



Lufthansa's general remarks

A. Market inefficiency and the Code of Conduct

Airlines are effectively forced to participate in each CRS as they control the airlines' access to the travel agent. Under the regime of the EU Code of Conduct, which should provide fair market conditions, CRS providers managed to raise prices on a global basis by 3- 7% per year over the past decade without improving their service offer accordingly. These price increases and the internal efficiency gains allowed the CRS companies to earn artificially high profit margins (capital returns 1998 – 2004 > 30% p.a.). Such margins attracted even financial investors which took over major stakes in all four major CRS providers.

In order to increase their individual market share, each CRS passes on to travel agencies a significant portion of the fees received from airlines. This leads to an inefficient competition between CRS providers for market share which is being funded by ever-increasing booking fees charged to airlines. As a matter of fact airlines are neutral to the CRS system that a travel agency uses. Vis-à-vis travel agencies CRSs have very few differentiating factors other than the incentives that they offer. Therefore airlines cannot be satisfied with the situation that they are paying for the individual CRS systems to lure travel agencies away from one another. By limiting the competition in the airline ticket distribution industry, the Code of Conduct encourages this inefficient competition for travel agencies.

In a business environment wherein airlines are forced to cut costs in order to remain competitive and profitable, distribution costs cannot continue to climb but have to be lowered dramatically. Facing increased competition especially in European traffic with more and more Low Cost Carriers entering the market, airlines have to look for opportunities to reduce cost in order to offer a competitive product for European consumers. Distributing low yield fares via direct sales such as website is one opportunity to cut distribution cost and match low cost carrier airfares. Nevertheless high CRS fee in the EU caused by regulation should not bias the business model in favour of direct sales. However, content differentiation is a very important element of airline's distribution strategy. Under the regime of the EU Code of Conduct airlines except parent carriers remain in control over the distribution of their content – an important achievement which should not be disposed.

B. Deregulation is a necessity for market entries and enhanced competition

Some provisions of the Code of Conduct such as the MIDT data offer which should be available to all market participants or the provisions of standardized data and data quality as in Art. 4 would qualify for a regulation. However, market efficiency can only be improved by full CRS deregulation. Such deregulation would allow airlines to negotiate with CRS providers on an equal footing, and



would allow market forces to determine the cost of airline ticket distribution. New players and new technology would find its way to the European market. The final result would be that distribution costs of different channels would be in line with their performance ratios and not be based on insane incentive payments that the CRSs forward to "their" travel agencies.

Questions 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?

After seeing the effects of CRS deregulation in the United States, Lufthansa is convinced that a complete abolishment of the Code of Conduct would be the best route forward. Only after deregulation did new players enter the American market (e.g. G2 Switchworks, ITA Software, Farelogix), while Europe has experienced no such competitive influx. Not coincidentally, the CRS business model in the liberalised US market was changed in 2006, which led to a new market outcome with significant efficiency gains for all stakeholders.

The air transportation markets of the EU and US are comparable in terms of size, maturity, and structure, so the positive effects gained by deregulation in the US will also likely be achieved in Europe. In 2006, US carrier attained to cut their CRS costs and gained competitive advantage against European competitors. That said, failing to deregulate in Europe would prolong already existing distortions in the highly important transatlantic market to the detriment of all European airlines and the related European industries.

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?

We are convinced that given the market developments described by the EU Commission the risk of market foreclosure is reduced. In the future, airlines and CRS providers should act in a liberal market environment. Article 82 of the Treaty prevents any player in a market from exerting pressure on other players by abusing a market dominant position. Therefore, the general competition rules are a sufficient remedy/deterrent against the risk of market foreclosure.

Questions 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)?

Greater market efficiency would benefit all companies involved in the distribution of air transport services, regardless of the size of the company.



Bigger airlines would certainly benefit from economies of scale when purchasing CRS services. Nevertheless, smaller airlines also suffer today from prohibitively high CRS costs. Lower prices for CRS distribution would therefore also be beneficial for them. Many airlines have done well promoting their direct sales channels over the last few years and CRS effectively lost this business, deregulation would also help CRS providers to regain market share.

Smaller and medium-sized travel agencies already suffer from growing content fragmentation as carriers resist providing full content to CRS services; furthermore, a lot of airlines do not participate in CRS distribution at all. Pricing freedom in the market would allow airlines to negotiate more favourable terms with CRS services. Thus, would mitigate the need for content fragmentation, which would clearly benefit small & medium-sized travel agencies. We do not believe that deregulation will finally lead to a higher degree of content differentiation.

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?

The obligations should definitely be lifted. Ownership without control in general does not cause any risk regarding market foreclosure. Effective control should be regarded in the way it is handled in competition cases and thus be considered as existent or not. Minority shareholders in CRS providers do not have effective control. Therefore the definition of parent carriers in the Code of Conduct is obsolete. In the case of effective control (via specific rights or ownership) the general competition rules are sufficient to protect the market from airlines deterring CRS companies' business policy.

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.

Restrictions on financial investments in CRS providers are not required. Airline as any other private investor should be free to benefit from the high return in CRS business. If an airline effectively controls a CRS provider, then the competition laws of the EU, especially merger control, are enough to protect structure resulting in market foreclosure.

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?

MIDT data remains an important traffic indicator especially for intercontinental markets. It facilitates airlines to optimize their network, allocating capacity to attractive routing for their customers and thus supports airlines to consistently



improve their offer to the market. The MIDT product exists on a give-and-take-basis: Airlines and travel agencies should provide the booking data and all players should be able to purchase the data. Regardless of its benefits, a special regulation is not needed to ensure the future availability of MIDT.

Due to Art. 6 of the Code of Conduct the current price for the data is prohibitive for many, especially smaller players. The provision of group purchase that was designed for the purpose of allowing more players (airlines and agents) to benefit from greater transparency, was never accepted by the CRS providers and did not solve the problem.

LH favours an environment of full pricing freedom because we assume that free negotiations for MIDT data will finally enable all players to purchase the data that is necessary to run their business.

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

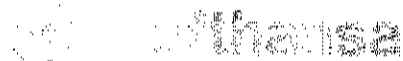
Travel agency identification in MIDT is very useful for all airlines. It improves transparency and security in planning which finally leads to more efficiency. This efficiency promotes the whole aviation industry including all stakeholders. It would be at risk if agents' identities are removed from MIDT.

The exclusion of travel agents' identities is not at all a solution for the problem of imbalanced competitive conditions between few airlines which can afford MIDT and the large number of airlines which can not afford it. The route forward is full deregulation and pricing freedom concerning the market for MIDT. Any apprehended misuse of distorted competition would be covered by Article 82 of the Treaty.

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?

As observed by the Commission the industry has changed in the recent years regarding information sources for the air transport consumer and regarding the consumers' behaviour. Different from the times when the Code of Conduct was crafted the consumer nowadays determines the display which fits his individual needs best, i.e. lowest price finder or preferred airline carrier etc. Today, the concept of a neutral display is a highly theoretical one.

The free market forces between service provider and consumer will determine the displays; the mandatory principal display in the CRS and the detailed prescription of neutrality are not needed any more.



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?

Lufthansa does have little experience and very few knowledge about the utilisation of rail services and agreements between rail services providers and CRS. Thus, Lufthansa is not able to provide a reasonably founded statement.