UNITED AIRLINES

STAR ALLIANCE

Commission Consultation Paper on the
Possible revision of the CRS Code of Conduct

Comments of United Airlines
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Q1. In 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 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 the risks?

As the Commission recognizes, the EU CRS Code has produced unintended and harmful consequences for passengers, travel agents, airlines, new GDS entrants ("GNEs") and competition. Even if the Code were beneficial when introduced in 1989, which United does not concede, market developments in the intervening 18 years strongly counsel in favour of its elimination. These developments include the creation of alternative sources of airline information, additional distribution channels and new market entrants, and the virtual elimination of airline control of GDS systems.

Post-deregulation experience in the United States illustrates that there are benefits that can flow from deregulation in the EU. In the brief history of U.S. deregulation, booking fees have declined for the first time, new entrants are bringing their services to market and incumbent GDSs are providing more new services than they offered during the two decades of U.S. regulation. The market for GDS services in the United States has not reached a completely satisfactory competitive equilibrium. And United has concerns about some of the vendors' business practices. But deregulation is in its infancy. The legacy of regulation in the United States -- and the persistence of GDS regulation in other parts of the world -- perpetuate a GDS market that gives incumbent providers a high degree of market power over new entrants, airlines and travel agents. With vigorous antitrust enforcement, however, United is nonetheless optimistic that the initial results of deregulation signal genuine progress towards a more competitive market in GDS services.

Part I of this response to questions 1 and 2 of the Consultation Paper examines the unintended yet harmful effects that the Code has had upon competition. Part II demonstrates that the principal arguments advanced against deregulation are unfounded. Part III recounts the benefits resulting from deregulation in the United States, benefits that could equally flow from repeal of the CRS Code in the EU.

I. The CRS Code Distorts Competition

The EU Code creates unnecessary costs, inefficiencies and market distortions unimaginable when the rules were first adopted. The mandatory participation and non-discrimination rules force most airlines, parent or non-parent, to contract with GDSs on terms effectively dictated by GDSs. By ensuring that GDSs had a guaranteed market -- the airlines that owned the systems initially -- the rules had the effect of compelling many airlines that did not have an ownership position to also participate in the systems to ensure that their services were also available to travel agents using the systems. Because travel agencies generally use only one GDS, airlines cannot afford, even for a short period, the loss of market share that would result if they withdrew from any one of the GDSs. Thus, the mandatory participation rule had the unintended effect of forcing non-system owners to participate in all GDSs to avoid losing market share to system owners that are under a legal obligation to participate. In the United States, carriers still find it necessary to participate in all GDSs. As the market adjusts in the coming years, however, United expects that airlines and other participants in the travel and tourism industry will gain the commercial freedom to explore avenues to strengthen their bargaining position vis-à-vis GDSs.

The non-discrimination rule relieves GDSs of the need to negotiate freely with participating airlines based on the value that each party offers the other, including volume of business and quality of inventory. The requirement that GDSs charge their largest and smallest customers the same booking fee alone illustrates the market-distorting effect of the non-discrimination rule. The rule also eliminates the incentive for GDSs to negotiate discounts with an individual airline because the same discount must be offered to all airlines participating in the GDS at the same level of service. In practice, the rule allows GDSs to charge fees higher than they could command in a competitive marketplace. In combination with rules giving GDSs a guaranteed market, the Code has served to enrich GDSs by insulating them from competition on either price or service.

II. The Arguments Against Deregulation Are Unfounded

Several arguments have been advanced against deregulation. None of these arguments support continued application of the Code, particularly in light of market developments, the cost to market participants of perpetuating the regulations and existing protections against anti-consumer and anti-competitive behaviour.

First, deregulation opponents argue that sectoral rules must be maintained to protect consumers from deceptive practices and to avoid anti-competitive behavior. Experience in the United States suggests that this fear is unfounded. United is aware of only one complaint since deregulation three years ago. In 2005, the American Society of Travel Agents complained to the U.S. Justice Department of Justice ("DoJ") and the U.S. Department of Transportation ("DoT") regarding airline ownership of a GNE but withdrew the complaint shortly after it was filed. United is not aware of any contemplated action by DoJ or DoT in this area.

