United States General Accounting Office

GAO

Report to the Honorable
Michael P. Forbes,
House of Representatives

July 1999

DOMESTIC AVIATION

Effects of Changes in How Airline Tickets Are Sold

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United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

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July 28, 1999

The Honorable Michael P. Forbes
House of Representatives

Dear Mr. Forbes:

The U.S. airline industry has gone from record losses during the early part of the decade to record profits in more recent years. Airline cost-cutting initiatives and sustained growth in traffic have contributed to this dramatic turnaround. Travel agencies, the primary channel for selling airline tickets, have not been immune from airlines' cost-cutting efforts. Commissions paid to travel agencies represent airlines' fourth largest expense, after labor, fuel, and the cost of airplanes. To decrease their costs, airlines have reduced these commissions and established Internet sites to sell more tickets themselves. Such actions have led some travel agency representatives and consumer groups to question whether airlines are attempting to drive travel agencies out of business, thereby depriving consumers of an important source of comparative price and schedule information.

To examine these issues, you asked us to determine the following: (1) How have changes in the way airlines sell tickets affected travel agencies and consumers? (2) What are airlines' policies and practices for the sale and use of airline tickets sold by travel agencies compared with the sale and use of tickets sold directly by airlines? (3) What are airlines' policies and practices for making their airfares, particularly discount fares, accessible to travel agencies and consumers? and (4) What are airlines' policies and practices regarding the use of data on travel agency sales?

Results in Brief

Changes in the way the airline industry sells tickets have had mixed effects on travel agencies and consumers. Since 1995, airlines have saved as much as $4.3 billion by reducing commissions paid to travel agencies. Through the use of new technology such as the Internet and electronic ticketing, airlines have found new ways to lower the cost of selling their tickets. Doing so has reduced airlines' reliance on travel agencies, and the number of travel agencies is declining. Nevertheless, industry surveys indicate that total travel agency revenues are rising, as the remaining travel agencies diversify their products and services to other types of travel-related sales. About 40 percent of travel agencies have also instituted service fees for ticket processing, ranging from $10 to $50, to offset lower commissions.

The effect on consumers is difficult to measure. Some portion of airlines' cost savings from reduced commission rates has likely been passed on to consumers, especially leisure travelers, through lower airfares, but the extent is unknown because fares are also affected by many other factors, such as lower airline fuel prices. Furthermore, any fare savings may be offset by travel agencies' service fees. Direct ticket sales, especially via the Internet, appeal to some consumers, though travel agencies continue to play an important role in providing comparative information for consumers who are less interested in or adept at getting this information on their own.

Airlines generally apply the same ticketing policies to themselves and to travel agencies. Airlines' policies are contained in rules that govern the sale and use of all airline tickets—rules, for example, that require a Saturday night stayover to obtain a discounted fare. The travel agency industry alleges that airlines apply their rules more strictly to travel agencies than to themselves, with the intention of luring customers away from travel agencies. While admitting some unintentional lapses in the past, airlines argue that they have a strong financial incentive to enforce their rules—if they did not do so, business passengers would buy the lower-priced tickets intended for leisure travelers. Furthermore, airline representatives say, even if they did not have this financial incentive, they are not precluded from imposing different rules on travel agencies.

U.S. and some foreign airlines offer special discount fares that are only available through their Internet websites. Airlines have developed these websites to lower the cost of selling their tickets, increase sales, and better manage their inventory of airline seats. While the travel agency industry and consumer groups assert that airlines should make all their fares available through all sales channels, including travel agencies, airlines are not required to do so.

Airlines obtain data on travel agency sales from a variety of sources and combine them to develop complete sales information, by agency, for each airline market. According to the airline industry, the data are needed to manage their travel agency incentive programs, including the payment of additional commissions—called overrides—to travel agencies that exceed sales targets. GAO and the Department of Transportation's Inspector General have criticized override programs as anticompetitive and harmful to consumers because they increase the likelihood that the information provided to consumers will be biased. The travel agency industry contends that the sales data used to calculate overrides are proprietary. While presently under review, current Department of Transportation regulations require that the providers of computer reservation systems used by travel agencies make their ticket sales data available to all interested airlines. The Department of Justice and an independent mediation panel examined this issue in 1984 and 1991, respectively, and did not find airlines' access to travel agencies' sales data to be unlawful.

