

**BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.**

DEPARTMENT OF TRANSPORTATION  
97 DEC -9 PM 4: 24  
DOCKET SECTION

QA 29477

**IN THE MATTER OF**  
**Part 255,**  
**Computer Reservations Systems**

OST-97-2881-38

**DOCKET NO. 49812**

**COMMENTS OF THE LARGE-AGENCY CRS COALITION**

Communications with respect to this document should be sent to:

Mark Pestronk  
Law Offices of Mark Pestronk, P.C.  
4041 University Drive, Suite 450  
Fairfax, VA 22030  
(703) 591-1900  
(703) 591-9116/Fax

December 9, 1997

15pgs.

## TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION .....	1
A. ANSWERS TO NINE OF DOT'S 15 QUESTIONS .....	2
B. THE THREE LOOPHOLES .....	6
C. CAUSE AND EFFECT OF THE LOOPHOLES .....	8
D. THREE MORE PROBLEMS IN NEED OF SOLUTION .....	10
E. PROPOSED RULE CHANGES .....	11

**BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.**

**IN THE MATTER OF**

**Part 255,  
Computer Reservations Systems**

**DOCKET NO. 49812**

**COMMENTS OF THE LARGE-AGENCY CRS COALITION**

**INTRODUCTION**

The Large-Agency CRS Coalition (“LACC”) is an ad hoc group of 11 of the 50 largest travel agencies in the United States:

1. Adelman Travel Systems, Milwaukee, WI
2. Casto Travel, Sunnyvale, CA
3. Direct Travel, New York, NY
4. McCord Travel, Chicago, IL
5. Omega World Travel, Fairfax, VA
6. Stevens Travel Management, New York, NY
7. Total Travel Management, Troy, MI
8. Travel Incorporated, Atlanta, GA
9. Tzell Travel Specialists, New York, NY
10. VTS Travel, Mahwah, NJ
11. Wright Travel, Nashville, TN

LACC has been formed for the sole purpose of submitting direct and reply comments in response to Advance Notice of Proposed Rulemaking 97-9 and participating in any subsequent rulemaking proceeding.

LACC urges DOT to re-adopt the CRS for another five-year period, with six changes:

- Three changes are designed to plug loopholes in the 1992 rules that the vendors found and have exploited.
- Three other changes are designed to address inequities in the agency-vendor/airline relationship that DOT has never before addressed.

**A. ANSWERS TO NINE OF DOT'S 15 QUESTIONS**

DOT has asked for comment on 15 specific questions about how well the 1992 rules have operated in practice. LACC has a direct interest in the answers to nine of those questions:

**1. Should the Rules Be Continued? If So, for How Long?**

LACC believes that the CRS rules should be continued for another five years, with the changes proposed in these comments.

**2. Have the Rules Been Effective?**

No, the rules have not been effective in untying CRS service from airline competition, encouraging use of multiple systems, or uninhibiting conversion, as the vendors found and have exploited three major loopholes, as explained in Part B below.

**3. In Those Areas Where Commenters Believe That the Rules Have Not Been Effective, Should Provisions Be “Modified ...”?**

Yes; in Part E below, we recommend modifications designed to plug the loopholes that we discuss in Part B below.

**4. Do the Changes in Ownership of the Systems ... Indicate That There Is Less Need for Regulation?**

No; the spinning off of the vendors into separate corporations, the stock swaps between parents and subsidiaries, and the introduction of global ownership have, as a practical matter, meant nothing to travel agencies. In their contracting practices and in the anti-competitive pricing and tying practices discussed in Part B, the vendors behave exactly as they did formerly — as tools of the major U.S.-carrier affiliates.

**5. Have the Rules Allowing Travel Agencies to Use Third Party Hardware and Software ... Had Any Impact?**

The rules have had very little impact because, most of the time, vendors offer hardware-bundled configurations at prices (expressed in terms of bookings per CRT or in terms of segment bonuses for exceeding the quota for free service) that are so close to those

for hardware-free configurations that an agency's purchase of third-party hardware is economically unwise. We propose to remedy this problem by a rule change discussed in Part E. below.

9. Does the Rule Requiring Each System to Make Available to Participating Airlines All of the Marketing and Booking Data ... Benefit Airline Competition?

