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Mr. Chairman and Members of the Committee:

I appreciate the opportunity to come before this Committee to address the Internet's role in the marketing of airline services. The Committee has wisely chosen to hold hearings on this issue, which is of great importance to airline travelers and the airline and travel agency industries.

Because of the Internet's importance in airline distribution, my office and the Office of the General Counsel have begun studying whether the airlines' use of the Internet raises competition and consumer deception issues that may require regulatory action. Since we have not completed our studies, I do not know what we will conclude. The Inspector General's Office is conducting its own study of airline distribution issues and Orbitz, and will be providing the Committee with its conclusions.

In my testimony I wish to do three things--provide a general description of the airlines' use of the Internet and the development of airline distribution since deregulation, outline the legal and policy principles applicable to the airlines' use of the Internet, and describe the studies we are undertaking to examine the questions presented by the airlines' plans for using the Internet.

The Internet offers many benefits for its users, as anyone who has surfed the web knows well. The Internet provides all kinds of information on travel services and destinations. Consumers who are comfortable using the Internet can easily research travel destinations, conveniently find out what travel services are available, and plan trips. Many consumers like to use the Internet for travel planning and booking--it is quick and convenient--and the Internet is capturing a growing share of travel bookings.

The Internet gives travel destinations, especially smaller ones, an efficient and economical way to market themselves. For example, Megan Ward, the spokeswoman for the Texas Travel Industry Association, stated that small rural Texas communities can obtain websites relatively cheaply and can attract families and other leisure travelers with information not available through other channels: "Definitely the winners are the smaller communities across the country, especially in Texas, who may not have had the funds necessary for marketing. This gives them a massive amount of exposure." Similarly, a tourism official for the Maldive Islands, a nation of 300,000 people, has stated,

"Marketing is quite expensive and we are working on a very small budget. Because of the Internet we are able to do a lot of marketing with less expense."

Travel suppliers--airlines, hotels, and cruise companies, for example--have recognized how the Internet provides a means of conveniently and economically providing information and booking services to consumers. The Internet enables travel suppliers to reach new customers who otherwise would be unlikely to use that supplier--or even travel at all.

The Internet also provides airlines and other travel suppliers a less expensive method for obtaining bookings. According to a 1999 study cited by a recent General Accounting Office (GAO) report, for example, each booking made through traditional travel agencies cost America West $23, a booking made through an electronic travel agency cost $20, a booking made through the airline's reservations agents cost $13, and a booking made through the airline's website cost $6.

Because airlines save money when consumers make bookings through an airline website, individual airlines are encouraging customers to use their websites for bookings. Southwest and AirTran, two airlines with a low-fare operating strategy, now obtain at least a quarter of their total bookings from the airline's website. Ryanair, a European low-fare airline, is obtaining a third of its bookings from its own website. The efforts of these airlines to encourage travelers to book through the airline website are consistent with their overall strategy of keeping their costs low, a strategy which requires them to reduce their distribution costs along with their other costs.

Airlines have been offering limited types of discount fares through their individual websites that are not obtainable through other distribution channels, including the airline's own reservations agents. The airlines generally use these Internet fares to sell "distressed inventory"--seats that otherwise would likely go unsold--to travelers willing to travel on short notice in exchange for a low fare. The GAO has found that this practice is common in the travel industry--Amtrak, rental car companies, hotels, and cruise lines also offer some low prices through their websites that cannot be obtained from any other source. The airlines' use of the Internet to sell "distressed inventory" by offering special low fares is comparable to practices followed in earlier years, when airlines used a small number of travel agencies as consolidators to sell seats that would otherwise not be sold. Offering special fares over the Internet may make them available to more consumers.

The Internet's advantages for consumers who are willing to research and buy travel online have caused a rapidly growing number of consumers to use the Internet to book travel. In 1999 just over four percent of all airline bookings were done online. In 2003 online airline bookings are expected to account for eleven percent of all airline bookings.

Not every consumer will be willing to buy travel on the Internet,

for a large number of travelers prefer to use travel agents. Many travelers value the personal relationship they have with their travel agent, and a key part of that relationship is the travel agent's ability to solve problems if something goes wrong. Some studies have shown, moreover, that consumers are more likely to find the lowest available fare when they use a travel agency than when they use other sources of travel information. Aside from that, many consumers place more trust in the advice given them by a travel agent than in the information given them by airlines.