Background

Consumers have many ways to buy airline tickets. Travel agencies sold about 75 percent of all airline tickets in 1996, down from 85 percent in 1993, according to Air Transport Association estimates. Airlines pay the travel agencies a standard commission based on a percentage of the value of each ticket. Airlines sell the other 25 percent of tickets directly by telephone, at airline counters, and, increasingly, through airline websites. The approximately 33,000 travel agencies in the United States range from small firms, many with less than $1 million in total revenues, to large multifaceted corporations like American Express, with billions of dollars in revenues and thousands of employees. In the last few years, independent electronic agencies, such as Microsoft's Expedia and Preview Travel, have also begun selling airline tickets through the Internet. Travel agencies, regardless of their size or form, offer three basic services for consumers: (1) price comparison, (2) ticket processing, and (3) information and expertise.

Airlines' relationships with travel agencies have changed considerably over the last two decades. At the time of airline deregulation in 1978, airlines and travel agencies sold about the same number of tickets, and travel agencies' commissions averaged about 8-percent of the value of tickets sold. Following deregulation, airlines sought to lower the cost of selling their tickets and shifted more of their ticket sales to travel agencies. Airline competition for travel agency sales led to higher commission rates and the payment of additional commissions, called overrides, to agencies exceeding certain sales targets. Commission payments allowed travel agencies to offer free services, such as trip planning and ticket processing, to their customers.

Airlines set their own fares and commission rates, but the listing of fares and the settlement of ticket payments and commissions are generally handled by jointly held airline companies. Over 550 airlines provide their fare information to the Airline Tariff Publishing Company, which is owned by 24 domestic and international airlines. This company distributes the fare information to computer reservation systems.[1] These systems provide computer terminals that the travel agencies use to search airfares and schedules and book airline tickets. Payment for travel agencies' ticket sales is handled through the Airlines Reporting Corporation (ARC),[2] an airline-owned company that remits travel agency payments (less the commissions) to airlines.

Effects on Travel Agencies and Consumers From Changes in the Way Airlines Sell Tickets

Changes in the way airlines sell tickets have contributed to airline profits while they have had mixed effects on travel agencies and consumers. Airlines have cut the commission rates paid to travel agencies and, through the use of new technology such as the Internet, have found ways to increase the percentage of tickets they sell directly to consumers. These actions have reduced travel agencies' revenues. The effect on consumers is mixed. Consumers now have new ways to buy tickets while retaining access to agencies for other travel needs. The extent to which airlines have passed their savings on commission costs along to consumers through fare reductions is difficult to measure given the variety of other factors that also affect ticket prices; however, leisure passengers have likely benefited more than business passengers. Moreover, any fare savings may be offset to some degree by many travel agencies' imposition of service fees.

Lower Commission Costs and Other Factors Contribute to Airline Profits

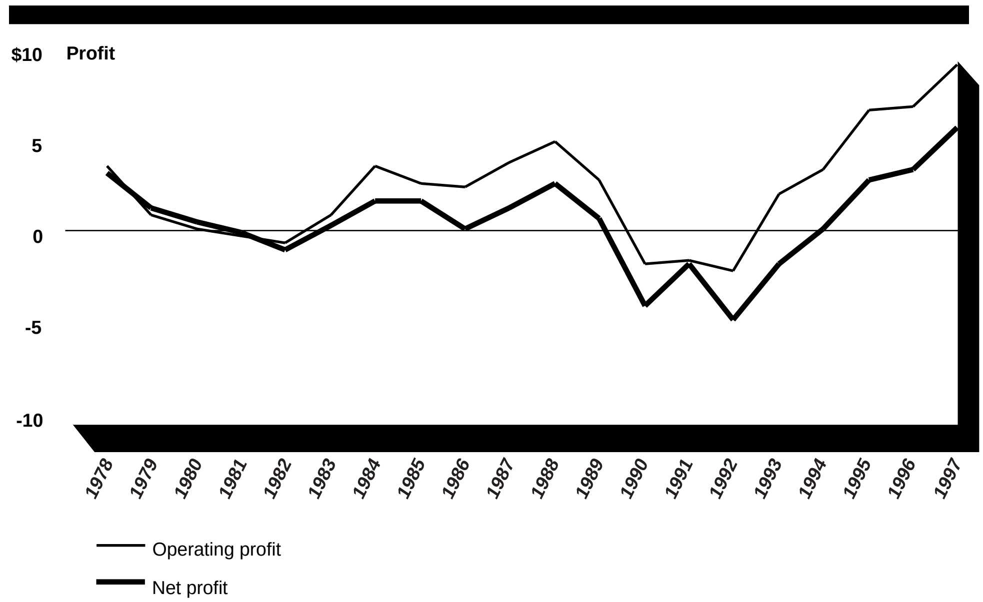
Airline profits have risen dramatically since record losses earlier this decade. As figure 1 shows, operating profits for U.S. airlines topped $8.6 billion in 1997, following a loss of nearly $2.5 billion in 1992, according to Air Transport Association data. Both airline operating profits and net profits have increased every year since then.[3]

