium to short term travel agents will be required to pay for access to content that would otherwise be distributed by airlines through non-CRS channels. [CONFIDENTIAL]¹¹ [CONFIDENTIAL].

⁸ [CONFIDENTIAL]

⁹ Consultation Paper, para. 20.

¹⁰ [CONFIDENTIAL]

¹¹ [CONFIDENTIAL]

B. RESPONSES TO QUESTIONS TO STAKEHOLDERS

Question 1

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?

Galileo favors a revision of the Code of Conduct but does not support a complete deregulation of the CRS industry. Galileo believes that key parts of the Code should be retained, namely the rules on the mandatory participation of parent carriers in all CRS, and the requirement that CRSs in which airlines have an ownership interest not discriminate between the offers made available to carriers, as set out in articles 3a, 4, 5, 8, and 10 respectively.

While there have been a number of significant changes in the European CRS landscape, most notably the reduction in the number of parent carriers and the emergence of direct booking channels, abuses of market power continue by parent carriers and their affiliated CRS. [CONFIDENTIAL]¹² [CONFIDENTIAL]. Given that Amadeus is still airline-controlled, Galileo is not in agreement with the Commission's view that "*the market context has changed and the regulation now seems to be standing in the way of an efficient functioning of the market*".¹³ Certain features of the CRS industry have changed little since the publication of the Brattle Report:

- Although most airlines have disposed of their interests in CRSs a number of powerful parent carriers continue to operate in the EEA. This makes the situation of CRSs in the U.S. an imperfect comparator for the present study.¹⁴
- *Ex post* remedies alone do not safeguard the rights of European stakeholders. Enforcement of competition law rules is both time-consuming and costly, and provides inadequate remedy to those stakeholders forced to withdraw their services or facing a loss in competitiveness as a result of abusive practices.

In addition, certain recent developments underline the need for the retention of key provisions of the Code of Conduct:

- [CONFIDENTIAL].¹⁵

¹² [CONFIDENTIAL]

¹³ Commission working document, First progress report on the strategy for the simplification of the regulatory environment, COM (2006) 690 final, p.35.

¹⁴ See Consultation Paper, para. 6.

¹⁵ [CONFIDENTIAL]

- The economics of CRSs are increasingly fragile given pressures from airlines to reduce booking fees based on the availability of direct bookings alternatives, on the one hand, and pressures from travel agents to increase financial assistance to maintain the CRS's subscriber base on the other. Amadeus however does not face these pressures to the same extent given the support of its parent carriers.

Question 2

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?

The Code of Conduct operates as a powerful deterrent to abuse of a dominant position by parent carriers and their controlled CRS. Slow and costly *ex post* competition law remedies alone will not safeguard the rights of European stakeholders particularly those forced to withdraw services in affected territories as a result of such abuse. As one commentator put it, *"It's a complicated area and it's much easier for regulations to be enforced in a timely and simple manner where they are specifically defined rather than to rely on competition law which can be both costly and time-consuming for people to try to make a case that way."*¹⁶

Further, competition rules do not in all circumstances oblige parent carriers to participate equally and fairly in competing CRS systems and fines are unlikely to remedy a competing CRS's lost business or loss of market share. Galileo supports the Commission's avowed objective to *"increase market efficiency by giving more room to market forces,"*¹⁷ in the travel distribution industry [CONFIDENTIAL]. In an unregulated environment, parent carriers could also prevent the display of flights from rival airlines on their affiliated CRS. In addition, travel agents, other CRSs, and most importantly, consumers would have no means of detecting instances of content and special route fares withheld from competing CRSs, or where parent carriers have waived fare conditions for Amadeus subscribers. Moreover Article 82 EC could not prevent key travel content from being gradually fragmented along airline /"home market"/low cost lines: this would be highly detrimental to transparency and European market integration.