Second, opponents argue that deregulation will lead to content fragmentation – the unavailability of consolidated air service fare and schedule data. Although the Commission recognizes that deregulation has not resulted in fragmentation in the United States, it is United's view that ensuring the availability of consolidated air service and price information is not a legitimate regulatory goal, particularly if the broad objective is to promote competition. Information is critical to a competitive market (whether for GDS services, air services or any other market), but the presence of a single source of information is not the lynchpin of a competitive market. Given the extraordinary increase in the availability of information, the low financial and time costs of obtaining information as well as air carriers' desire to see their services displayed and sold, there is no good argument that GDS or carrier competition is well served by regulation aimed at ensuring a single source of fare and schedule data. If regulators aim to promote competition among GDSs, they need not regulate at all, and certainly should not focus on full content, to achieve this aim.[1]

Third, some argue that the rules should be maintained for the parent carriers of Amadeus to avoid abuse of a dominant position. In particular, the 2003 Brattle/Norton Rose report recommended that the EU retain the mandatory participation and non-discrimination requirements in the parent carriers' home markets. Whatever the merit of this argument at the time, the parent carriers have since divested and now hold only a minority stake in Amadeus and the parent carriers are increasingly subject to competition in their home markets. In United's view, while the parent carriers may benefit as ordinary shareholders, they will be forced to negotiate with Amadeus at arms length in the same manner as the more than 100 other airlines that participate in Amadeus. In a free market with widely available information, travel agents and airlines would have a number of means to pressure any GDS that attempted to engage in market distortion. These include contractual terms prohibiting such conduct and the threat of terminating the commercial relationship.

General competition rules, if vigorously enforced, are a sufficient remedy or deterrent for abusive behavior. Even if parent carriers could leverage their minority ownership to engage in abuse in their home markets, the relevant competition authorities can respond by bringing the full force of Article 82 of the EC Treaty to bear. In a free market economy, a strong presumption against ex ante regulation exists. Opponents of deregulation have failed to demonstrate why Article 82 is inadequate and why sector-specific regulation continues to be necessary (if it ever was necessary or desirable). This prohibition has served as an effective deterrent and sanction against such abuse in other sectors and will serve the same purpose in

[1] In the United States, GDSs leverage their continuing market power to deprive airlines of the ability to receive full value for the content they provide; such free negotiations are possible only if it were commercially feasible for a carrier to withdraw from a GDS. But, as the market adjusts, airlines should ultimately be free to negotiate with GDSs to obtain fair value for the content they provide. GDSs in turn will be forced to differentiate themselves further from one another by their content offerings, and, as in every other competitive market, consumers should have a variety of sources of content from which to select. GDS users should also be willing to pay for the degree of content access they need; not all users need or want full content.

relation to GDSs. Competitors have every incentive to monitor abusive behaviour and bring it to the attention of the appropriate enforcement authorities.

United relies upon antitrust rules in the United States to constrain anti-competitive behaviour by GDSs. After deregulation, as noted, GDSs continue to exercise considerable leverage over airlines because of their exclusive relationships with travel agents. GDSs are still able to use this leverage to extract fees that are above market-clearing levels and to impose unreasonable contract conditions such as prohibiting United from selectively distributing content across distribution channels. As a result, United is concerned that the proposed Travelport/Worldspan merger would further reduce United's negotiating position with the few remaining GDSs, hamstringing its ability to reduce distribution costs. In United's view, vigorous enforcement of the competition laws will be required but should be sufficient to constrain anticompetitive conduct by the incumbent GDSs. Regulation, on the other hand, does not address the vendors' basic market power and merely serves to insulate them from the competition that would exist if they were forced to give up their restrictive contract terms. In this regard, at the time of deregulation, DoJ expressed its intention to ensure that temporary but continuing disparities in bargaining power did not lead to abuse of dominant position by GDSs.

Finally, the continued application of the rules to parent carriers would have adverse commercial effects on airline non-owner partners. In addition to the examples above, United would be limited with respect to distribution initiatives it may want to co-develop in conjunction with Lufthansa as part of extensive code-share arrangements because, as a parent carrier, Lufthansa would be denied commercial freedoms available to United.

III. Deregulation in the United States has Produced Significant Benefits

Experience in the United States illustrates the potential benefits that could flow from full deregulation in the EU:

- Deregulation has reduced GDS fees, although not to market clearing levels as discussed above. United has enjoyed a 20 percent decrease in GDS booking fees relative to the fees it would have expected if the rules had remained in effect. During regulation, United and other carriers experienced regular fee increases; United estimates that its GDS fees increased 350 percent while the U.S. CRS Code was in effect and that booking fees increased 7.5 percent annually between 1990 and 2000. These price increases occurred without corresponding service improvements, even as technology costs plummeted, GDSs enjoyed increased economies of scale, air fares remained relatively constant and the U.S. consumer price index measuring inflation increased by an average of 2.2 percent annually. Tellingly, the publicly-traded GDSs enjoyed an average net profit margin of 13.5 percent during the decade 1990-2000, twice that of the major U.S. airlines.

