

**Written Statement of David A. Schwarte – Executive
Vice-President &
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Good morning, ladies and gentlemen. I want to thank all of you for letting me address you on a very important topic, one with profound long-term implications for all businesses and consumers who buy air travel.

Industry Background

In late 1984, the CAB (the predecessor of the Department of Transportation) adopted rules of fair play for computer reservations owned, controlled or marketed by airlines. It did so to stop a variety of unfair practices that it found had become rampant in an unregulated CRS environment. They included biased displays that favored the owning carriers and their allies; and discriminatory fees, where airlines that **were not** friends of the CRS owners paid fees that were 1400 percent more than those **who were**. These practices had mushroomed after the creation of the CRS industry in the late 1970s. The CAB found that by the time it acted airline competition had been impaired, with new entrants losing hundreds of millions of dollars, and that millions of consumers had been deceived as a consequence of bias – since the full range of flight and fare options had hidden from travel agents.

The heart of the problem, CAB found, was that airlines that owned the electronic distribution outlets for airline tickets had both **the means** and **the incentive** to use control over those outlets to advance their fortunes as airlines.

Well, the fundamental economic forces of the airline industry have not been repealed. Yet today, because of a loophole in the U.S. CRS rules -- which were adopted before the Internet became a tool for consumers to grab the wheel -- online travel portals used by consumers are totally outside the scope of those regulations, even if owned by consortia of large airlines. The two other jurisdictions that have CRS rules, Canada and the European Union, both apply the full protections of those regulations to any web site that offers the services of more than one carrier. I know the audience will find it ironic that while Orbitz today argues vehemently against applying the CRS rules to web sites like Orbitz, three of the five carriers that now own Orbitz took exactly the opposite position in December 1997 when the DOT initially called for comments on this issue.

If the DOT does not act promptly to close this loophole in its regulations, there is every likelihood that by the time it does act, a very unfortunate chapter in airline history will have repeated itself.

To help the audience understand our perspective, let me say a few words about Sabre. Sabre owns the Sabre computer reservations systems, the most popular travel agency CRS in the U.S., and, indeed, the world. Sabre also owns 70% of Travelocity.com, an award-winning consumer travel portal. (Since March 2000, Travelocity has been a publicly traded company with its own board of directors.) Travelocity is the most popular travel site on the web -- both in terms of number of users and dollar volume of tickets sold.)

Since March 15, Sabre and Travelocity have been completely free of any airline ownership. We will continue to succeed if, and only if, we give buyers of

travel, and the travel agents and corporate travel departments that serve them, optimal tools to pinpoint the lowest fares and the best service. Thus, our interests are truly aligned with those of travelers.

In that critical way, we are fundamentally different from a system owned or controlled by big air carriers. Let's face it: every dollar a CRS or web site saves a traveler on air fares comes out of some airline's pockets. Chris Tarry, an airline analyst with Commerzbank put the difference in business objectives succinctly last February when commenting on the plans by European carriers to build their own version of Orbitz:

Airlines could also regain control over the availability and pricing of discounted tickets currently distributed through other Internet channels.... In those [other] sites, 'the philosophy is to push the price lower -- a complete reversal of the aims of an airline's own yield management team.

Why Orbitz Raises Serious Consumer and Competition Concerns

So what are we seeking? Let me tell you right up front that we are not here demanding that Orbitz be stopped. There are some who do say that this type of collaboration among the biggest five carriers is too dangerous and should be grounded before take-off.

By contrast, we are simply demanding fair access to data. Why? Because we are very concerned that the five major airlines that own Orbitz -- United, American, Delta, Continental and Northwest -- and who account for four of every five passengers carried in the U.S., will use their control over vital airline fare, inventory and other data to undermine competition with Orbitz. That information is literally the lifeblood of any system that distributes airline tickets.

