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A Conversation With...

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director general and CEO
International Air Transport Association

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The Unwritten Chapter

The European Commission is considering deregulating the computer reservations system industry in Europe, but there are many reasons why this would be the wrong choice.

A reasonable set of rules remains critical until European airlines divest their ownership stakes in Europe's largest CRS.

■ By Bruce Charendoff | *Ascend* Contributor

Anyone contemplating the history of computer reservations systems, also known as global distribution systems, will recognize that the book is divided into three chapters. In chapter one, titled "Airline Ownership and Regulation," all four of the world's major CRSs were developed and owned by major airlines. They were used initially as potent new marketing tools for their airline owners and subsequently as vehicles for distributing multiple carriers' flights in return for compensation.

As these marketing and business objectives inevitably collided, and the carriers that did not own CRSs found themselves at the untender mercy of the handful of competitors that did, regulations were fashioned in several countries, including the United States and Europe, specifically to temper the anticompetitive effects of vertical integration between airlines and distribution systems.

In chapter two, titled "Airline Divestiture and Deregulation," the airline owners of the three U.S. systems — *Sabre*® global distribu-

tion system, *Galileo* and *Worldspan* — fully divested their ownership stakes in the CRSs, removing the major competition concerns and logically paving the way for U.S. deregulation, which occurred on July 31, 2004.

Chapter three, titled "Europe's Decision," is a work in progress. Regulators in the European Commission are currently considering whether to liberalize the E.U. CRS code of conduct while Europe's dominant CRS, *Amadeus*, continues to be owned in significant part by Air France/KLM, Lufthansa and Iberia. All stakeholders in the European travel industry have a vested interest in the result; the decision will have a major competitive impact on airlines, travel distributors and consumers. The lessons of history and a proper balancing of current interests should lead Europe to maintain a reasonable, reformed set of CRS rules until airlines divest themselves of their ownership interests in Europe's largest CRS.

Why Airline Ownership of CRSs Matters

When a supplier owns the distribution networks its competitors must access to bring their products or services to market, the prospect of competitive havoc looms large. From 19th century oil companies with ownership interests in pipelines and railroads to 21st century telecom companies owning broadband services, such vertical integration can create insurmountable market barriers if left unchecked. One of the preeminent examples of this phenomenon was (and is) airline ownership of computer reservations systems. An airline that owns a CRS has the means and the incentive to skew competition in both the airline and distribution markets. Prior to the enactment of CRS rules, this discrimination took many forms — from the sledgehammer of higher booking fees charged to competitor airlines to the more subtle, but quite effective, practice of preferencing screen displays in

Amadeus, which has a market share of 55 percent throughout Europe, has an even larger share in the home markets of its owner airlines: Iberia Airlines, Lufthansa German Airlines and Air France. In the home markets of its parent airlines, Amadeus maintains a dominant position.



favor of its own flights. However, of all the weapons airline ownership created, the deadliest was an airline owner's refusal to participate in any CRS other than its own. By detonating this weapon of mass destruction, airlines were able to lock in their double dominance of airline and distribution markets.

Consider, for example, the plight of a travel agent in Frankfurt, Germany. In choosing a CRS, the agent required access to the fares, schedules and features offered by Lufthansa, Germany's dominant carrier. When Lufthansa told German travel agents that Amadeus, the system it owns, would be the only system that would have full access to its travel content, travel agents had no reasonable choice other than Amadeus. CRSs that cannot deliver access to the content consumers demand is neither an efficient nor a useful tool. Once Amadeus established itself as the dominant CRS, airline competitors seeking to distribute their services in Germany remained dependent