[1]The computer reservation systems are Sabre, 82.8 percent of which is owned by the parent company of American Airlines (AMR); Apollo USA (operated by Galileo International), owned by United (15.2 percent), British Airways (6.7 percent) and Swissair (6.7 percent); WORLDSPAN, owned by Delta (40 percent), Northwest (34 percent), and TWA (26 percent); and Amedeus (formerly Systems One), owned by Air France (29.2 percent), Iberia (29.2 percent), Lufthansa (29.2 percent), and Continental (12.4 percent).

[2]ARC is owned by 14 airline shareholders, although more than 140 domestic and international carriers participate in ARC's settlement program.

[3]Operating profit (or loss) is the difference between operating revenues (passenger, charter, freight, and mail revenues) and operating expenses (labor, fuel, promotion and sales, and other costs, including depreciation). Net profit (or loss) is the result of operating profit after taxes, interest on debt, and other items.

Figure 1: Airlines' Operating and Net Profit, 1978-97



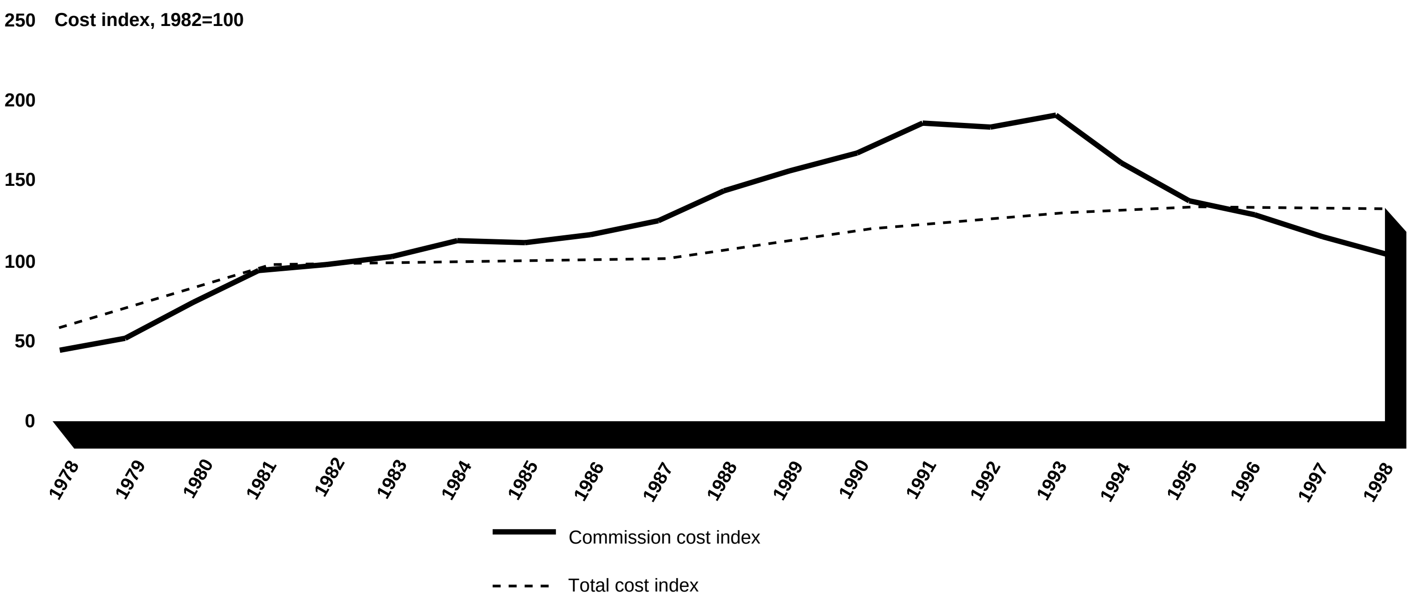
1997 dollars in billions

Note: To measure real change in airline profitability, annual amounts have been restated in 1997 dollars using the chain-type price index for gross domestic product.