No; the rule requiring dissemination of this private agency information injures airline competition because it enables airlines to identify each agency's corporate clients and to develop plans to move them to agencies that use the airline's affiliated CRS. The information also enables airlines to employ market-share override programs<sup>1/</sup>, which are designed to limit the overall level of travel agency compensation by making it inherently impossible for travel agencies to earn overrides on competing airline routes. Moreover, the information is a trade secret to travel agencies, which are private, unregulated businesses which resent dissemination of their confidential sales data without their permission.

In addition, upon information and belief, the data actually disseminated to airlines is provided in such formats that only the very largest U.S. airlines can afford the additional cost of "cleaning up the data" to make it useful to marketing officials. Thus, smaller U.S. carriers, including all start-up airlines, are effectively deprived of the marketing advantage that the data provides to the major U.S. carriers.

Accordingly, LACC requests that DOT amend its rule 180 degrees to prohibit a vendor's dissemination of a travel agency's data to any other company, including the vendor's owning airlines.

---

<sup>1/</sup> DOT has stated that this is not the forum in which to consider override programs. However, the point here is that the dissemination of data is anti-competitive — not that the override programs need to be changed by DOT.

12. Do the Systems Inappropriately Charge ... for Agency Transactions That Are Unnecessary or Valueless for Airline Participants?

Yes; the vendors apparently charge airlines for so-called “passive bookings” made by travel agencies for a variety of legitimate business reasons. LACC members know about these charges because the airlines have threatened in writing to pass them on to the agencies in the form of “debit memos” or bills which mirror the CRS charge and add a stiff fine.

DOT’s Question 13 goes on to ask why airlines cannot stop these “illegitimate or unnecessary travel agency transactions by taking action against travel agencies”. By posing this question, DOT demonstrates that it does not understand that passive bookings are legitimate and necessary in a variety of contexts, such as when reservations are made by an agency and tickets are issued by a consolidator or cruiseline, or when reservations are made but the traveler changes his mind before the ticket is issued. Therefore, the solution is not for airlines to crack down on agencies; rather, it is for the vendors to eliminate their fees for passive bookings.

13. Do Systems Use Subscriber Contract Terms That Adversely Affect Competition in the CRS or Airline Industries? If So, How Could the Rules Be Changed to Eliminate Such Adverse Effects?

Yes; as explained in Part B below, notwithstanding DOT’s efforts in 1992, the vendors have exploited loopholes in the 1992 rules in order to continue to be able to inhibit use of multiple systems and conversions. As a result of their behavior, the vendors have adversely affected CRS competition, as well as airline competition at hub cities, as explained in Part C below.

14. Some Industry Participants Have Asserted That Some of the Major Airlines With CRS Ownership Interests Coerce Travel Agencies at Their Hubs into Using Their Systems .... [A]re There Any Practicable Rules That Could Be Adopted That Would Limit or Eliminate Such Practices?

The assertions are quite true. As explained in Parts B and C below, CRSs continue to be used as a tool to reinforce fortress hubs through vendors' exploitation of the loopholes they have found in the DOT rules. Therefore, we have proposed in Part E below practicable changes that will eliminate these anti-competitive practices.

**B. THE THREE LOOPHOLES**

Since the last CRS rules were adopted in late 1992, the system vendors and their controlling carriers have found and exploited three loopholes that have emptied the 1985 and 1992 subscriber-contract rules of much of their meaning:

First, all four vendors have instituted de facto minimum-use clauses by making the cost of non-use so prohibitive that the agency cannot possibly afford to switch systems or add a second system in mid-contract. These prohibitive costs are known as "penalty pricing" in the industry. For two of the vendors, penalty pricing takes the form of requiring agencies to pay the vendors between \$2.40 and \$3.11 for every booking which the agency does not make, up to the number of monthly bookings required by the productivity quota in the contract. For complete non-use of a system, these penalties can be as high as \$1,000 per CRT per month, assuming a quota of 321 bookings per CRT per month, which is not an untypical quota. For the other two vendors, penalty pricing takes the form of excessively high rack rates, or fixed monthly charges, which the agency must pay for non-use. These charges can be as high as \$400 per CRT per month, or \$24,000 over the term of a five-year contract; this so far exceeds the actual cost of a PC that it is obviously nothing more than

a deterrent to conversions. Both booking-fee penalty pricing and excessively high rack-rate penalty pricing violate the purpose of Section 255.8(c).