- The reduction in GDS fees since deregulation, if generalized to the U.S. industry, suggest that today air carriers in the United States are paying hundreds of millions of dollars less in GDS fees than they would have expected under regulation, and have enjoyed improvements in service. This reduction in U.S. fees and the fact that U.S. GDS fees are lower than fees negotiated under the EU Code suggest that the U.S. Code exercised an artificial and inflationary impact on booking fees and that the EU Code is doing the same today.

- Lower fees have also made GDSs more accessible to a number of low-cost carriers ("LCCs") that eschewed participation prior to deregulation because of the prohibitive costs involved. Their enhanced participation has increased the information easily available to travel agents and improved the range of options available to consumers. In a break from their focus on point-to-point services, U.S. LCCs increasingly participate in GDSs in an effort to capture connecting traffic. LCC participation increases competition between traditional network airlines and LCCs, thereby enhancing the choice of itineraries, fares, types of service and carriers available to consumers and ironically achieving through deregulation some of the major objectives of the CRS regulations.

- The freedom to negotiate with the GDS allows an airline to negotiate for proper consideration for the value of the product it offers to the GDS. Under the old regime, for example, Qatar Airways paid the same booking fee as United even though United offered the GDS a far greater volume of business and more valuable portfolio of products, fares (such as special fares) and services in the U.S. domestic market. After deregulation, United has been able use the value of its product in negotiations with GDSs to secure lower booking fees, although not yet to market clearing levels as discussed. The 20 percent reduction in distribution costs achieved recently provides concrete evidence of the benefits of deregulation.

- Deregulation has spawned GNEs to compete with traditional GDSs. Although GNEs have yet to gain significant market penetration because of the considerable market leverage that traditional GDSs continue to exercise in the aftermath to deregulation, they do exercise a competitive constraint on traditional GDSs and are a testament to the innovation permitted in an open market. To the extent that the EU Code creates any sort of barrier to entry of new technology, it is truly distorting the competitive forces that could lead to consumer benefits.

- Deregulation, including the entry of GNEs, has forced GDSs not only to lower prices, but to improve technology and provide new services and services outside of the scope of the "full content" agreements airlines have negotiated. This is due to a newfound competitive desire by GDSs to differentiate themselves from airline websites and less complex distribution intermediaries.

- Travel agencies, which like airlines were previously captive to GDSs, now occupy a stronger negotiating position vis-à-vis GDSs and enjoy direct arrangements with airlines that include commission payments. Under regulation, GDS paid agents for business with the booking fees collected from airlines (Galileo reported $700 million in travel agency commission costs in 2000, its largest operating expense). The U.S. CRS Code helped contribute to the demise of the airline-agency relationship because the high (and constantly escalating) level of GDS fees left airlines with little money for commissions. After deregulation, travel agencies can bargain more freely with GDSs and benefit from enhanced content and GDS functions such as automated exchanges and customizable solutions.

Importantly, by creating regulatory certainty and clarity in the GDS model moving forward, free from the uncertainty created by DoT's prolonged rulemaking, the conclusion of the rulemaking proceeding placed the GDSs on more stable business ground. It is worth mentioning that some GDSs were supporters of deregulation. GDSs have attracted new LCC business through lower costs, have developed new, attractive services and enjoy solid financial health. The rise of GNEs, after two decades of no meaningful market entrant, reflects the potential for genuine competition in the wake of deregulation and, increasingly, GNEs will be realistic competitors for at least some types of distribution. Through regulation, the U.S. government sought to increase consumer welfare and competition in air services; competition among GDSs was perhaps unwittingly sacrificed to this goal. With deregulation, competition between GDSs has increased to the benefit of a host of stakeholders in the distribution chain.

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?)

United believes that all stakeholders would benefit from deregulation. GDS support for deregulation in the United States underscores this point. Deregulation would generate the following benefits in the EU:

- Airlines would have the ability to negotiate a fair value for the products and inventories they offer to GDSs;

- Associated cost savings, potentially in the hundreds of thousands of Euro if the U.S experience can be generalized to the EU market, can benefit other stakeholders, including consumers in terms of lower fares, agents in terms of commissions, shareholders and employees;

- Consumers can enjoy distribution methods driven by their preferences rather than regulation and gain access to more LCC product offerings through GDSs;

- GNEs can put their business proposition to market with service, competition and price improvements;

- Travel agents would be free to negotiate with the GDSs on price and service terms and seek improved terms with airlines; and

- GDSs would be given the incentive to offer new and improved services.