Source: Air Transport Association and U.S. scheduled airlines.

Growth in passenger demand and lower costs have contributed to airlines' turnaround. Passenger traffic grew 26 percent between 1992 and 1997. A decline in airlines' costs, notably fuel and commission costs, also contributed to improved profits, according to Air Transport Association data. Commission costs, generally airlines' fourth largest expense after labor, aircraft, and fuel, rose faster than overall costs until 1993, when commission costs amounted to 10.9 percent of airlines' total operating costs. Since then, airlines' commission costs have fallen to 6.5 percent of their total operating costs. As figure 2 shows, commission costs have nearly returned to their 1982 levels and have helped stabilize airlines' total costs.

Figure 2: Airlines' Cost Indices, 1978-98



Note: A cost index is an aggregate measure of the relative change in related costs. Airlines' total costs include labor, fuel, aircraft, landing fees, maintenance, financing and insurance, and commissions and other costs of sales. For example, the total cost index for 1998 is 134.1, which means that total costs have increased by 34.1 percent since 1982 when the index equaled 100.

Source: Air Transport Association and U.S. major and national airlines.

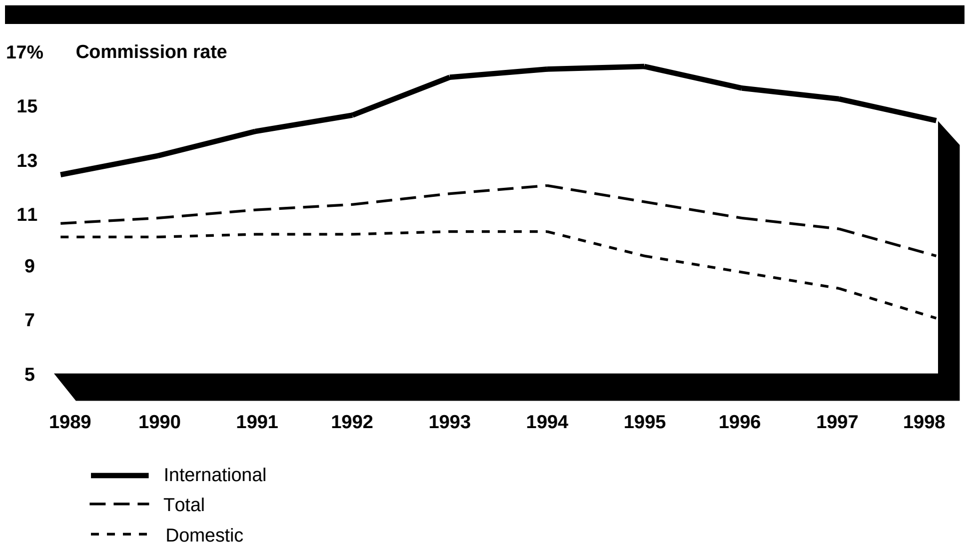
Commission Cuts Have Cost Travel Agencies as Much as $4.3 Billion in Revenues

Airlines' commission reductions have reduced travel agencies' revenues. In 1995, the major airlines capped commission payments on domestic fares at $50 per round-trip ticket—effectively reducing the commissions airlines paid to travel agencies for tickets costing more than $500, given the 10-percent commission rate in effect at that time. In 1997, all the major airlines—except Southwest Airlines—reduced their commission rates for domestic ticket sales to 8 percent.[4] In 1998, major U.S. airlines also set commissions on international tickets at 8 percent and capped total commissions at $100 per round trip ticket. Furthermore, most airlines have set commissions for tickets purchased on-line from Internet travel agencies at 5 percent, with a $10 maximum commission per transaction. Accordingly, commission rates for domestic fares peaked in 1994 at 10.05 percent, and, 1 year later, commission rates for international fares

[4]Southwest Airlines maintained a 10-percent commission with no cap.

peaked at 16.24 percent.[5] Commission rates have steadily declined since then. Through April 1999, average domestic and international commission rates were 6.57 and 12.88 percent, respectively.

Figure 3: Travel Agencies' Commission Rates, 1989-98



Note: Data excludes override payments.

Source: Airlines Reporting Corporation.