Second, three vendors have instituted fare-tying practices by requiring travel agencies to use a system as a condition for receiving corporate discount airfares to or from hub cities of the owning air carriers. These tying offers are made principally but not exclusively with respect to corporate accounts in excess of \$500,000 in annual airline sales. To circumvent the anti-tying rule of Section 255.8(d), the vendors make the tied offers directly to the corporations, which then inform the agencies of the required condition for receipt of the corporate discount. Sometimes, to preserve a veneer of legality, the vendors make an “end run” around the agency by offering both the CRS contract and the corporate discount directly to the corporation. These practices are called “corporate-tying” in the industry. They violate the spirit of Section 255.8(d)<sup>2/</sup>.

Third, three vendors (not all the same ones referred above) have effectively prohibited use of third-party hardware by offering hardware-bundled configurations at prices that are so close to those for hardware-free configurations that an agency’s purchase or lease of third-party hardware is economically unwise. As DOT knows, the vendors “price” their systems by offering a quota of bookings for free CRS service. Thus, the quota for hardware-laden configurations is usually so close to that for a hardware-free configuration that it becomes uneconomical to choose the latter. This practice is called “tying hardware” in the industry. It violates the purpose of Section 255.8(c), in that it impedes agencies from procuring PCs that can be connected to more than one system.

---

<sup>2/</sup> Several of the owning air carriers also offer overrides, in their hub markets, only to agencies that use their system. This violates the letter of Section 255.8(e). Since this practice is already illegal, LACC does not suggest any revision to the rule.

DOT should close the three loopholes by outlawing “penalty pricing”, “corporate tying”, and “hardware tying”, using the textual amendments proposed by LACC in Section E below.

### **C. CAUSE AND EFFECT OF THE LOOPHOLES**

Both the cause and effect of the loopholes are related to a single anti-competitive practice of the owning carriers: monopolization of air transportation through maintenance of high market share at fortress hubs. Thus, CRSs are used as tools to maintain and even strengthen those fortresses.

#### **1. Cause**

The great mystery of CRS usage today is the persistence of the so-called “halo effect” long after DOT effectively outlawed any bias in CRSs. Despite the absence of bias, every owning airline apparently believes that, an agency is somewhat more likely to book that airline when it uses the affiliated CRS than when it does not. Whether this belief has any basis in fact is irrelevant. It is only relevant that the owning airlines behave as though it does<sup>3/</sup>.

This belief manifests itself in various behaviors. On the positive side, for example, the owning airlines contribute to large free-ticket funds offered as part of CRS contract renewals and conversions. Similarly, they often renew or strengthen override agreements

---

<sup>3/</sup> The absence of meaningful dividends to the stockholder airlines shows that the airlines do not push their CRSs because they profit from CRS operations. Similarly, the fact that the owning airlines must pay their CRS’ booking fees shows that the airlines do not push their CRSs in order to save money.

voluntarily<sup>4/</sup>. On the negative side, they cause their CRS affiliates to engage in the anti-competitive behaviors noted above; i.e., “penalty pricing”, “corporate tying”, and “hardware tying” in order to ensure that their airline market shares are maintained or strengthened.

## 2. Effects

In most parts of the country, most of the time, agencies can choose to avoid the anti-competitive behavior noted above. After all, not every vendor engages in all three of the anti-competitive practices noted above, and agencies are mostly free to reject tied or high-penalty offers in favor of more reasonable offers. However, in airline hub markets, large agencies are not free to reject anti-competitive offers from the vendors owned by the monopoly airline. If the agencies were to contract with another vendor, they would certainly lose their corporate accounts whose discount fares are tied to use of the monopolist-owned vendor, and they would probably lose their override programs, ability to clear waitlists, and upgrade assistance, even if the agencies’ market shares on the monopoly airlines do not change one iota. As a result of these risks of enormous losses, they cannot realistically switch. They must accept the monopolist’s offer, even if it involves penalty pricing and hardware tying.

Once the hub-city agency accepts the monopolist’s penalty-priced and tied offer, the agency cannot switch systems in mid-contract because of penalty pricing and the threat of loss of corporate accounts. Thus, in hub markets, large agencies have no effective choice —

---

<sup>4/</sup> This voluntary behavior does not violate the provisions of Section 255.8(e) because the vendor is not requiring the agency to sign as a condition of receiving the new or strengthened override.

either at contract renewal or during the term of a contract. They must remain subscribers to the monopolist's CRS<sup>5/</sup>.