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?

For the reasons stated above in response to questions 1 and 2, the rules should not continue to apply to parent carriers of Amadeus.

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?

In United's view, airlines should be free to own and control CRSs, as they are today. Existing consumer protection and competition rules serve as a deterrent and sanction against anti-consumer and anti-competitive behavior. Restrictions on airline ownership or on airline control run the risk of imposing unforeseeable costs and competitive distortions and are not warranted in the current market context. In addition, regulations implemented today will persist into future, unforeseeable competitive and technology environments, constraining natural market behaviour in undesirable ways.

In United's view, three market features would be an effective deterrent to abusive behaviour by carriers that own or control GDSs: (1) the enormous and still growing availability of airline, schedule, price and booking alternatives as well as the transparency made possible by free and easily accessible fare and schedule displays, including displays that the consumer can select at will (driven by fare, preferred carrier, schedule or other criteria) via the Internet; (2) travel agent pressure for useful information in convenient displays; and (3) airline pressure on GDSs to act in a manner consistent with the airlines' commercial interests. These features, in combination, will have a sharp deterrent effect on any potential abusive behavior by carriers that own or control GDSs.

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

No. In a deregulated market, groups of airlines and alliances will have the ability to bargain collectively with GDSs for MIDT access, subject to the application of competition rules.

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

United strongly believes that the market would benefit from full and fair disclosure of all information consistent with existing data protection principles. As the Commission is aware, MIDT data tapes do not reveal fares paid, passenger identity or whether the booking is made by a business passenger, limitations suggesting that carrier access to MIDT data alone does not facilitate anti-competitive behavior, even hypothetically. Additionally, competition law, including the interpretations of the European Court of Justice most recently in its judgment in *British Airways v. Commission*, will govern the airline/travel agent relationship. United assumes that any decision to mask travel agent identity would be limited to information containing the identification of only travel agents established in the EU.

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 simply be removed? In case stakeholders favour a simplification or removal of these prescriptions, could they where possible quantify the reduction in administrative costs such a reduction will induce?

In United's view, display bias is not a legitimate area of sector-specific regulation now, if indeed it ever was. It is difficult to see how government intervention requiring each GDS to provide a display of airline schedule and fare data according to an algorithm determined by a regulatory agency is essential to ensuring competitiveness in either the market for GDS services or in the market for air services. Particularly in a deregulated market, if a GDS determines that its customers demand such a display and are willing to pay for it, the GDS will provide such a display. If there were no demand for the type of display that regulators would characterize as neutral, then regulatory intervention to ensure the availability of such a display would be a meaningless exercise. In a deregulated marketplace, airlines must negotiate for neutral display, just as the GDS must negotiate for full content. Such a negotiation is the hallmark of a competitive market that the regulator should embrace rather than seek to prevent.

Moreover, as a practical matter, in each of the contracts that United has concluded with the four GDSs since deregulation, GDSs are required to display content in a neutral manner because United provided value in return for this contract right. This requirement protects consumers against screen bias and provides United with the legal certainty that it is competing with other airlines on a level playing field. Assuming this trend is followed in the EU, the administrative costs involved in removing the prohibition should be minimal.

The high and increasing consumer-driven focus on price over schedule also minimizes the potential anti-competitive effect of any screen bias. Approximately half of United's bookings are price rather than schedule driven because of the growing price sensitivity of passengers.

In addition, consumer laws exist to protect consumers without the need for sector-specific legislation. National laws transposing Directive 2005/29/EC concerning unfair business-to-consumer commercial practices are one example. DoT made clear in deregulating that it would take actions for unfair and deceptive practices and unfair methods of competition against airlines and ticket agents on an ad hoc basis. The relevant authorities in the EU will presumably exercise the same enforcement authority.

Finally, consumers have a wealth of comparative information available through the Internet. The Internet has become a powerful tool in the hands of consumers to obtain information best tailored to their travel needs. Consumers can compare prices for their desired itineraries by surfing between airline sites or through a single site such as Expedia or Travelocity. While not all EU citizens have access to the Internet, penetration in the EU has increased significantly in large part as a result of successful Commission efforts to promote its use among consumers and businesses.

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

United lacks the information necessary to respond to this question.

For queries or responses related to these comments, please contact:

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