Anti-Competitive Aspects of Airline Ownership of Computerized Reservation Systems

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This article focuses on the contributions that airline ownership of computerized reservation systems ("CRSs") have made and continue to make toward the dominant market positions enjoyed by certain survivors in the post-deregulation domestic airline industry. Also explored will be current attempts—via mergers, consolidations and link-ups—to avoid threatened regulation or divestiture of airline-owned CRSs and to create global CRS alliances.

In order to fully understand the manner in which CRSs have impacted the airline industry, it is necessary to first consider the development of CRSs in relation to deregulation of the airline industry, with particular attention given to the primary policy considerations which fueled the deregulation movement.

I. PRIMARY PURPOSES OF THE AIRLINE DEREGULATION ACT OF 1978

In the hearing and consideration process which subsequently led to passage of the Airline Deregulation Act of 1978,[1] it was generally determined that the system of regulation in effect at that time had encouraged certain practices which allowed for the misallocation of resources in the airline industry. Proponents of deregulation believed that, if allowed to freely flourish through removal of all regulatory constraints, the competitive marketplace would correct the problems which were perceived to exist in the then-existent regulated airline environment. The primary specific perceived short-comings which deregulation and the Act were designed to address and correct were high air fares, carrier inefficiency, limitations on options available to the flying public and the tendency toward excess capacity in which proponents of deregulation believed regulation encouraged the airlines to engage.[2]

> The remedy [to problems caused by regulation] is for the [Civil Aeronautics] Board to allow both new and existing firms greater freedom to lower fares and . . . to obtain new routes. This freedom should lead the airlines to offer service in fuller planes at substantially lower prices, a form of service that most consumers desire.[3]

The potential and actual problems posed by market concentration in a deregulated airline industry were largely ignored by proponents of deregulation, under the guise of the theory of the contestable market. Under its contestability reasoning, deregulators believed that even a highly concentrated airline market would behave competitively if the significant cost

1. Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified as amended at 49 U.S.C. §§ 1301-1552 (Supp. 1984)).

2. Dempsey, *The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91, 118 (1979).

3. *Id.* (quoting Senate Subcommittee on Administrative Practice and Procedures, at 3 (Comm. Print 1976)).

barriers to entry and exit were removed.[4] "Deregulators believed regulated industries would become contestable once barriers to entry and curbs on abandoning unprofitable markets were removed."[5] However, the majority of proponents of deregulation apparently failed to comprehend or appreciate the level of creativity to which airline management and their driving competitive forces would rise in the quest for a permanent spot on the deregulated industry's horizon.

II. Expanded Carriers and New Entrants

The deregulation movement had as its nucleus the application of new economic theories to regulatory practices, which resulted in the widespread notion that the airline industry had become stagnant and inefficient and, as such, required the influx of vast numbers of new and smaller entrants to the market in order to breathe life back into the allegedly ailing industry.[6] As a result of this notion, a major provision of the 1978 Act allowed for phased-in entry of new carriers to the market, and new route authority was freely granted by the Civil Aeronautics Board. In September 1979, for example, the CAB granted new authority to seventeen airlines for new routes serving twenty-one cities.[7] Consequently, intense competition arose among the established trunk carriers, regional carriers, and the new entrants which started from scratch with little capital and used aircraft, but with relatively low labor costs.[8] All of this occurred in an environment in which there were vast differences in the costs of doing business in the industry, with, on the one hand, the established carriers which were accustomed to operating within the safe harbor of CAB protection, and, on the other, aggressive new or expanding carriers determined to establish a competitive edge and to set the air transportation industry on a bold new course.

III. Benefits v. Burdens of Deregulation

The subject of the present hotly contested debate, after ten years of deregulation in the airline industry, is whether the goals allegedly addressed by deregulation were best served by the lifting of *all* regulatory restraints on the industry, and whether deregulation has produced the results which were promised by the proponents of deregulation.[9] While

4. Welles, *Is Deregulation Working?*, Bus. Wk., Dec. 22, 1986, at 50, 52.

5. *Id.*

6. Fahy, *The Applicability of the Antitrust Laws to a Deregulated Airline Industry*, 10 Air L. 152 (1985).

7. Carr, *Airline Industry Decontrol in First Year Boosts Competition, Fails to Slash Fares*, Wall St. J., Oct. 23, 1979, at 6.

8. Fahy, *supra* note 6, at 153.

9. *See, e.g., The Brenner/Kahn Debate*, 16 Trans. L.J. 179-290 (1988).

those engaging issues are generally beyond the scope of this article, some significant points on the subject should be noted.

It is generally believed, by deregulation proponents and detractors alike, that deregulation has brought some significant benefits to the traveling public, to airlines able to adapt, to the national economy and to members of the workforce who are willing to work at competitive, albeit perhaps reduced, wages.[10] It is also generally believed that the operating efficiencies of the airlines that have survived to date have surpassed even the most optimistic predictions made prior to deregulation.[11]

However, other ills which deregulation was designed to correct, such as high prices, limitations on options and tendencies toward excess capacity have not been comparably improved, and many industry analysts contend that those problems have actually grown worse under deregulation. For instance, while increased competition during the first few years of deregulation did, in fact, bring about lower prices—primarily through the lower fare service offered by new entrants[12]—the ability of the established carriers to compete at virtually every price level, in addition to offering better service and more amenities, forced many of the new entrants to abandon their no-frills concepts or to withdraw from particular markets or from the system altogether. (Since deregulation, 198 new carriers came into being, but at least 160 carriers have gone out of business.)[13] And, as pointed out by Melvin A. Brenner in his recent case study on the effects of deregulation, new entrants to the airline industry had their "most favorable 'window of opportunity' in the early years of deregulation—before the existing carriers brought labor costs into line, expanded their route networks, or consummated their various mergers. Conditions for new firms will never again be as favorable."[14]

While a recent report by the Federal Trade Commission indicates that airline deregulation has saved consumers "$100 billion in the years since it took effect,"[15] it cannot generally be said that airline prices are lower across the board in 1989 than they were in 1978, although some figures indicate that, viewed on a whole and as compared to the 5.9% annual increase in the consumer price index since 1978, *real* airline fares in 1987, for instance, were 11.4% below 1978 fares.[16] It is, indeed, possi-

10. Levine, *The Legacy of Airline Deregulation: Public Benefits, But New Problems*, AVIATION WK. AND SPACE TECH., Nov. 9, 1987, at 161.