In the present climate (as outlined above in response to Question 1) where parent carriers withhold and/or threaten to withhold content with increasing regularity it is unlikely that competition rules could provide a timely remedy. Without the mandatory participation rule for parent carriers there is no safeguard as to the quality of services that CRSs can offer.

¹⁶ Deborah Dickens, Senior Manager Global Distribution, British Airways, June 29, 2005, as cited in Galileo/Sabre presentation to the Commission (DG Tren and DG Comp), Maintaining The Obligations Of Airlines Owning CRSs To Treat Fairly The Users Of Other Such Systems of February 19, 2003.

¹⁷ Commission Working Document, "First progress report on the strategy for the simplification of the regulatory environment", COM (2006) 690 final, p.35.

Question 3

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)?

Galileo believes that Article 10 should be retained in so far as it prevents airline-controlled CRSs concluding preferential distribution arrangements with its parent carriers that as-efficient competitors cannot match. Notwithstanding the current rules, certain airlines and flag-carriers in particular frequently leverage their considerable market power to try to reinforce the CRS in which they have ownership rights.¹⁸ CRSs should however offer each of its participating carriers the same opportunities to conclude the same discounting arrangements.

However Article 10 should also reflect the current realities of the travel distribution industry. A degree of pricing freedom already exists as evidenced by the generalised use of full content agreements. Except where abusive, this is a sign that markets remain competitive. The industry, in particular, has always understood that the obligations on CRSs imposed by Article 10(1)(a) do not prohibit airline-specific discounts that reflect the commercial importance and, in particular the volume of bookings on a particular market, of the relevant airline's reach to the CRS. In addition, Galileo believes that the ability to offer flexible pricing options such as "opt-in agreements" in exchange for key airline content and functionality is a commercial necessity where there are an increasing number of distribution options available to airlines, in particular, the possibility of airlines processing their bookings "in-house".

Question 4

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?

Galileo firmly believes that as long as airlines own/control CRSs or maintain vertical integration whether through financial investment or preferential technical/commercial agreements with CRSs, an unregulated level playing field is not feasible and that a strong regulatory deterrent to market abuse is necessary. It is of note that the shareholders of several of the airlines based in

¹⁸ The ability of certain airlines to leverage their market power has increased in the industry consolidation that has occurred following the publication of the Brattle report, e.g., the Air France/KLM merger (approved by the Commission on February 11, 2004), the Lufthansa/Swiss merger (approved by the Commission on July 4, 2005), and in 2006 Iberia's acquisition of 20% of the shares of Clickair. This trend seems likely to continue given the likely acquisition of Alitalia by another European airline (see Lufthansa Eyes European Rivals, News & Business, April 9, 2007) and/or the possible acquisition of Iberia by BA (see BA Considering Trumping £2.4bn Iberia Bid, The Sunday Times, March 31, 2007).

new Member States (that have acceded to the EU since the conduct of the Brattle Report) include Air France-KLM, Lufthansa and Iberia, which have effective control of Amadeus.¹⁹

Regulation, and the mandatory participation rule for parent carriers set out in Article 3a in particular, is necessary until such time as airlines completely divest their interests in and cease to control CRSs. The rule protects consumers (ensuring comprehensive travel agent information), airline competition (preventing any preferential relationship with CRSs), and CRS competition (with Amadeus the dominant CRS).

As has been noted by AEA, *“As long as the airlines have ownership stakes in any of the CRSs, there will remain risks that they could abuse their position in either the CRS market or airline market or both.”*²⁰ [CONFIDENTIAL]

Galileo anticipates that without the Article 3a mandatory participation rule for parent carriers:

- Parent carriers will limit their participation in non-affiliated CRSs undermining the competitiveness and attractiveness of those CRSs to travel agents. Accordingly, travel agents will at best operate dual-CRSs and at worst move to the airline-affiliated CRS. Consumers will have less information and choice and have to pay higher fares.
- Parent carriers will use content in their non-“home markets” as a means of increasing the market share of their affiliated CRS.
- There will be increased content fragmentation because airline-affiliated CRSs will have access to superior content and functionality in respect of their parent carriers.²¹ Confronted with an unassailable double monopoly, CRSs may decide to stop or considerably reduce their efforts in “protected” markets. This risks creating *de facto* CRS monopolies in some territories and render all non-affiliated CRSs merely fringe players.