As a result, we do not believe that the Internet will cause travel agencies to disappear. A Sabre official has predicted, for example, that travel agencies will account for 65 percent of all airline bookings in 2005 (45 percent by traditional travel agencies and 20 percent by travel agency websites). Many travel agencies have taken advantage of the Internet by creating their own websites. They seek to support and enhance their traditional services and to reach new customers. Most airline tickets are still sold by traditional travel agencies.

The Internet, moreover, has made possible the growth of online travel agencies, particularly Travelocity and Expedia. Last year online travel agencies captured just over half of all airline bookings made through the Internet. Between 1998 and 2001 the annual growth rate in the online agencies' bookings is expected to be almost 100 percent. The Internet also enables Priceline to offer consumers a new method of buying airline tickets, a reverse auction giving consumers the opportunity to try naming their own price for tickets.

Online travel agencies operate in a different environment from traditional travel agencies and so must use new methods of attracting customers, such as creating links with web portals like Yahoo! Online agencies have also begun to buy blocks of airline seats and hotel rooms at negotiated prices substantially below the supplier's published rates, which they then resell to their customers. The online agencies also recognize the need to hire agents to help online customers with problems and special questions. Many observers see the "click and mortar" model as the travel agency of the future.

We expect that many consumers will continue to value the services provided by travel agencies, whether brick and mortar agencies or online agencies (or click and mortar agencies) and that the travel agency industry will continue to remain an important distribution channel for travel services due to these consumer preferences.

The airlines' experimentation with the Internet reflects their search for new distribution methods since the airline industry's deregulation. Since deregulation, the airlines have chosen to use a wide variety of methods for distributing their services. Southwest, for example, has established a strategy of relying on low-fare service that includes downplaying the importance of travel agencies in distributing its services. Southwest thereby avoids the cost of computer reservations system booking fees and travel agency commissions. Many of the newer low-fare airlines

rely more on travel agency sales but still try to sell a larger share of their tickets directly to travelers than do the more established network airlines, which depend on travel agencies for as much as eighty percent of their total sales. Airlines generally want to sell their services through as many channels as possible in order to reach as many travelers as possible.

Individual airlines also treat different firms within each channel differently when doing so seems likely to increase the airline's sales. Airlines, for example, use consolidators to sell seats at low fares not made directly available from travel agencies and airline reservations agents. Airlines also commonly give favored travel agencies access to discount fares and marketing benefits not made available to other agencies and enable favored agencies to waive some restrictions on discount fares and to book customers on oversold flights. Those travel agencies having a preferred supplier relationship with an airline or other travel supplier commonly obtain override commissions, incentive commissions that encourage the agency to book a larger share of its customers with the preferred airline.

Like airlines, travel agencies have responded to market demands by developing different operating strategies--some primarily handle corporate travel while others primarily handle leisure travel. Some hold themselves out as generalists while others specialize, for example, on travel to a particular destination or particular types of travel, such as adventure travel. Travel agencies generally are addressing the shifting nature of the airline distribution system by focusing on the sale of travel services that are more remunerative, like cruises, and by providing their customers with advice and insight that travelers cannot obtain from other sources.

Airline distribution costs, which include commissions, credit card fees, computer reservations system fees, and the costs of the airline's own reservations and sales personnel, have made up almost twenty percent of the airlines' total costs. Throughout the 1980's and 1990's, the airlines worked on cutting all of their other controllable costs. They recently began tackling their distribution costs.

The airlines' efforts to cut their distribution costs have harmed many travel agencies. The major airlines have cut their travel agency commission rates and imposed caps on the amount of commission payable on individual tickets. Airlines have also sought ways to sell tickets directly to consumers or through channels less costly than the travel agency channel. These actions have significantly reduced travel agency revenues. As a result, most travel agencies have begun requiring their customers to pay fees for at least some agency services.

Last year the GAO investigated whether consumers have been affected by changes in the airlines' methods of selling tickets, among other issues. The GAO concluded that the airlines' use of the Internet gave consumers new ways to purchase tickets while still allowing consumers to use travel agents if they wished. The evidence available to the GAO, however, did not enable that

agency to calculate the overall advantages and disadvantages to consumers of recent changes in airline distribution.

As with many developments that promise to benefit many consumers, however, the use of the Internet in airline distribution might in some ways present potential threats to consumers and competition. Online firms selling travel may engage in practices that could create a risk of consumer deception. The airlines could use the Internet in ways that may reduce the availability of impartial and comprehensive travel information to consumers. And the development by five major airlines of a joint website--Orbitz (originally called T2)--for the sale of travel services raises questions on whether their operation of Orbitz may involve some potentially anticompetitive behavior.