The ultimate effect of these anti-competitive practices is as anti-consumer as any other airline practice in fortifying its hub, such as predatory pricing, gate-exclusion, and frequent flyer programs, or refusal to interline. Consumers pay higher prices and receive lower levels of service at hub cities monopolized by a major airline.

#### **D. THREE MORE PROBLEMS IN NEED OF SOLUTION**

In addition to the ways in which the vendors and their affiliated airlines have exploited the loopholes in the regulations, the vendors and their affiliate airlines have used their CRS-contract relationship in three other unfair ways:

First, as noted in Part A, question 9 above, the airlines use agency reservation data in a way that injures airline competition because their use enables airlines to identify each agency's clients, develop strategies for luring the clients to agencies more closely affiliated with the airline, operate zero-sum-game market-share override programs, and misappropriate agencies' confidential trade secrets.

Second, while recently reducing airline commissions and thereby disincentivizing agencies to rely heavily on airline bookings, the airlines have not allowed their captive vendors to reduce the onerous booking quotas of some travel agencies that need to reduce their bookings.

---

<sup>5/</sup> While a few agencies, including one member of LACC, have converted to a competing CRS in a hub city, they have been subjected to vicious efforts by the monopolist to shift business away from the converter, and other agencies have seen that the converter "has been taught a lesson".

Third, while recently reducing airline commissions to a level at which many travel agencies cannot survive, the airlines have not allowed three of the four vendors to permit agencies to terminate their contracts if they go out of business.

Accordingly, LACC suggests that the rules be amended to:

- Prohibit vendors from disseminating marketing and reservations information to airlines or anyone else;
- Require vendors to lower productivity quotas (or prices under other pricing formulas) following a documented decline in business due to airline commission cuts; and
- Require vendors to allow agencies to terminate their contracts if they go out of business<sup>6/</sup>.

### **E. PROPOSED RULE CHANGES**

The proposed language is underlined in the relevant paragraphs of Section 255 below:

1. To Prohibit “Penalty Pricing.

“255.8(b) No system may directly or indirectly impede a subscriber from obtaining or using any other system. Among other things, no subscriber contract or contract offer may require the subscriber to use a system for a minimum volume of

---

<sup>6/</sup> While the three vendors which do not provide, in their contracts, that agencies may so terminate may state to DOT that it is their “policy” to allow such termination in appropriate cases, a “policy” is not something upon which an agency devastated by the recent commission cuts can rely.

transactions, no subscriber contract or contract offer may require the subscriber to pay fees for non-use in excess of the fixed monthly charges for the hardware and software, and such charges must be reasonably related to the system's costs, and no subscriber ...."

2. To Prohibit "Corporate Tying"

"255.8(c) No system owner may require use of its system by the subscriber or by any customer of any subscriber in any sale of its air transportation services."

3. To Prohibit "Hardware Tying"

"255.9(b) This section prohibits, among other things, a system's: ...

"(5) Pricing of CRS services using third-party hardware at a level which is disproportionately high in relation to pricing of CRS services using system hardware."

4. To Prohibit Data Dissemination

"255.10 [Deleted in its entirety] No system shall make available to any other person any marketing, booking, or sales data that it generates from its system."

5. To Require Quota Reduction for Loss of Business

"255.8(f) No system shall refuse a subscriber's request to decrease the subscriber's cost of using a system if the subscriber documents a loss of productivity of at least 10% from the subscriber's productivity during the same month of the prior calendar year.

6. To Permit Termination If an Agency Closes

"255.8(g) No system shall prohibit a subscriber from terminating a contract without liability to the system if the subscriber ceases to conduct business."

WHEREFORE, for the foregoing reasons, LACC respectfully requests that the Department adopt the changes suggested herein.

Respectfully,

A handwritten signature in black ink, appearing to read 'M. Pestronk', written over a horizontal line.

**Mark Pestronk**  
**Law Offices of Mark Pestronk, P.C.**  
**4041 University Drive, Suite 450**  
**Fairfax, VA 22030**  
**(703) 591-1900**  
**(703) 591-9116/Fax**