We have serious concerns about possible plans to choke off our supply of this vital data for at least three reasons. First, there is a long and well-documented history in this business of big carriers that own one airline distribution company **intentionally** withholding from competitors the fare and other data needed to offer a viable product in the regions where that carrier is strong. It is no exaggeration to say that Sabre has encountered this form of abusive behavior nearly every time we sought to enter an overseas market.

Unfortunately, the exploitation by big airlines of this clout to injure competition in airline distribution business was also once widespread here on American shores. When the original CRS rules were adopted in 1984, they did not forbid CRS owners from discriminating against competing systems with respect to fare and other data. Viewing this as an invitation, a number of airlines made their best fares available only to users of **their** system. This was a particularly effective tactic at the big carrier's hubs, assuring that most agents had little choice but to take the system that carrier demanded.

By September 1992, this conduct had become so pernicious that DOT enacted rules that prohibited CRS-owning carriers from withholding from competitors fare and other data they provided to their own system. In a passage that is still fresh and relevant today, the DOT said:

We have determined to adopt the proposed rule. The rule is necessary, for some system owners do not participate in enhancements in other systems and do not provide complete information on their fares and services to competing CRSs, as we tentatively found in the NPRM. No one has argued that system owners never limit their participation in other systems as a weapon to obtain more subscribers at their hubs and no one has denied the potential usefulness of such tactics.

(Emphasis added.)

Similarly, today no one could reasonably dispute the “potential usefulness of such tactics” in compelling travelers to use Orbitz, especially since the carriers owning it account for over 80% of all travelers.

Second, and even more worrisome than this disturbing history is that ever since Orbitz was announced last November, there have been persistent indications in the industry that there is an understanding among the big carrier owners that Orbitz will enjoy exclusive access to at least certain types of airline fares. For example, the CTO of Orbitz was quoted in the June 1, 2000 edition of *Internet World* as follows:

Sure. Everyone goes through one of four or five computer reservations systems that all have the same information. These are all publicly available fares. We're getting the same stuff as everyone else, except that the special fares that are on the Web sites of particular airlines, we are pulling into one place to book.

(Emphasis added.)

This very troubling admission confirms other comments that Orbitz will enjoy a privileged position when it comes to fares and other data on its airline owners.

Third, another very bad sign for those hoping that Orbitz owners would play fair and not play favorites when it came to data was their selection of the Boston Consulting Group for a lead role in putting Orbitz together. BCG has been instrumental in the formation of Orbitz and for many months BCG personnel served as its media spoke-persons. A few months ago two senior BCG

consultants published a controversial book entitled *Blown to Bits*.¹, which was copyrighted by BCG. Some of the BCG consultants involved in the Orbitz project were acknowledged by name by the authors of *Blown to Bits* for their assistance.

In *Blown to Bits*, the authors describe strategic challenges that the emergence of the network economy poses for established suppliers, intermediaries and retailers. The authors issue a call to arms for retailers to retake control of distribution of their products and services from those Internet companies too closely aligned with the interests of buyers. The key to regaining control is essentially a group boycott by suppliers of independent outlets of distribution. Once the retailers reclaim control, the authors advise them to then impede the consumer's search for options. For example, the authors write:

...the more intense the competition among navigators [i.e., distributors independent of suppliers] for the loyalty and attention of consumers, the weaker is the navigators' bond to any one seller and the greater the pressure on them to serve as the buyers' rather than the sellers' agent.

From the product suppliers' point of view, the tilt in affiliation threatens their influence over the buying process

Blown to Bits at 125.

Lest there be any doubt about why having Internet navigators (like Travelocity) aligned with the interests of consumers is a bad thing, the BCG consultants continue:

Informing the consumer of purchasing alternatives available from other suppliers; explaining why a premium feature is not worth the money; sharing unflattering information on product performance or customer satisfaction; these are the kind of navigational services that consumers would expect from a navigator serving *their* interests.

¹ Philip Evans and Thomas S. Wurster, ©2000 The Boston Consulting Group, Harvard School Press.