11. Welles, *supra* note 4, at 50.

12. Brenner, *Airline Deregulation—A Case Study in Public Policy Failure*, 16 TRANSP. L.J. 179, 192 (1988).

13. Jones, *Who's Sorry Now?*, Fin. World, Jan. 26, 1988, at 18.

14. Brenner, *supra* note 12, at 194.

15. *Deregulation Said to Save Airline Consumers Billions*, Wall St. J., Feb. 9, 1988, at 8, col. 3.

16. Jones, *supra* note 13, at 19.

ble for today's traveler to take advantage of tremendous savings in fares, as compared to pre-1978 fares, on those routes and in those fare structures which remain competitive. However, many airlines participating in competitive pricing—which often requires offering seats at prices below the average cost for that airline—have felt compelled to raise prices substantially on less competitive routes in order to compensate for "losses" from competitively priced fares.[17] In fact, according to a study published by the ENO Foundation in 1985, and the study's updated figures published in 1987, while fares on certain routes may have decreased as much as 20% since 1978, the fares on other non-competitive routes have increased by as much as 200%![18] (While the accuracy of such figures may be debatable,[19] they are presented in an effort to counterbalance the widely held notion that the majority of post-deregulation fares have gone down.)

Despite truly valid indications of genuine savings to the air traveler since deregulation, it is important to consider the potential airline fare structure of the future, since rapid concentration and consolidation of the airline industry has given "rise to the fear of ever-increasing fares."[20] With the on-going trend toward mergers and further market concentration, incentives for true competition among the remaining few megacarriers will undoubtedly diminish, as each carves out and becomes more content with its share of the industry pie. As Dr. Alfred E. Kahn has so astutely observed, "When you have the same six carriers meeting each other in market after market, there is danger of softer competition."[21] In such an atmosphere, it seems unlikely that future fares will decrease.

In the area of options offered to the flying public, one benefit since deregulation is the expansion of "single-airline, limited-stop service" between most medium-sized to large cities in the country.[22] However, the airlines' hub and spoke system and the resulting airline dominance at airport hubs has served to significantly reduce the choices that are available to much of the traveling public, and in many cases has also caused a corresponding increase in fares on exclusive or near-exclusive routes. Julius Maldutis, airline analyst for Salomon Brothers, contends that airline dominance at airport hubs "is the most prominent recent development of airline regulation."[23] In fact, in a 1987 report by Mr. Maldutis, he noted

17. Brenner, *supra* note 12, at 195.

18. *Id.* at 196-97.

19. *See*, Kahn, *Airline Deregulation—A Mixed Bag, But a Clear Success Nevertheless*, 16 TRANS. L.J. 229, 235-36 (1988).

20. Jones, *supra* note 13, at 18 (quoting Julius Maldutis of Solomon Brothers).

21. Welles, *supra* note 4, at 52.

22. Levine, *supra* note 10, at 161.

23. Ott, *Congress, Airlines Reassuring Deregulation's Impact*, AVIATION WK. AND SPACE TECH., Nov. 9, 1987, at 163.

that the 10 most concentrated airports "have one airline that has garnered more than a 66% passenger enplanement share."[24] More recent figures relied on by Melvin A. Brenner indicate that at five principal hub airports, one-carrier domination exceeds 75% of available passengers.[25] (Additional comments by Mr. Maldutis, made in November 1987 before the Senate hearings on reregulating the airline industry, were as follows: "Consumers believe that the industry is characterized by massive delays, lost luggage, surly employees, poorly maintained equipment, unsafe and crowded skies, misleading advertising, unavailability of low fares—the list goes on and on.")[26]

Other post-deregulation complaints include those from residents of communities that have completely lost airline service, since those residents are now denied easy access to the deregulated airline system. Between 1978 and 1984, a staggering 114 communities totally lost scheduled air service, while only 23 communities gained such service.[27] At least 410 small communities have suffered the loss of jet airline service[28]—a service which may not have been replaced by commuter airlines. In all, estimates are that by 1984, "225 airports had suffered more than a 50 percent decline in available seats, including some 119 airports that lost service completely."[29]

With respect to the airlines' pre-deregulation tendency to overschedule and waste excess capacity, this practice "has continued undiminished under deregulation."[30] Most airlines continue to engage in scheduling practices which exhibit the apparent policy decision that high levels of service frequency are more desirable than fewer flights operating at greater passenger capacity.[31]

Many extremely significant results of airline deregulation either were not envisioned or were not given proper consideration by those who originally wrestled with the potential benefits and problems facing the industry and the nation prior to deregulation. As Michael E. Levine notes: "[W]e had underestimated the ingenuity of the industry in the search for protection from the rigors of competition. Computer reservation systems, hub-and-spoke route systems, frequent-flyer programs and others all were invented by airlines as ways to find shelter from market forces."[32]

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24. *Id.* at 163.
25. Brenner, *supra* note 12, at 189.
26. Jones, *supra* note 13, at 18.
27. Dempsey, *The Dark Side of Deregulation: Its Impact on Small Communities*, Fall 1987 ADMIN. L. REV. 445, 455.
28. *Id.*
29. *Id.* at 456.
30. Brenner, *supra* note 12, at 204.
31. *Id.*
32. Levine, *supra* note 10, at 161.

Frequent-flyer programs may have been created in response to new low-cost entrants to the market. But airline size and the established positions of the seasoned carriers in the market at the time of deregulation were marked factors in the development of hub-and-spoke systems and of airline-owned computer reservation systems. Subsequently, the developments of hub-and-spoke systems and of CRSs have had a pronounced effect on the ability of airlines to effectively compete in the deregulated airline environment. Alfred Kahn, one of the most avid promoters and supporters of deregulation, recognized at least by 1986 the "enormous competitive advantage" big carriers have due to the "development and exploitation" of computerized reservation systems.[33]

The analysis below explores the method by which computer reservation systems have helped the dominant U.S. airlines achieve and maintain their dominant positions in the deregulated airline industry.