Galileo believes that given the existing trends in the industry in the EEA the repeal of Article 3a would entail the loss of a vast number of segments from Galileo and other stand-alone CRSs to airline-affiliated CRSs. This would unquestionably raise the costs of smaller competing

¹⁹ [CONFIDENTIAL]

²⁰ AEA White Paper prepared by Oxera, April 2002, as cited in Galileo/Sabre presentation to the Commission (DG Tren and DG Comp), Maintaining The Obligations Of Airlines Owning CRSs To Treat Fairly The Users Of Other Such Systems of February 19, 2003.

²¹ See Consultation Paper, para. 73. See too the numerous examples of content withdrawal and threats of content withdrawal from Galileo set out above.

CRSs and eventually jeopardize the viability of stand-alone CRSs, which would become “second tier CRSs” in many EU countries.

Question 5

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?

For the reasons set out above, and because airlines are the suppliers of vital content for the CRS industry Galileo favors regulating airlines that participate in the ownership of CRSs regardless of whether such airlines, jointly or individually, formally own the majority shareholding (as long as they exercise a significant degree of influence over a CRS). Until such time as airlines withdraw from participation in the ownership of CRSs Galileo supports the retention of a mandatory participation by parent carriers in all CRSs. *See* replies to Questions 3 and 4 above. Where airlines have stakes in CRSs and/or participate in the operations of CRSs this should be disclosed to the Commission to ensure that the obligations imposed on parent carriers under the Code are respected. Further, Galileo believes that its subscribers support retention of Article 3(a).

The reasons for the disclosure of airline ownership in CRSs have previously been advanced by the DG TREN itself in a letter of November 28, 2002, “*In a European air transport market, which remains fragmented, and where incumbent flag carriers often have a very strong commercial position in their home market, this ability given to airlines raises significant concerns in terms of competition for the provision and distribution of air transport services. Moreover it endangers the actual role of independent advisor travel agents may have with regard to consumers.*”²²

Question 6

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?

In general, airlines use MIDT data to negotiate sales and marketing arrangements with travel agents and engage in route planning through booking trend analysis. Further, the increasing trend of disintermediation by the majority of airlines is reducing the relevance of MIDT data to reflect all segments booked on a particular airline. Galileo is not aware of any attempts by airlines to control agents using MIDT data, although sales and marketing agreements with airlines may impact on agents’ distribution and commercial activities.

²² See Galileo/Sabre presentation to the Commission (DG Tren and DG Comp), Maintaining The Obligations Of Airlines Owning CRSs To Treat Fairly The Users Of Other Such Systems of February 19, 2003.

In practice, MIDT data is distributed to “groups of airlines” that are not related through ownership links.²³ Galileo understands Article 6(v) to pertain to airlines that are closely linked and effectively a merged operation. Galileo is opposed to providing MIDT data to a “group” other than on this basis.

Question 7

Should travel agents’ identity no longer be revealed in the MIDT?

See reply to Question 6 above.

Galileo believes that the bargaining power of travel agents vis-à-vis CRSs has not declined. This is evidenced by the steady increase in financial assistance paid by Galileo to agents over time, particularly in territories where Galileo does not have market share. However the bargaining position of travel agents vis-à-vis airlines in the EU has evolved over time and in general airlines do not to pay commissions to travel agents, contrary to the diagram illustrating the flow of payments in travel distribution at paragraph 17 of the Consultation paper.

Question 8

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?