Id. at 127 (emphasis added). The authors set out a specific strategy for suppliers and retailers to best hobble these unwanted, independent navigators:

Product suppliers and traditional retailers alike fear the rise of the agent navigator who facilitates broad-reaching comparisons without even being a party to the transaction. However, a component of critical mass for either kind of new navigator is often the incumbents' product information, price lists, and willingness to accept business switched through that navigator. *This opens up the possibility of denying critical mass. If enough suppliers refuse to sell through the e-tailer, or enough retailers refuse to provide information to the dispassionate agent, neither the e-tailers nor the agent can achieve critical mass.*

Id. at 115 (emphasis added). And what should a group of sellers do to prevent the independent navigators from achieving critical mass? The BCG consultants have a stunning answer:

Unless the selling business is highly concentrated, it is unlikely that the navigator's ability to achieve critical mass will depend on the availability of data from any one source. Therefore, while it is undoubtedly in the interests of all sellers *collectively*, it is not in the interest of any one seller *individually* to deny its own data to the navigator. But if everyone reasons that way, the navigator will achieve critical mass.

Blown to Bits at 139 –140 (emphasis in original). Finally, assuming the call for a joint boycott has been heeded, the BCG consultants explain what the sellers should do once they regain control of distribution from these pesky independents:

Perhaps provide comprehensive but not necessarily comparable data on one's own products and those of direct competitors, and slightly *bias* the presentation through the ordering of alternatives and the occasional emphasis or *omission*... *Conceal* from consumers the navigator service's supplier affiliation.

It is hence, small wonder that Orbitz has tried hard to claim independence from the five airlines that own it and provide its board of directors. "Concealing" its "supplier affiliation" has been in its play book from the very start.

As I stated at the outset, the fundamental problem is that none of the safeguards of the U.S. CRS rules apply to travel portals used by consumers. In our view, it would be fatally inconsistent for the U.S. Government to conclude, on the one hand, that CRS rules are necessary to protect travelers who booked through travel agents against “evils” such as biased displays, but that, on the other, travelers who used their home PCs to shop for travel on the Internet were fair game.

Nearly everyone will immediately understand the public policy benefits of protecting consumers who use the Internet from being deceived as to their travel options. But why should businesses and consumers care whether a company like Orbitz attains dominance among travel portals due to unfair advantages conferred on it by its big airline owners? The answer to that question also becomes crystal clear after only a moment’s focus.

As explained above by the airline analyst from Commerzbank, for web sites independent of airlines “the philosophy is to push the price lower” and this philosophy is “a complete reversal of the aims of an airline’s own yield management team.” If a web site owned by the five largest carriers in the U.S. does not face intense competition from robust, healthy independent travel portals, can we really expect that site to pioneer the way with innovations that save consumers money on airfare?

Action Needed

DOT should take effective action now to guard against the abuses by Orbitz and its owners that history and common sense teach us are inevitable. It

should extend the CRS rules in their entirety to any travel portal used by consumers that offers the services of more than one carrier. Alternatively, the Department of Justice (or DOT) should seek a consent decree that expressly forbids Orbitz owners from discriminating against other systems and travel web sites in terms of their level of participation and the data they provide.

A few last words about allegations of bias in Travelocity. We have begun to encounter claims by Orbitz, and carriers owing Orbitz, that they object to Travelocity because it is “biased.” We want our response to be loud and clear and unmistakable: **HOGWASH!**

Travelocity takes its data from Sabre – which by law must be neutral – and uses that data for its displays. It does not reorder the data in any way to take carrier identity into account, directly or indirectly. But since it’s easy for someone who knows how CRSs and travel portals operate to create the illusion of bias by a careful manipulation of the systems, I will respond to that charge in the most simple straight-forward way I know – by calling Orbitz’s bluff about bias.

Orbitz, Travelocity is ready to accept the application of all the CRS rules, including those provisions that ban bias. Are you?

I thank you for your attention and look forward to your answering your questions.