IV. Economic Considerations After Deregulation

To offset some of the economic disadvantages created by the entry of new low-cost carriers into the previously regulated market, after deregulation the more senior carriers turned their attention to their well-established distribution and computerized reservation systems, where they found a competitive advantage over their fledgling rivals. Because of the extensive development of these systems and the wide-spread travel agent contacts and arrangements already established, the older carriers found that they actually had distribution costs which were lower than many of the newcomers.[34]

However, because of the numerous cooperative agreements—especially with regard to rate regulation—which had existed under CAB regulation, the established carriers discovered that they had, in effect, been forced to subsidize some of the distribution costs of the new and growing carriers with which they now found themselves competing.[35] This subsidization took place, according to the established carriers, primarily through the substantial costs which those carriers had borne in developing their CRSs and distribution networks.

As a direct result of the recognition by the major established carriers that their so-called subsidization of new carriers could not continue in the deregulated free market environment, the competitive focal points in the airline industry became the distribution and reservation systems. The shift from route and fare competition to "systems" competition has been a

33. Brenner, *supra* note 12, at 188 (quoting speech by Alfred E. Kahn to the Regional Airline Association, *Airline Deregulation: the American Experience*, at 13-14 (May 1986)).

34. Fahy, *supra* note 6, at 153.

35. *Id.*

subtle one, and many industry analysts did not fully grasp until recently the potential for profound impact such a shift would have on the structure of the domestic airline industry. This impact is especially significant in light of the success the older carriers have achieved to date in resisting attempts to re-regulate the industry. And, it is now becoming apparent that airline-owned computer reservation systems will have a tremendous impact on shaping the future of the international air transportation industry.

V. ORIGINS AND GROWTH OF CRS VENDORS

Computerized reservation systems—which consist of central databases with periodically updated information, feeding to terminals of subscribing travel agencies and carriers—originated as in-house tools with which airlines kept track of internal flight information, schedules, and other data.[36] During the early 1970s, the industry tried but failed to establish a single-industry CRS for use by all travel agent representatives. After the last of such attempts failed in 1976,[37] United, American and TWA began offering their own computer services to travel agents via lease agreements; Eastern and Delta joined the CRS market in 1981.[38]

The current airline-owned CRS vendors in the United States and their systems are:

SABRE, owned by American Airlines, which by most accounts is the world's largest privately owned computer system;

APOLLO/COVIA, founded by United Airlines, but now owned by United, US Air, and four European carriers—British Airways, Swissair, KLM and Alitalia;

PARS Marketing Corp., created by Trans World Airline but now owned jointly by TWA and Northwest Airlines, Inc.;

System One, owned by System One Holdings, Inc., a subsidiary of the Texas Air Group (which includes Continental, Eastern and others); and,

DATAS II, owned by Delta Airlines.[39]

A recent joint venture agreement between American and Delta has been reached, in which SABRE and DATAS II will be merged into a new company. Delta will pay American $650 million for participation in the new system, pending Justice Department and Department of Transportation approval.[40] The new system will be marketed as a global CRS, and

36. Saunders, *The Antitrust Implications of Computer Reservation Systems (CRS's)*, 51 J. AIR L. & COM. 157, 160 (1985).

37. Fahy, *supra* note 6, at 158.

38. Helliwell, *Networks Provide a Critical Competitive Edge for Airlines*, P.C. WK., Jan. 19, 1988, at C1, C3.

39. Shifrin, *American, Delta Computer Reservations Deal May Intensify Global Competition*, AVIATION WK. AND SPACE TECH., Feb. 13, 1989, at 94.

40. *Id.*

ownership positions will be offered to U.S. airlines with no current CRS interests, and perhaps to foreign carriers and other businesses, at a price of $20 million per 1% share.[41] The new venture has been valued at approximately $2 billion, and, if approved, will combine SABRE's 37% of the domestic CRS market share with DATAS II's 6%, for control of an estimated 43% of the domestic CRS market.[42]

VI. CRS TICKETS ISSUED AND BOOKINGS MADE

According to figures available as of December 1987, approximately 40% to 45% of *all* tickets issued by U.S. travel agents are issued through American's SABRE system, about 33% are through United's APOLLO system, and 15-16% of such U.S. tickets issued are through System One.[43] Of all airline tickets sold in the U.S., at least 57% are sold through computer reservation systems.[44] While figures vary, there is little doubt that since deregulation, the percentage of domestic airline tickets issued by travel agents has increased substantially; 1985 figures indicate as much as 86.4% of all domestic and international tickets issued were issued by travel agents,[45] and 95% of U.S. travel agents are "hooked up" to a CRS.[46]

Most industry estimates concur that travel agency automation systems are responsible for booking approximately 80% of all airline reservations in the U.S.[47] Additionally, by virtue of their access to CRSs, travel agents can provide a multitude of other services to travelers, including issuing tickets and boarding passes, making car and hotel reservations, selling package tours and issuing travelers checks and flight insurance. The ramifications of airline ownership of travel-related enterprises, such as hotels and car rental agencies, should become increasingly significant with the realization of the importance of the CRS to the overall travel industry, and with the realization that the *primary tool* of the industry—the CRS—is directly controlled by the actual competitors in the airline and travel industry. These ramifications become even more significant in light of an appreciation for the methods with which a CRS can be biased in favor of its carrier owner or "host vendor." Such are the aspects of the

41. O'Brian, *Delta, AMR's American Airlines Plan to Merge Computer Reservation Systems*, Wall St. J., Feb. 6, 1989, at B10, col. 2.

42. Shifrin, *supra* note 39, at 94.

43. Shifrin, *Texas Air Unit Charges American with Restraining CRS Business*, AVIATION WK. AND SPACE TECH., Dec. 7, 1987, at 51.

44. Levine, *Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy*, 4 YALE J. ON REG. 393, 415 (1987).

45. *Id.* at 414, n.95.

46. Feldman, *Will CRS Revolutionize International Air Travel?*, AIR TRANSP. WORLD, Aug. 1988, at 39.

47. Shifrin, *supra* note 43, at 51.

CRS controversy which most seriously implicate anticompetitive concepts.