Let me now outline the legal and policy principles applicable to the Internet's use in airline distribution. First, online firms are subject to the same consumer protection provisions as other travel firms. And, like firms in any other unregulated industry, airlines and travel agencies are subject to the antitrust laws enforced by the Justice Department. In general, the antitrust laws prohibit (i) conduct by a single firm which involves monopolization or attempted monopolization and (ii) collective action involving two or more firms that unreasonably restrains trade.

While conduct by a single firm seldom raises antitrust questions, collective action by competitors often presents serious antitrust issues. Nonetheless, the antitrust laws allow competitors to create a joint venture when doing so provides efficiency benefits without unreasonably or unnecessarily restricting competition between the participants. For example, the airlines have long operated programs providing for the accreditation of travel agency firms and a joint clearinghouse for the settlement of the travel agencies' payment for airline services booked by their customers.

This Department has the authority under 49 U.S.C. 41712, commonly referred to as section 411 of the Federal Aviation Act, to prohibit airline practices as unfair methods of competition if they violate antitrust principles, even if they do not violate the letter of the antitrust laws, and to prohibit unfair and deceptive practices.

The Department, as you know, is committed to ensuring that the airline industry remains competitive. In exercising our authority under section 411, we will bear in mind Congress' decision to deregulate the airline industry. Congress did so because it determined that each airline should be free to determine what routes it will serve and what fares it will charge. As part of deregulation, airlines became free to determine how best to distribute their services. The Department no longer has the authority to regulate the airlines' relations with travel agencies unless necessary to prevent unfair methods of competition and unfair and deceptive practices.

As I stated, however, airlines would violate the antitrust laws

and commit unfair methods of competition in violation of our statute if they acted collectively in ways that illegally reduce competition. The Department is investigating questions that have been raised by both travel agencies and smaller airlines about Orbitz' potential adoption of restrictions on the airlines' participation in Orbitz that could undermine the competitive position of smaller airlines and other distribution channels. We are also investigating whether Orbitz' operation may also create opportunities for its owners to collude on pricing and service. We appreciate the concerns expressed by many travel agencies and consumers over changes in airline distribution practices that may deny consumers the ability to obtain impartial and complete advice on airline services and fares from travel agencies. Travel agents provide the public with valuable information and strengthen the ability of airlines to compete on the basis of service and fares.

The Department is examining these issues in order to carry out our responsibility to see whether airlines are engaged in practices that may violate section 411. We have therefore requested Orbitz to answer a series of questions on its organizational and operating plans and to provide documents relevant to our inquiry. If Orbitz' organization and operational plans seem to involve practices that would violate section 411's prohibition against unfair methods of competition, we will take action redressing those problems. As a separate matter we are reviewing the enforcement complaint filed by the Association of Retail Travel Agents against the major airlines that created Orbitz. We will be considering whether that complaint warrants the institution of an enforcement proceeding.

The Justice Department is conducting its own investigation into Orbitz, and, as Ken Mead has told you, the Inspector General's Office is examining Orbitz and the airlines' use of the Internet.

In addition to our study of Orbitz, we are informally studying recent developments in airline distribution. The primary purpose of this study is to educate ourselves on distribution matters, so we may exercise our regulatory authority intelligently when questions under section 411 do arise on airline marketing.

We are also asking all interested persons in our pending rulemaking on computer reservations systems (CRSs) to submit comments on whether our existing CRS rules should be extended to cover in some respects the use of the Internet for airline distribution.

Finally, AIR-21 calls for the creation of a National Commission to Ensure Consumer Information and Choice in the Airline Industry, which will study recent developments in airline distribution and make recommendations on whether changes are needed. The Secretary has asked the Congressional leadership for their proposed nominations to the Commission and has asked the major airline and travel agency trade associations for suggestions on who he should nominate.

We will remain mindful of what the Transportation Research Board said last year in its report: "In general, however, changes in the distribution system should be viewed as opportunities to enhance the system's overall benefits to consumers, and should not be dissuaded unless the neutrality and completeness of the distribution system is fundamentally threatened. DOT should remain alert to the possibility of such erosion."

Thank you Mr. Chairman. This completes my prepared statement, and I would be pleased to respond to your questions and those of the Committee.