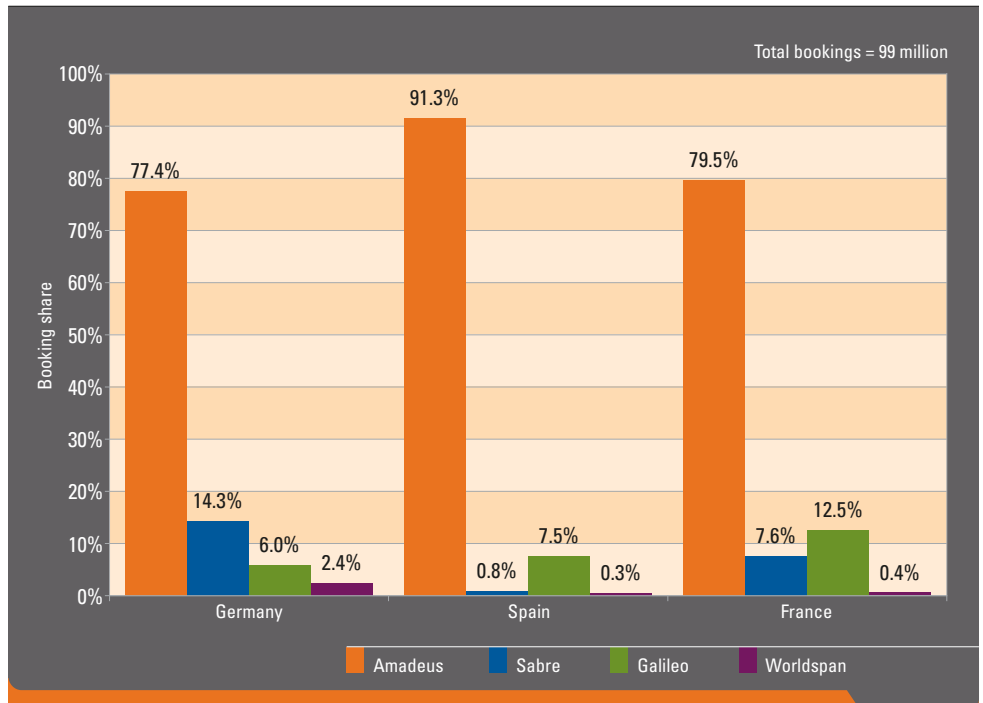
HIGHlight

While the Internet has emerged as an important travel distribution tool, its penetration in Europe is still in its infancy.

on a Lufthansa-owned system to reach travel agents and ultimately consumers. Of course, Lufthansa had every incentive to discriminate against these airlines. While the E.U. CRS code of conduct has many features, non-discriminatory or mandatory participation is the bedrock principle that as codified has served as an effective deterrent to the anti-competitive practices airline owners have engaged in, without governments and industry participants having to resort to cumbersome and costly lawsuits.

Airline ownership has always been the *raison d'être* for CRS rules throughout the world. Amadeus remains significantly owned by Air France/KLM, Iberia and Lufthansa. Together, these airlines own nearly 47 percent of Amadeus and retain seats on the board and the all-important compensation committee of Amadeus's newly constituted holding company. Among other things, these airlines have the ability to veto the annual budget of Amadeus. In the United States prior to deregulation, the trigger for coverage under

GDS Bookings in Germany, France and Spain



From July 2005 through June 2006, Amadeus maintained a booking share of more than 75 percent in each of the home markets of its parent airlines — Germany, Spain and France.

the CRS rules was an airline's ownership of a mere 5 percent of a CRS — even that relatively small amount of ownership was perceived as a threat serious enough to be countered through the application of bright-line rules.

European CRS Marketplace Today

Amadeus and its owners have complained about the burdens of the CRS rules and have been the lone voices pushing for their removal. Of course, these complaints need to be measured against the realities of Amadeus GDS shares throughout Europe. The CRS landscape in Europe today remains dominated by Amadeus, which had 55 percent of last year's CRS bookings throughout the European Union. However, the dominant position is even more dramatic in its parent carriers' home markets, where Amadeus boasts a 73 percent share of the German, 76 percent of the French and 90 percent of the Spanish GDS industry. The CRS rules are vital to keeping CRS competition alive and well in Europe.

European Commission's Distribution Myths

The European Commission's equivalent of the U.S. Department of Transportation, known as DG-Energy and Transport, or DG-TREN, has been reviewing the E.C. CRS rules since 2002. In fact, DG-TREN hired a consultancy known as the Brattle Group to study the CRS rules and make recommendations about what should be done. In 2003, the Brattle

Group concluded that in light of Amadeus' continuing airline ownership and the dangers of "double dominance" in the airline and distribution markets, reasonable rules should be maintained, particularly the rule requiring non-discriminatory participation by parent carriers of a CRS. Based on this finding, in February 2004, the European Commission issued an extended regulatory impact statement indicating its continuing concern.