Aside from their obvious value as useful industry tools, airline-owned computer reservation systems are "attractive profit centers in their own right."[48] The five U.S. carrier-owned systems cost a total of over $1.5 billion to develop, but the healthy return on the investment apparently justifies the cost. It is alleged that American Airlines, for example, earns more from ticket commissions from its CRS than it does from its flight operations.[49]

The capacity of these systems is equally staggering. According to 1986 figures reported in The Wall Street Journal, American Airlines' SABRE system had at that time 50,000 terminals in 12,000 travel agency offices, containing 17.5 million airline fares, with schedules of 650 airlines around the world and the ability to make reservations on more than 300 of those airlines.[50] Since those figures concerning SABRE were reported in 1986, American upgraded its system to include 5 mainframe computers running in parallel, with the capacity to drive over 100,000 terminals.[51] Current estimates indicate that the proposed SABRE-DATAS II merger will create a system with 79,600 terminals in approximately 17,000 travel agencies.[52] System growth in capacity for processing information is also astounding. For instance, in 1983, United's APOLLO system was processing approximately 400 transactions per second; that same system now handles up to 1,150 transactions per second.[53]

The typical travel agency office pays a CRS vendor anywhere from $500 to $1,000 per month for rental fees for terminals and printers.[54] Those rental fees include all inquiries and reservations made, but the agency additionally pays approximately 10 to 15 cents per unit for ticket and printing costs. The travel agency, on the other hand, derives its income primarily from a percentage commission on airline tickets sold, cars rented and hotel rooms booked. The CRS vendor may also pay an additional flat rate for each flight segment booked through its system.[55]

"From the beginning, the competition among the airline networks has been one part technological, two or three parts contractual and manipula-

48. Etheridge, *Sky Wars Over Europe*, DATAMATION, Feb. 1, 1988, at 84-1.

49. *Id.*

50. Rein, *DOT's Continuing Regulatory Oversight of the Airline Industry*, 425 PRACTICING LAW INSTITUTE/COMM. 7, Jun. 4, 1987.

51. *Id.*

52. Shifrin, *supra* note 39, at 94.

53. Garretson, *United Subsidiary Begins Migration to Distributed Net*, P.C. WEEK, Jan. 19, 1988, at C1, C8.

54. Helliwell, *supra* note 38, at C4.

55. *Id.*

tive."[56] Travel agencies have not escaped the manipulative contractual practices of the CRS vendors. In fact, one of the most active legal battlefields in the airline industry at present involves CRS vendor attempts to either enforce contracts with travel agents seeking to switch CRS vendors, or CRS vendor attempts to woo agencies away from current vendors, with incentives such as offers to pay all damages incurred in breaching CRS contracts.[57] (For instance, System One is currently defending more than 80 travel agencies in lawsuits with SABRE or APOLLO/COVIA, as part of System One's offer to defend agencies when they breach CRS contracts to change to System One.)[58]

The 1984 government rulemaking directed at removing bias from computer reservation systems also addressed CRS-travel agency contractual arrangements, ruling that such contracts longer than five years were not permitted.[59] However, some of the more creative vendors attempted to circumvent the five year contractual cap by forcing agencies to rollover their contracts to new five year terms each time a new piece of equipment was added.[60] Such practices were terminated in the face of threatened government intervention,[61] but the daring practices themselves—and the numerous lawsuits the vendors have brought against travel agencies for breaches and against each other for encouraging those breaches—indicate the airlines' view of the importance of computer reservation systems to the airlines' competitive positions in the industry.

VII. Increased Passenger Bookings for Vendor Airlines Through System Bias and Vertical Integration

Early on in the course of initial leasing by airlines of their CRS services to travel agents, the airlines recognized that such automation of travel agencies would result in increased air transportation business for the CRS vendor/airline. The "special relationship"[62] which developed between the CRS vendor and travel agent resulted in a natural tendency for the agent to make more passenger bookings on flights of its CRS vendor/carrier. Additionally, agents leasing automated systems understandably had more confidence about a CRS vendor's information concerning

56. *Id.*

57. *Id.*

58. Godwin, *Res Damages Clause Upheld in Austin Case*, Travel Weekly, Feb. 9, 1989 at 1. *See, e.g.*, United Airlines, Inc. v. Austin Travel Corp., 681 F. Supp. 176 (S.D.N.Y. 1988), *aff'd*, 867 F.2d 737 (2d Cir. 1989).

59. 49 Fed. Reg. 32,540 (1984) (codified at 14 C.F.R. § 255 (1986)).

60. Helliwell, *supra* note 38, at C4.

61. *Id.*

62. Fahy, *Regulation of Computerized Reservation Systems in the United States and Europe*, 11 Air L. 232, 233 (1986).

its *own* flights.[63] (The Department of Transportation has dubbed the positive effects of this "ongoing mutually supportive business relationship" the "halo effect.")[64]

In exploring the potential of travel agents' use of CRSs, vendors and industry analysts began to learn about something which is now commonly known as "system bias." System bias involves the manipulation of flight information on a CRS terminal so that the displayed flight information subtly favors the CRS vendor/carrier's flights.[65] System bias has been recognized in at least three different forms—screen bias, connecting point bias and database bias. CRS vendors allegedly use bias to increase the number of bookings which are made on their flights.[66] The Department of Transportation and the Government Accounting Office refer to these additional bookings attributable to airline ownership of a CRS as "incremental revenues" and contend that CRS vendor airlines have "continued to earn substantial incremental revenues even after the CAB's [1984] anti-screen bias rule took effect."[67]

The air transportation industry is generally composed of three levels or categories of activities: air transportation services, reservation information distribution, and air transportation sales.[68] An airline-owned CRS represents a vertical integration of air transportation services and reservation information distribution.[69] Through this type of vertical integration, an air carrier that owns a computer reservation system can favorably influence its competitive advantage in the market by using its information distribution processes (its CRS) to increase its transportation sales and revenues, transferring income from non-CRS vendor airlines to CRS vendor airlines and from minor to major CRS vendor airlines.[70] The DOT has estimated that system bias, combined with high booking fee charges, results in the transfer of over half a billion dollars annually to the two major

63. *Id.*

64. *Competition in the Airline Computerized Reservation System Industry; Hearings Before the Subcommittee on Aviation of the House Committee on Public Works and Transportation*, 100th Cong., Second Sess. (September 14, 1988) (testimony of Victor S. Rezendes, Associate Director, Government Accounting Office, Resources, Community and Economic Development Division) [hereinafter cited as "1988 Hearings."]

65. Saunders, *supra* note 36, at 180 (citing *Review of Airline Deregulation and Sunset of the Civil Aeronautics Board: Hearings Before the Subcommittee on Aviation of the House Committee on Public Works and Transportation*, 98th Cong., 1st Sess. 40, 66-77 (1983) [hereinafter cited as "1983 Hearings."]