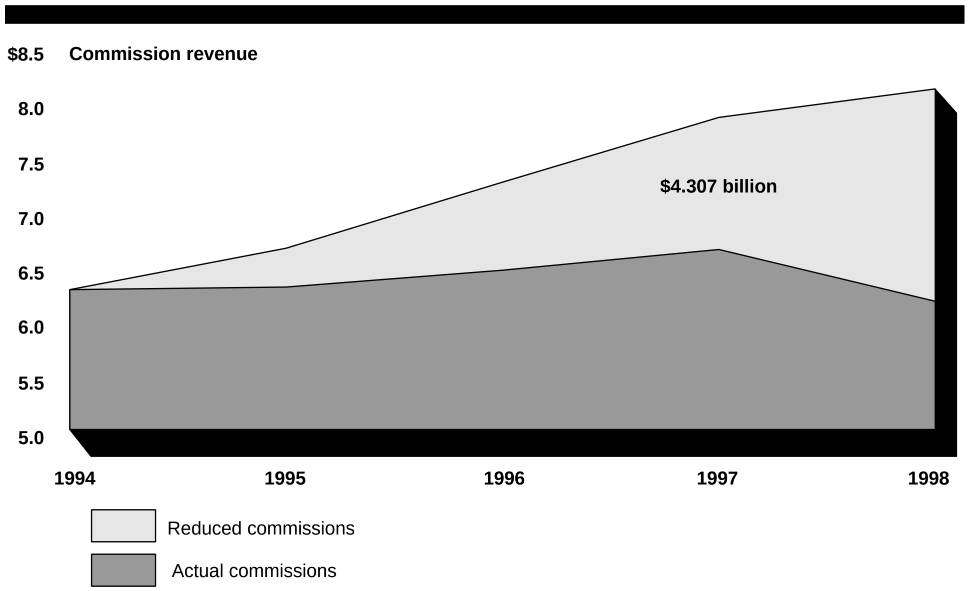
Although commission rates have been declining for several years, travel agencies' revenues from commissions did not begin to decline until 1998. Revenues did not decline as quickly as commission rates because the total value of tickets sold by travel agencies has increased. However, travel agencies would have earned up to $4.3 billion more between 1995 and 1998, as depicted in figure 4, had domestic and international commission rates remained at their peak levels.[6] The majority of these lower revenues, about $3.45 billion, were due to reductions in domestic commission rates,

[5]All average commission rates and amounts paid are based on commissions paid by all airlines exclusive of any override payments, as provided by ARC.

[6]To estimate an upper bound for travel agencies' reduced revenues, we assumed that declining commission costs did not result in a change in ticket prices. To the extent that airline commission cost savings led to reduced ticket prices, the quantity of tickets sold would have increased and, therefore, the loss in commission revenue would have been less than $4.3 billion.

which began in 1995. Declines in commission rates for international tickets cost U.S. travel agencies another $858 million in revenues.

Figure 4: Actual and Reduced Commission Revenue, 1994-98



Dollars in billions

Source: GAO's analysis of Airlines Reporting Corporation data.

In addition to reduced commission costs, airlines have lowered their ticketing costs in other ways. Electronic or "e-ticketing," whereby an airline issues a confirmation number and receipt to a passenger instead of a ticket, is cheaper and easier to process than a paper ticket since there is no need to print a ticket. Introduced in 1995, e-ticketing now accounts for an estimated 30 percent to 60 percent of all tickets sold. In addition, airlines have increased the percentage of tickets sold through new distribution channels, especially the Internet. The percentage of tickets sold by travel agencies peaked in 1993 at 85 percent, according to the Air Transport Association, slipping to 75 percent in 1996, the most recent year analyzed.