Nevertheless, despite all these objections and the recommendation of its own consultant, DG-TREN signaled its intention in October 2005 to scrap the E.C. CRS rules, stating that "the risk of competitive abuse of a dominant position initially requiring [the rules] no longer applies." As part of a so-called "better regulation" initiative, the European Commission published a list of more than 1,400 regulations that it has deemed "outdated" and "superfluous" and sought approval from the European Parliament to jettison them as soon as possible. The inclusion of the CRS rules on this list was surprising and, many believe, inappropriate, since key provisions of these rules remain vitally important safeguards.

DG-TREN's strikingly minimal analysis was predicated on the incorrect notions that Amadeus' ownership and control had changed dramatically and that U.S. deregulation served as an appropriate precedent for Europe to follow. Amadeus has indeed reorganized, but its continuing, significant ownership in the hands of some of Europe's largest airlines



undermines the argument. U.S. deregulation proceeded only after all U.S. carriers fully divested their interests in the U.S. systems; indeed, the U.S. DOT specifically left open the possibility of re-regulating the industry should airline ownership of CRSs once again appear in the marketplace.

Additionally, DG-TREN argued, because the Internet has become an alternate form of airline distribution in recent years, the reliance on CRSs has lessened to a point where rules have become unnecessary. This is a great exaggeration of the reality of true travel distribution demographics. The majority of European air bookings are processed through CRSs today, and that trend is expected to continue through 2014. Many Internet bookings, including those made through online travel companies, actually are processed through CRSs.

What's more, according to the European Commission, as much of 50 percent of the citizens of the European Union are effectively locked out of the Internet entirely and hence large sectors of the community remain vulnerable to abusive practices by carrier-owned CRSs. On June 12, the European Commission-sponsored group i2010 summarized the extent to which large segments of the citizenry of the European Union remain locked out of the Internet completely:

- Broadband penetration is still only at 13 percent of the E.U. population (or about 25 percent of households), with significant differences in access between rural and urban areas.
- In the European Union, only 10 percent of persons over 65 use the Internet.

HIGHLIGHT

No travel agent can afford to choose a system that lacks the travel content its customers demand.

- Only around 3 percent of public Web sites fully comply with minimum Web accessibility standards — a real problem for the 15 percent of the E.U. population with disabilities.

According to an April study conducted by Carl Marcussen, senior researcher for the Center for Regional and Tourism Research in Denmark, only 12.6 percent of European travel sales are projected to be processed online this year. Of that amount, Marcussen, who holds a doctorate degree in marketing, estimates that 56 percent will represent air travel sales. So, overall, less than 7.1 percent of European air travel sales will be made on the Internet this year. While the Internet has emerged as an important travel distribution tool, its penetration in Europe is still in its infancy. Contrary to DG-TREN's summary conclusion, the Internet is not a substitute for CRSs and is certainly not a basis on which to scrap important regulatory protections. Indeed, CRSs actually provide the

data and technology that power many top European Internet sites.

Finally, DG-TREN has proffered the argument that existing competition law should be sufficient to discipline today's market, which is not the case. Competition law challenges, brought in the form of lawsuits, are inordinately expensive and take several years to resolve. The subtle behaviors airline owners have employed, such as not providing fare-sale content to competing systems or biasing screens against competitor airlines in key markets, are much better suited to *ex ante* rules that provide an immediate deterrent to such practices than after the fact litigation that provides a remedy far too late to make a difference. CRS rules have accomplished their objective without creating onerous market distortions.

Next Steps

DG-TREN's effort to repeal the rules has not been embraced so far by the other European Commission directorates or in the European Parliament. As a result of an inter-service consultation process on this issue, a more thorough impact study is planned this year, one that is expected to update the findings of the Brattle Group report and take into account the views of stakeholders in the industry. This study, to be conducted by an outside consultancy yet to be named, will make recommendations to the commission about how to proceed.

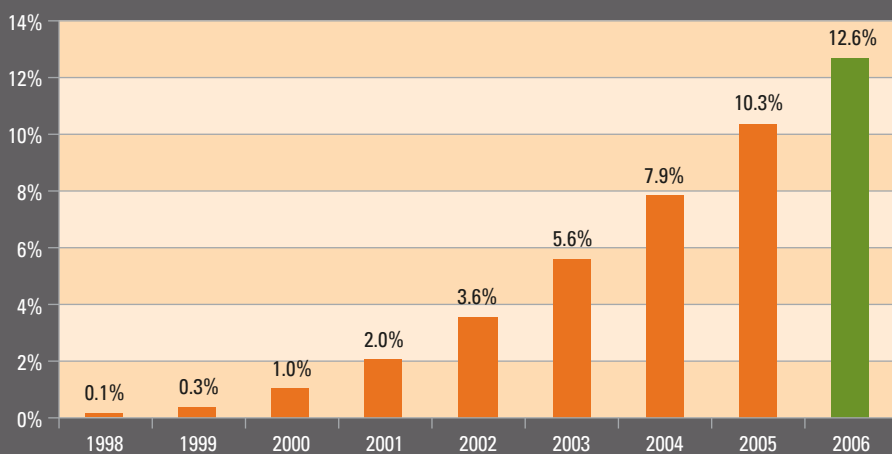
C-FARE's Effort to Keep Reasonable Rules