66. *Id.* at 181.

67. 1988 Hearings, *supra* note 64, at 8.

68. Saunders, *supra* note 36, at 181.

69. Cohen, *The Antitrust Implications of Airline Deregulation*, 28 ANTITRUST BULL. 131, 152 (1982).

70. 1988 Hearings, *supra* note 64, at 8-9.

CRS vendors—SABRE and APOLLO/COVIA.[71] As simply stated recently by the G.A.O. to the Subcommittee on Public Works and Transportation, "[t]he airline that owns a CRS is also able to sell more airline tickets by virtue of its CRS ownership."[72] Therefore, the use of bias in a vertical integration has obvious and sweeping economic and anticompetitive implications.

VIII. SCREEN BIAS

Screen bias is the type of bias which has historically caused the greatest controversy. When searching for flight information, a travel agent can generate several screens of information concerning flights for a particular requested route. While a potential passenger might hope that the agent would review all relevant screens before making a booking recommendation, in practice, it is estimated that 70% to 90% of all bookings are made off the first screen viewed—50% off the first line.[73] Since CRSs can be programmed to ensure that flights of a particular carrier appear first on the screen,[74] CRS vendor/carriers have a tremendous motivation and temptation for making sure that information concerning their own flights appears before all other flight information on their systems. In fact, CRSs can be so drastically manipulated and biased in favor of the vendor's flights that even exact matches of a consumer's request may not appear on the CRS terminal screen ahead of a vendor's flight which does not so closely match.[75] Agents are well aware of such biases, but allegedly may tend to book less desirable flights in order to save time and money.[76]

As previously mentioned, 1984 government rulemaking concerning CRSs was directed at removing bias from the systems. The main thrust of the rule was to attack preferential display formats.[77] The rule prohibits loading the computer display information based on carrier identification, and the rule require CRS vendors to "apply the same standards of care and timeliness to loading information concerning participating carriers as it applies to the loading of its own information."[78] While blatant screen bias undoubtedly decreased after promulgation of the rule, complaints have continued that the two largest vendors—American and United—still

71. *Id.* at 8.
72. *Id.* at 5.
73. Saunders, *supra* note 36, at 180 (citing 1983 Hearings, *supra* note 65, at 67).
74. *Id.* at 182.
75. 49 Fed. Reg. 32,550 (1984).
76. Saunders, *supra* note 36, at 182.
77. 49 Fed. Reg. 32,550 (1984).
78. 14 CFR § 255.4(d) (1984).

manipulate their displays to favor their own flights.[79] In fact, the U.S. District Court for the Central District of California recently denied defendants' motions for summary judgment on Continental Airlines' $1 billion racketeering, mail and wire fraud claims against American and United and their CRSs, which claims allege that American and United preferentially display their own fares and schedules while suppressing those of competitors.[80]

IX. Connecting Point Bias

With the explosive growth of the airline hub-and-spoke system, the resulting carrier dominance at particular airports, and increased competition among CRS vendors for travel agent contracts, connecting point bias may be the most influential bias-based tool presently at a CRS vendor's disposal.

Specifically, connecting point bias can be used to design systems so that vendors' hubs are the most prominent or only connecting points displayed, subordinating or ignoring different connecting points of competing carriers.[81] Screen bias can be overcome by an agent who continues to view additional screens; connecting point bias is virtually undetectable to agents and *cannot be avoided* in a system in which it is incorporated.[82]

Connecting points are used, of course, to construct a departure-to-destination flight plan when a non-stop or direct flight is not available. Connecting point bias involves the ability of the CRS vendor to exclude key connecting points which would require booking on another airline. Vendors actively utilizing connecting point bias in their systems use their own major hubs as the primary connecting points for the vast majority of flights, systematically excluding as connecting points the bases and hubs of competing airlines.[83] No CRS can include all possible connections for every flight, so most CRSs use a limited number of possible connecting points in association with particular departure and arrival points.[84]

The unwary traveler, seeking to book a connecting flight along a logical geographic route, is potentially at the mercy of a travel agent using a CRS which has incorporated connecting point bias into its system. Neither the traveler nor the travel agent may be aware that both are relying on flight information which is biased in favor of an airline's preferred connecting points. It is quite possible that more logical choices may not be considered for the traveler because bias has caused those choices to

79. Helliwell, *supra* note 38, at C4.

80. *In Re Air Passenger Computer Reservations Systems Antitrust Litigation*, No. MDL 667 ER (C.D. Cal. Feb. 17, 1989.)

81. Saunders, *supra* note 36, at 182-83 (citing 1983 Hearings, *supra* note 65, at 73).

82. *Id.* at 183.

83. *Id.*

84. *Id.* at 182.

appear in such inferior positions that they may never be viewed by the agent. In such a case, the traveler may simply be informed that no other options exist for connecting flights, other than the ones which favor bookings on the CRS vendor airline.

X. DATABASE BIAS

Database bias involves the withholding of information or the failure to incorporate information into a system's database in a timely fashion, thereby allowing the system to reflect inaccurate information.[85] This sort of bias is the direct result of control over the processing of or failure to process information.

It seems reasonable to assume that the use of database bias has decreased somewhat with the recent widespread availability of direct access to airline databases—a feature which is now commonly offered to travel agents. Direct access, introduced by System One, allows a travel agent to "reach through" its vendor's reservation system to access directly the databases of airlines and to compete in "real time" with agents of that airline.[86] Without direct access to other databases, a travel agent attempting to book a reservation can be "bumped" by another agent attempting to make an identical contemporaneous booking, if the other agent has direct access, or is "directly connected" to the appropriate database.[87] Currently, at least 22 airlines—including all those owning reservation systems—offer the direct access option through System One, which promotes the feature heavily.[88]

With such powerful tools in their hands, it is easy to see why CRS vendor/carriers are so interested in widespread use of their CRSs, to the exclusion of as large a percentage of other CRSs as possible. Without system bias, a carrier will be assured a greater number of bookings on its airline from users of its system, due to a natural tendency to book on the vendor airlines' flights. *With* system bias, the possibilities for increasing bookings and for securing a competitive advantage in the marketplace are astounding.

