

Client Update

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The U.S. Department of Transportation Deregulates Computer Reservation Systems

Depending on your perspective, deregulation of the U.S. airline industry in the late 1970's was either good or bad for the industry. A similar dichotomy of views now exists with respect to the decision announced by the U.S. Department of Transportation ("DOT") in January of this year (69 Fed. Reg. 28456) to deregulate the airline computer reservation systems ("CRS"), which have been regulated by DOT for the last twenty years.

The New Situation: Market Forces will Govern rather than Regulations.

In a significant policy shift, the DOT decided to eliminate all of the rules governing the computer

reservations systems, including the long-standing rules that prohibit systems from displaying airlines in a manner that is biased against certain carriers. The regulations were implemented in 1984 when the government learned that the airlines which owned the systems were abusing their ownership rights and biasing fare display options in favor of the owner-carriers. The rules have required unbiased screen displays, mandatory participation of carrier-owners in all the systems, and have prohibited discriminatory booking fee pricing by the systems.

On January 31 of this year, most of the rules governing these systems were lifted. This includes the

prior rules that (a) systems charge the same prices to different airlines for having their routes and fares listed in the system, and (b) airlines that own part of a system must participate at the same level in other systems. Three following three remaining rules will be phased out at the end of July 2004:

1) The bar against systems biasing flight listings in favor of some airlines to the disadvantage of others,

2) The prohibition against systems requiring an airline to show all fares, including low-cost Web-based fares, on the system as a condition of participation in the system, and

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

LOS ANGELES
(213) 620-1780

SAN FRANCISCO
(415) 434-9100

ORANGE COUNTY
(714) 513-5100

SAN DIEGO
(619) 338-6500

SANTA BARBARA
(805) 568-1151

WEST LOS ANGELES
(310) 824-0097

DEL MAR HEIGHTS
(858) 720-8900

WASHINGTON D.C.
(202) 218-0000

3) The rule against requiring an airline to participate in that system at the same level (or higher) that it participates in another CRS.

These restrictions are subject to the six-month phase out period to give the market adequate time to adjust.

DOT's Rationale for Scrapping the Rules.

The DOT and industry members that support the changes contend that the following changes in the market will protect airlines from the ills that the rules were intended to guard against:

U.S. Systems No Longer Owned by Airlines.

The rules originally were imposed because the original CRS firms were owned by individual airlines, which skewed airline flight information that was presented to travel agents. For example the United Airlines system would list UAL flights before competing flights, thereby causing travel agents to choose UAL flights over other airlines which offered service in the same market. However, the three current U.S.-based systems – Sabre, Galileo, and Worldspan – are no longer owned by any airline. A fourth CRS – Amadeus – is owned by three European airlines.

Availability of Information over the Internet.

DOT emphasizes that the development of alternative sources of information and booking capabilities on the Internet, and the airlines' control over access to their Web fares, has begun to make the system "responsive to market force discipline." In other words, DOT maintains that if a CRS engages in discriminatory or other improper behavior there are means in which airlines and other industry participants can financially harm the system without the need for regulatory sanctions. To some extent this has already occurred, with travel agents looking to fare information from airline websites, and travelers bypassing the systems by booking with airlines directly, or through Internet sites such as Travelocity.com. Those in support of the changes point to the fact that CRS firms already have introduced new contracts, which cut the fees that the air-

lines pay to list their flights, and maintain that prices are already down approximately 13%.

The Potential Impact on Airlines Which Fly in or to the United States.

Airlines can hope that the market forces will work and that if the systems revert to bad habits such as biasing one airline over competing carriers, the market will punish that CRS. But there can be no guarantee. The systems still wield considerable power in the market and are in business to make money. Indeed, some of the U.S. carriers are opposed to the change, maintaining that the systems still have "market power" even if not owned by airlines. (In this context, "market power" could include the ability to force airlines that want to be listed in the system to pay prices and to agree to terms that are more onerous than would be applicable if there were real competition in the market.)

As a lawyer for American Airlines testified before the DOT "Completely deregulating the CRS market in its current form * * * is not going to unleash new competitive forces. What it's going to do is it's going to unleash the perverse [economic] incentives that already exist in this misaligned and broken market structure." And, Europe's air carriers also have expressed concern over DOT's decision, fearing that elimination of rules prohibiting bias in the display of fares data could eventually force airlines to pay the system owners for preferred display. Moreover, DOT itself found that "the systems currently still have market power over most airlines," but added that the "continuing changes in airline distribution, particularly the growing importance of the Internet for airlines, travel agents, and travelers, should continue to erode the systems' market power." In announcing the policy shift, the DOT stated:

The systems continue to have marketing relationships and other relationships with their former owner airlines. * * * The lack of control by any U.S. airline will not eliminate the possibility that a system would agree with an air-

line to engage in conduct that would undermine the competitive position of the airline's rivals. Each system, after all, continues to have market power over most airlines, and each of the larger airlines dominates some local markets, primarily at its hubs. A system and such an airline might agree that the system would change its operations so as to benefit the airline while the airline would use its local dominance to strengthen the system's marketing efforts.

Furthermore, the DOT concluded that "systems are likely to bias displays in the absence of rules prohibiting such bias," but nevertheless decided to scrap the rule against display bias effective July 31. DOT reasoned that "on-going developments" in the market will reduce the systems' market power over airlines over time, and will enable travel agents and their customers to easily use alternative sources of information to an extent that it should deter the kind of display bias that would significantly mislead travel agents and consumers.

Airlines Should be Diligent to Protect their Positioning in the Systems

If one airline agrees to a price premium to have its scheduled flights and fares featured more prominently in the system, the CRS will be tempted to take the money, especially where DOT will not step in. For this reason *carriers should be especially diligent in auditing how the systems are operating, and should keep in communication with their travel agency contacts, to ensure that passengers are not being directed to a*

competing carrier. Ultimately, if a carrier believes that it is being harmed by restrictive or discriminatory practices being undertaken by the CRS, it may need to resort to remedies under the antitrust laws of the United States (or other applicable jurisdiction) which are designed to protect competition from abuses of market power. In addition, the DOT has promised that the U.S. Department of Justice will take action against any agreements between a CRS and airline that violate antitrust laws, and that DOT may exercise its statutory authority to take appropriate action if such contractual relationships appear to constitute unfair methods of competition.

ABOUT THE AUTHOR



Roy Goldberg is special counsel in the Business Trial Practice Group in the firm's Washington, D.C. office. He has extensive experience since 1989 in commercial and regulatory litigation before federal and state courts, government agencies and domestic and international arbitration panels. Substantive areas of litigation include aviation matters, commercial contract disputes, construction disputes, challenges to government user fees and rules and regulations, intellectual property disputes, and international trade matters.