The Coalition for Fair Access to Reservations in Europe, or C-FARE, was formed to keep the "mandatory" or "non-discriminatory" participation obligation in place for carriers that own a CRS. What this means is that the owner carriers would continue to be obligated to participate in the other systems on a fair and equal basis. C-FARE's objectives are shared by several influential groups in Europe, including British Airways, ECTAA (the major European travel agency trade association) and BEUC (the major European consumer organization).

At the same time, there is recognition within C-FARE that some of the CRS rules that are currently on the books, which may have been justified in the late 1980s, may no longer make sense. The coalition is willing to work with the European Commission to identify those provisions that should be sunset, while securing a firm commitment to keep the bedrock protections in place that remain relevant so long as airline ownership of CRSs exists.

The Business Travel Coalition is also a founding member of C-FARE. Chairman Kevin Mitchell said, "There is support in the travel industry for responsible reform of the E.U.

Trends in Online Travel Market in Europe



Source: Carl H. Marcussen, Centre for Regional and Tourism Research, www.crt.dk/trends, April 2006.

Although the European online market for travel has increased during the past eight years, it still represents only 12.6 percent of the travel spend, meaning traditional travel agents remain the dominant form of distribution.



As the European Commission considers deregulating global distribution systems in the European Union, it must be careful that it does not wreck competition and consumer choice in the process.

tion, innovation and consumers are at risk. CRS-owning airlines have the means and the incentive to force travel agents to use their systems by withholding special fares and services from other systems. No travel agent can afford to choose a system that lacks the travel content its customers demand. With airline ownership and without reasonable CRS rules, higher prices and less innovation and choice have been the inevitable result.

For more than 16 years, Europe's CRS rules have protected the European travel industry against these problems. The principal rule, "non-discriminatory participation," requires CRS-owning airlines to provide fair and equal treatment to all players. This indispensable rule has stood the test of time.

Full deregulation is clearly the wrong choice for the European travel industry and especially for European consumers — so long as airlines own Europe's dominant CRS. That is why there was a firestorm of opposition across the travel industry when DG-TREN suggested in October 2005 that it might take that step. With DG-TREN now looking to an independent expert to update the Brattle Group analysis, industry participants should be sure to make their views known on this important policy debate. ■

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CRS code of conduct but not a reckless and precipitous deregulation that will do considerable and irreversible harm to consumers, corporations' data privacy protections and the competitiveness of the European travel industry sector. BTC calls on the [European Commission] to subject this proposal to a thorough economic impact analysis as it has pledged to do with all significant regulatory

review initiatives. The European Parliament and the consumers it represents deserves nothing less than full transparency of process and highly professional, competent analysis."

CRSs are the backbone of travel ticketing worldwide. They give consumers and their travel agents the tools to find the lowest fares on the airlines that best meet their needs. When airlines own and control CRSs, competi-

+count it up

5 billion

Amount in U.S. dollars U.S. domestic airlines are expected to lose this year, which has been cut in half by a reduction in domestic capacity that returned some pricing power to U.S. carriers.

1

Number of accidents per every 1.3 million flights by member airlines of the International Air Transport Association in 2005, representing less than half the global average and the lowest accident rate ever.

9

Percentage European carriers decreased flight operation unit costs from 2001 to 2004, despite a 63 percent increase in fuel during the same period.

30

Percentage of the European cost structure that labor represents, which is lower than the United States' 33 percent but higher than Asia/Pacific's 19 percent.

24

Percentage of distribution and back-office costs Europe's airlines have reduced from 2001 to 2004 because of the use of advanced technology.

2 billion

Amount of savings in U.S. dollars the International Air Transport Association has achieved on its US\$42 billion bill for airport and air navigation costs, which makes up 11 percent of the total cost structure for IATA's member airlines.