* * * * *

It might be assumed that once a CRS vendor's dominance of travel agent users reaches a certain point, monopolization by the vendor would be relatively easy to show. This is not the case, however, due primarily to the ability of vendor/carriers to avoid definitive showings of monopoly or oligopoly in the airline industry via creative manipulation of analyses of

85. *Id.* at 183.
86. Helliwell, *supra* note 38, at C4.
87. *Id.*
88. *Id.*

not only relevant product markets, but especially of relevant geographic markets.

XI. Relevant Markets and Market Concentration

The relevant product market for the CRS industry has been called the "air transportation computer reservation services" market,[89] despite arguments by American and United that the relevant product market is "airline ticket distribution services."[90] Valid arguments can be made for both of these views, as well as other product market definitions. However, determinations of market power and concentration in the CRS industry (and in the airline industry in general) do not depend much upon the particular *product* market definition used. A much more significant impact on determinations of CRS (or airline) market power and concentration result from the application of different definitions of the relevant *geographic* market. As demonstrated below, drastically differing answers to questions of market concentration are possible depending on whether one views the relevant geographic market as national or regional.

For example, no CRS vendor's share of the "air transportation computer reservation services" market is alarmingly great when viewed on a national basis,[91] and facially, no great significance attaches to airline ownership of CRSs under such an examination. However, there appears to be a distinct correlation between regions of the country where a CRS vendor offers a large number of flights, and regions of the country where the majority of its CRSs are used.[92] Therefore, to analyze accurately true CRS market concentration, it may be necessary to define the relevant product market in two ways—in combined air carrier service/computer reservation system terms, and then to view that product market within the confines of regional relevant geographic markets.

In support of such a market analysis, consider the fact that CRS vendors do not even market their systems in geographic areas where they do not have substantial flight activity. Indeed, they normally require at least the prospect of a high volume of sales before they will *permit* a travel agency to subscribe to their services.[93] For instance, in Denver, where United has a hub, United's APOLLO/COVIA is responsible for a 76% share of the airline ticket sales market, whereas in the Dallas-Fort Worth area, where American is the dominant air carrier, American's SABRE enjoys a 91% share of the same market.[94]

89. Cohen, *supra* note 69, at 152.
90. Saunders, *supra* note 36, at 167 n.79.
91. *Id.* at 170.
92. *Id.* at 168; *see also* Levine, *supra* note 44, at 464.
93. Saunders, *supra* note 36, at 168.
94. 1988 Hearings, *supra* note 64, at 3-4.

As measured by the traditional anticompetitive yardstick—the Herfindahl-Hirschman Index ("HHI")—one can analyze relevant market statistics (reflected below) on a *national* basis and conclude that the U.S. airline industry is not overly concentrated. However, an analysis of the same statistics by *region* or by *airport* indicates phenomenal concentration in the industry.[95] Consequently, it is puzzling and disturbing that this alternative regional analysis apparently has not been given more careful consideration by government agencies charged with responsibility for overseeing anticompetitive aspects of the airline industry.

According to Department of Transportation figures, the U.S. airline industry for the period 1977-1987 included 27 domestic carriers which operated with a share of 1% or greater in the U.S. markets.[96] And, according to market share broken down by airline based on enplanements at all U.S. airports for the period of 1977-1987, the greatest market share of *any one airline* for *any relevant year* was 14.98% (United in 1978).[97] The highest HHI for the entire ten-year period based on enplanements at all airports is 1,303 (1987).[98]

With such figures in mind, consider now the following Department of Transportation categorizations with respect to levels of concentration in the national air system:

—an HHI score below 1,000 indicates little concentration;
—between 1,000 and 1,800 indicates moderate concentration; and
—above 1,800 means there is high concentration.[99]

Obviously, an HHI score of 1,303 (referenced above) as a high figure for the U.S. airline industry from 1977-1987, using a *national* relevant geographic market definition, would indicate only moderate market concentration under the above DOT categorizations.

However, examination of the HHI by individual airport for the same ten-year period yields incredibly different results. For instance, the lowest HHI for 1987 for any of 50 U.S. airports for which figures were compiled is 1,208 (Las Vegas); the highest HHI is an unbelievable 10,000 (Dallas Love Field, which is almost totally dominated by Southwest Airlines).[100] The weighted average of *all* HHI figures for *all* 50 airports for 1987 is 3,531—significantly higher than the DOT's standard of "above 1,800" which qualifies for the designation of "high concentration."[101]

Notwithstanding such compelling statistical information which would

95. Flint, *Too Many Mergers, Too Little Competition?*, AIR TRANSP. WORLD, Jan. 1988, at 81.
96. *Id.* at 82.
97. *Id.* at 81.
98. *Id.*
99. *Id.* at 131.
100. *Id.* at 82.
101. *Id.*

seem to indicate incredible market concentration by region or by airport in the domestic airline industry, air carriers seeking merger approval since deregulation apparently have faced little opposition by the government to the use of a *national* relevant geographic market definition for purposes of such merger determinations.[102] Government adoption of a national market definition is perhaps due to the existence in the airline industry of many traditional market definition factors which support use of a national geographic market definition, such as the national planning and operational aspects of the airline business.[103]

However, the factor which may be most significant to both the government's acceptance of a national market definition for the airline industry and the government's resulting opinion that market concentration levels for merger purposes have been and are acceptable is the Department of Transportation's undying faith in the ability of the free market system to flourish, even in the face of overwhelming anticompetitive activity. ("Faith in the ineluctable benevolence of the free market is most devout at the Transportation Department, the Interstate Commerce Commission, and the Federal Communications Commission, which are charged with overseeing the process of deregulation.")[104]

Salomon's Julius Maldutis goes so far as to suggest that use of a national market definition has led (or permitted) the Department of Justice (in its previous advisory capacity to the DOT in airline merger matters) to misapply the Herfindahl-Hirschman Index to all previously approved post-deregulation airline merger determinations, resulting in reliance on erroneous information about the true levels of market concentration which existed at the times all such mergers were approved.[105] As Mr. Maldutis told a recent Senate committee studying the effects of air carrier mergers on the airline deregulation picture, [it is] "very tempting to say that no mergers should have been approved," due to the already high levels of concentration in the airline industry.[106]