Travel agents, and consequently CRSs’ business, depend on fair and complete access to travel information to provide the widest consumer choice. However in cases of vertical integration normal business incentives are distorted. Articles 3a, 4, and 5 of the Code of Conduct guarantee travellers the best available fares and prices irrespective of airline affiliation of the CRS through which the booking was made. Given the current strong bargaining power of airlines in negotiations with all participants in the travel industry, the pressure from dominant companies such as Air France-KLM, Lufthansa and Iberia to guarantee access to the most valuable content will lead to distortions of the competitive situation on national markets even in the absence of vertical integration between the CRS and the airline. The Code continues to protect the availability of unbiased travel information and to safeguard against content fragmentation. **[CONFIDENTIAL]**

²³

See Commission Preliminary Conclusions & Agenda Items, November 28, 2002 circulated to stakeholders in advance of the consultation meeting of December 16, 2002, point 3. The Commission advocates defining “groups” to include (i) a number of regional airlines that combine resources in circumstances where individual MIDT market data is not available to them, and (ii) airlines that have “formed a very close alliance falling under the EC’s merger rules...airlines which have effectively merged their operations and which plan their market strategy together.”

Galileo further believes that the benefits of retaining the principal display outweigh the costs of the software formula required to comply with the Code. Travel agents value access to full content via a single integrated principal display because otherwise travel agents would need to use multiple sources to gather the same data, and to perform the same functions which would be less efficient and considerably more costly. However, Galileo is aware that travel agents' preferences may evolve over time and CRSs should be able to respond to their display requirements, subject to the safeguard that airline affiliated CRSs are prevented from distorting or biasing their displays to discriminate in favour of their parent carriers.

Question 9

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?

In Galileo's experience Article 21b of the Code of Conduct has not provided European railway operators with sufficient incentive to distribute fares through CRSs. CRS distribution of train fares is widely seen as uneconomical because of the fee parity with airline segments implied by the Article 21 b and in particular by Articles 21b(3)-(6).

It is increasingly common to charge the same fee to airlines and rail operators where the CRS service is comparable in respect of time and cost and if the fare is available on the same screen. However, if there is no direct comparison between services, and due to the difference in the structure of rail distribution (predominantly national, short distance and booked direct) and air distribution (predominantly international, long distance and booked through agents), it may be difficult always to charge the same fee to rail operators.

The fee parity and uniformity implied in Article 21b for airlines and railway operators is a potential obstacle to multi-modal distribution via CRSs because it effectively prices CRSs out of the distribution segment for railway operators. It is therefore necessary for CRSs to have the freedom to negotiate and set fees flexibly with railway operators to reflect the specific value of CRS distribution services to railway operators. In Galileo's experience it is also necessary that these distribution arrangements reflect the differential value (in terms of yield) that railway operators increasingly associate with the elements of their product portfolio (e.g., regional vs. high-speed trains).

There are a number of features that distinguish the distribution of rail tickets via CRS from the distribution of airline tickets:

- Real time inventory is a key feature for rail services offered through CRSs for travel agents to check availability, view seat maps, access seat information, and to provide the ability to print tickets on site or remotely. There is a wide variety of rail tickets and travel agents must be able to print all ticket types.
- There is a growing demand for tickets on departure and travel agents must be able to arrange for customers to collect tickets from machines at major train stations.

- Some distributors, such as Galileo Rail, also integrate with agents' mid- and back-office systems to facilitate the production of management reports and invoices.

[CONFIDENTIAL] Galileo continues to support the 2004 recommendations of the Rail Air Intermodality Facilitation Forum ("RAIFF" initiated and led by DG Tren), which call for the EU to initiate the technical infrastructure necessary for railway operator systems to communicate in a standardized manner with third party systems. In view of the forthcoming liberalization of the European rail market, this is a precondition for effective competition between rail operators. Also, CRSs need to be able to enter into distribution agreements with railway operators with sufficient flexibility in order to accommodate the specific requirements of this mode of transport (set out above) in contrast to airlines.

* * *