Under a national market definition, the market shares for CRS vendors are relatively low,[107] and undoubtedly fall short of a finding of monopoly power under traditional monopoly tests.[108] While market share figures for CRS vendors change dramatically under a regional market analysis (Department of Justice figures from over three years ago indicate that there were 29 urban areas were a CRS vendor had more than a 40%

102. *See, e.g.,* Flint, *supra* note 95, at 84.
103. United States v. Grinnell Corp., 384 U.S. 563, 574-76 (1966).
104. Welles, *supra* note 4, at 51.
105. Flint, *supra* note 95, at 84.
106. *Id.*
107. Saunders, *supra* note 36, at 170; *see also*, 1988 Hearings, *supra* note 64, at 3.
108. United States v. Aluminum Company of America, 148 F.2d 416 (2nd Cir. 1945).

share of the market, with a 70% market share for one CRS vendor in at least five of those same areas)[109]—it is likewise unlikely that regional CRS market concentrations would satisfy the test for a showing of monopoly power.[110]

Nevertheless, serious study and consideration are undoubtedly warranted into the effects of high regional market air carrier concentration, and high airline-owned CRS concentration in corresponding regional markets. Findings made from such study and consideration should give even the most fervent airline deregulation proponent cause for at least a modicum of concern as to the wisdom of the last few years of regulatory decisions which impacted the airline industry. When high levels of regional concentration are coupled with the significant barriers to entry in the present airline industry—which are so great that only one new air carrier entrant, People Express, was able to gain more than a 1% share of the market since deregulation[111]—the realistic prospects for future healthy growth and competition in the airline industry are bleak, especially if the current practices of anticompetitive activity through airline-owned computer reservation systems are allowed to continue unchecked.

As a matter of independent consideration, totally separate from antitrust considerations, the potential effect of a highly concentrated regional airline market on the relevant region and/or community should also be examined from the point of view of that region or community, due to the potential for harm to the community which could result from the presence of a dominant air carrier in the region.

> Other industries, even when comprised of only a few large firms, do not usually end up with a one-supplier monopoly in specific local markets. But this can happen in air transportation.
>
> Moreover, because of the nature of transportation, a local monopoly can do greater harm to a community than could a local monopoly in some other industry. This is because transportation is a basic part of the economic-/social/cultural infrastructure, which affects the efficiency of all other business activities in a community and the quality of life of its residents. The ability of a city to retain existing industries, and attract new ones, is uniquely dependent upon the adequacy, convenience, and reasonable pricing of its airline service.[112]

As of January 1, 1989, jurisdiction over airline antitrust matters shifted from the DOT to the Department of Justice, although DOT retains jurisdiction over CRS issues.[113] It remains to be seen whether or not the

109. Saunders, *supra* note 36, at 171.

110. United States v. Aluminum Company of America, 148 F.2d at 424.

111. Welles, *supra* note 4, at 53.

112. Brenner, *supra* note 12, at 189.

113. *U.S. Airline Concentration Burden Shifts to Justice Department*, AIR TRANSP. WORLD, Feb. 1989, at 34.

Department of Justice will take a different, tougher approach than did the DOT in policy making decisions and in other activities which address antitrust issues in the deregulated airline industry. With the G.A.O. currently studying approximately 15 airports where one airline has more than a 60% market share, or where two airlines have more than an 85% market share, and with Department of Justice economists studying airline concentration and its possible impact on fares, the methodology for such analyses will probably be the same, "[b]ut the conclusions could differ."[114]

XII. CRS Expansion in the United States and Abroad

The increasing scrutiny of airline mergers, market concentration factors and airline ownership of CRSs which has taken place over the last few years has undoubtedly impacted the tactics employed by CRS owners in recent maneuverings occurring and alliances forming in the airline CRS world. Airline CRS expansion has manifested itself in a wide variety of forms recently. For instance, while CRS vendors seem to be constantly updating their systems in order to improve and expand capacities for functioning as reservation systems, some vendors have also begun to explore other possibilities for uses of the systems. United, for example, through its information systems subsidiary, Covia, Corp., has begun to integrate all its systems, such as baggage handling and flight planning, as well as flight, hotel and car reservations provided through APOLLO, into the vast and advanced APOLLO/COVIA distributed network.[115] This undertaking by United is requiring the replacement of approximately 60,000 terminals used by travel agents subscribing to APOLLO.[116]

SABRE meanwhile has developed its own integrated PC software, which runs on IBM hardware, for use by travel agents subscribing to SABRE. SABRE hopes to sell as many as 50,000 copies of the software, which is called SabreWorks.[117] A similar user-friendly subscription travel service—EAASY SABRE—is also available to PC owners through most public networks, allowing individual travelers to join travel clubs and to book their own air, hotel and car rentals.[118]

And PARS, with an aggressive marketing campaign, has recently begun offering to subscribers additional services such as a geographic information database, information on international educational, cultural and social exchange programs, world-wide luxury motor home rentals, and

114. *Id.* at 89-90 (quoting the Justice Department's Gloria Hurdle).

115. Garretson, *supra* note 53, at C1.

116. *Id.*

117. Burke, *Sabre Gets the Works*, P.C. Week Jan. 26, 1988, at 121.

118. *CUC Int'l Discount Club for EAASY Sabre Users Draws Concern*, Travel Weekly, Dec. 19, 1988, at 2.

bookings of temporary office and conference facilities for business travelers.[119]

However, without doubt, the area of CRS expansion which encompasses the most formidable and aggressive activity by domestic vendor/carriers is their all out push to penetrate and perhaps set the pace for the European and Far Eastern computer reservation systems markets. The U.S.-European battle has been termed a "dogfight," with the possibility of enormous spoils or gains.[120] Until recently, European national airlines working in alliances formed to protect themselves[121] had been successful in holding back the push by U.S. airlines to significantly penetrate the European CRS market.[122] American Airlines, furious over what it considered restrictive practices, sued British Airways for allegedly restricting American from the United Kingdom's CRS market.[123] American and British Airways recently settled their dispute privately, with DOT approval, to the dismay of other U.S. carriers that feared their own competitive positions in the European market would be undermined by American's then-developing relationship with British Airways and by American's agreement to provide British Airways with valuable information on U.S. CRS practices in exchange for a market position in the United Kingdom and in Europe.[124] Perhaps in response to fears of that developing alliance, United last year sold 49.9% of COVIA to the USAir Group, Inc. and to the four European airlines (British Airways, KLM, Swissair and Alitalia) that make up Galileo, one of the two European CRSs.[125] (Additional shareholders in Galileo include Aer Lingus, Austrian Airlines, Olympic Airways, Sabena and TAP Air Portugal.)[126] Galileo originally estimated that it would spend $120 million developing its system and projected hookup of existing member databases to a central system by mid-1989.[127]

The other European CRS group is called Amadeus, with its head office in Madrid, development facilities in Nice and operations center in Munich.[128] Amadeus plans on spending $270 million to bring its centralized

119. *PARS Offers New Data and Services*, TRAVEL WEEKLY, Jan. 26, 1989, at 9.

120. Etheridge, *supra* note 48, at 84-1.

121. Condom, *CRS versus Deregulation*, INTERAVIA, Mar. 1988, at 193.

122. Etheridge, *supra* note 48, at 84-4.

123. *Id.*

124. Ott, *American Airlines Settles CRS Dispute With British Airways*, AVIATION WEEK AND SPACE TECHNOLOGY, Jul. 18, 1988, at 90; *DOT Allows American, BA to Settle Res Dispute*, TRAVEL WEEKLY, Dec. 26, 1988, at 3.

125. Shifrin, *supra* note 39, at 95.

126. Feldman, *Galileo Gearing Up to Blunt U.S. CRS Threat*, AIR TRANSPORT WORLD, Dec. 1988, at 32.

127. Etheridge, *supra* note 48, at 84-4.

128. *Id.*

system on-line by July of 1989.[129] Amadeus' primary partners are Air France, Iberia, Lufthansa and SAS, and the Amadeus system is incorporating System One software into its development.[130]

Just as the U.S. airlines failed to do years ago, the 21 member Association of European Airlines failed to agree on the development of a single European air carrier computerized reservation system.[131] The formation of the two above-referenced separate European CRS groups is the result of that failure.

Despite initial facially cooperative agreements by U.S. carriers, seemingly directed at development of separate European reservation systems, it now appears that U.S. CRS vendors intended to penetrate the European market with their own systems as quickly as possible, before the Europeans and British had time to fully develop their systems.[132] In fact, some industry analysts envision a PARs and System One merger, and a move toward the creation of three worldwide systems—

COVIA/Galileo;

System One/PARS/Amadeus, along with Abacus in Asia (Cathay Pacific, Singapore Airlines, and China, Malaysian and Philippine Airlines), and Gemini in Canada; and

SABRE/DATAS II and some sort of Pacific alliance with Japan Air Line and Qantas.[133]

If this is true, Europe, Asia and the Pacific will merely be different battlegrounds on which the U.S. carrier/vendors will wage the same wars they have waged against each other at home, since the obstacles to CRS competition and barriers to entry for the CRS market which are posed by the sophisticated U.S. systems do not change significantly with the crossing of territorial boundaries. The recent activities toward consolidation by the major CRS vendors supports such a view and brings the air carrier industry closer to the day of the global airline reservation system.

XIII. POSSIBILITIES FOR REGULATION

While airline bashing has become a popular and lively activity on Capitol Hill and in most segments of the country as well, few seriously recommend a return to the day of full regulation of the airline industry. As Michael E. Levine has observed:

We should not attempt to scourge the industry by antitrust fire and storm in

129. *Id.*

130. Feldman, *Will CRS Revolutionize International Air Travel?*, AIR TRANSPORT WORLD, Aug. 1988, at 39.

131. Etheridge, *supra* note 48, at 84-4.

132. *Id.* at 84-5.

133. Godwin, *Delta Expected to Buy Into Sabre*, TRAVEL WEEKLY, Jan. 30, 1989, at 4.

> order to create the utopian world of perfect competition many of us hoped for. . .
> . . . [A] sensible response to the deregulated world would accept generally that deregulation has made the airline system very much better, in particular ways that have surprised us all, while also recognizing that those improvements have been brought at the expense of a new set of problems, at least a few of which may be amenable to correction.[134]

Areas of the airline industry which most directly impact consumer protection issues will undoubtedly be the first areas to which reregulation or closer government supervision are directed, if that does in fact occur. For instance, recent government requirements concerning airline participation in a flight on-time/delay reporting procedure may be one of the first steps in that direction. Procedures for monitoring airframe safety inspections, gathering information, supervising and/or correcting problems in the areas of labor protection and lay-offs after mergers, flight cancellations and lost baggage can also be expected.[135]

As previously mentioned, an on-going formal DOT investigation is taking place to consider problems with carrier-owned computer reservation systems,[136] but other indications are that Congress is seriously considering or has already decided to force carriers to divest the systems.[137] Ironically, fears of reregulation or forced divestiture of CRSs may have encouraged U.S. CRS vendors to step-up plans for CRS mergers and involvement in global systems. This may in turn create an environment even more anticompetitive than reregulation proponents could have imagined. Nonetheless, any reluctance to reregulate the industry in some fashion has apparently been waning on Capitol Hill, as Senate Commerce Committee Chairman Ernest Hollings expressed earlier last year: "If our hearings lead us to the conclusion that we must act on some form of reregulation—then we will not hesitate."[138]

The need for some sort of closer and more careful supervision of or direction to the airline industry is apparent. The question is whether Congress and the appropriate agencies will be able to address the problems of the industry quickly and effectively, without engaging in emotional, knee-jerk reactions which sacrifice long-term and rational solutions to larger problems, in exchange for immediate attention to and results in areas of lesser importance. Additionally, the ability of the FAA to effectively solve its dilemmas in the areas of the aging domestic fleet, air traffic control, airport expansions and overall safety issues will directly affect the success or failure of increased industry supervision or reregulation.

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134. Levine, *supra* note 22, at 162-63.
135. Jones, *supra* note 25, at 18.
136. Scocozza, *The Role of DOT*, 425 PRACTISING LAW INSTITUTE/COMM. 117, Jun. 4, 1987.
137. Jones, *supra* note 25, at 18.
138. *Id.*

Perhaps more importantly, government and industry analysts' divergent views of the benefits and burdens flowing from deregulation of the airline industry will weigh heavily in determinations concerning areas of the industry which call for reregulation. Simply stated by a DOT spokesman recently, "Depending on one's point-of-view regarding [specific areas of industry concern], deregulation is either succeeding or failing."[139]

139. Scocozza, *supra* note 136.