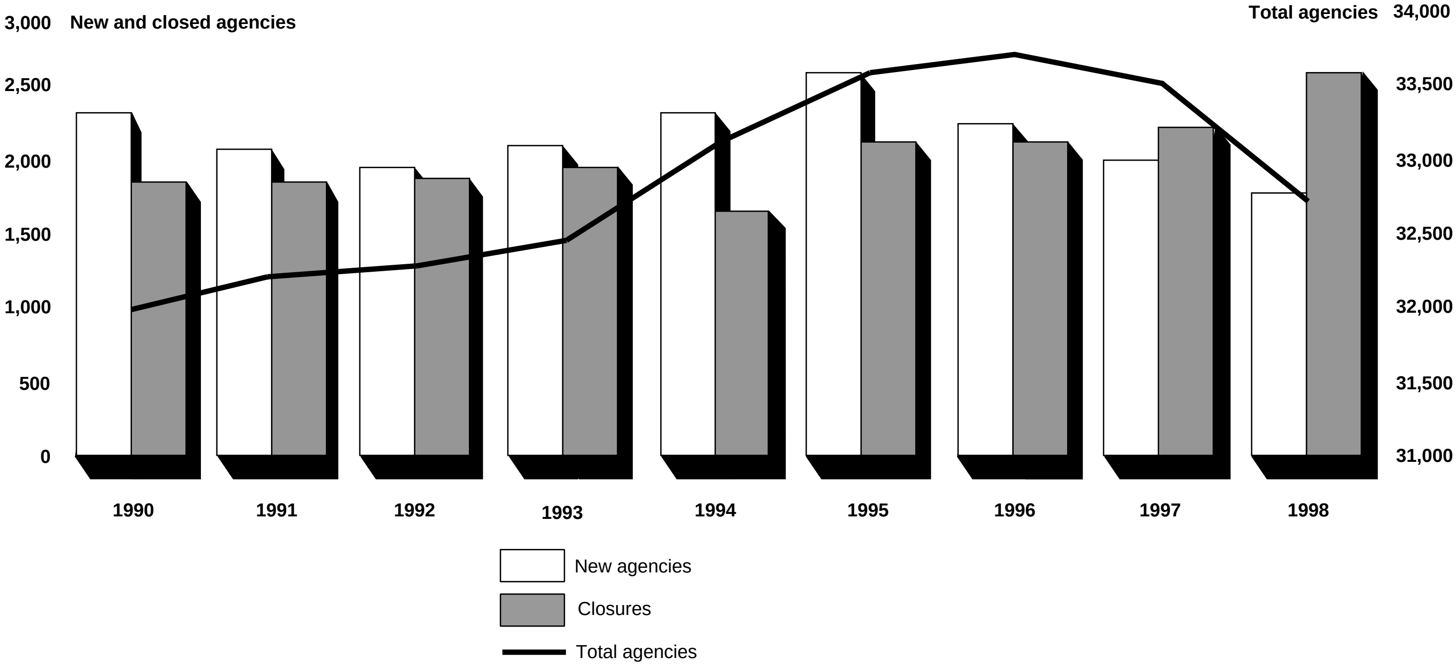
Changes in airline ticketing practices have strained relationships between the travel agency and airline industries. A complaint registered with the Department of Transportation by the United States Travel Agent Registry in 1998, an organization that represents travel agency interests, is illustrative of this strained relationship. In the complaint and subsequent rebuttal to the airlines' response, the Travel Agent Registry asserted that U.S. airlines are attempting to remove travel agencies from the business of selling airline tickets, in violation of federal statutes.[7] By way of example, the Travel Agent Registry cites commission cuts, special fares and incentives, and other inducements available only to customers who buy directly from airlines. Airline officials countered that airlines' actions are intended only to reduce their ticketing costs. Moreover, airline officials said that travel agencies, as agents of the airline, are not competitors in the sale of airline tickets. The Department of Transportation has yet to rule on this complaint.

The Travel Agency Industry Is Adapting to Airline Industry Changes

The number of travel agencies peaked in 1996, when industry data showed a total of 33,715 agencies (see fig. 5). By 1998, the number stood at about the same level as in 1994—32,694, a decline of 1,021 agencies over the 2-year period.

[7]The complaint cites 49 U.S.C. 41712, "Unfair and deceptive practices and unfair methods of competition in air transportation or the sale of air transportation;" United States Travel Agent Registry v. Delta (OST-98-4776), v. United (OST-98-4785), v. American (OST-98-4786), Nov. 18, 1998; and v. Continental (OST-98-4836), Dec. 1, 1998. See app. I for a summary of this and other complaints.

Figure 5: Number of Travel Agencies, New Agencies, Closed Agencies, and Total Agencies, 1990-98



Source: Airlines Reporting Corporation.

Faced with declining commissions from airline ticket sales, many travel agencies have cut their costs and begun charging fees for their services. According to a 1998 travel agency industry survey, 77 percent of travel agencies have reduced their operating costs since the commission cuts took place. This includes reducing staff or compensation and making greater use of automation. Between 1995 and 1997, the percentage of agencies charging service fees for processing airline tickets increased from 19 percent to 42 percent for leisure travel and from 10 percent to 38 percent for business travel. In a 1998 survey of 500 agency members of the American Society of Travel Agents, 64 percent indicated that they charge service fees compared with 2.6 percent before the reduction in commission rates.

Travel agencies have adapted in other ways as well, becoming larger, more diverse, and somewhat less reliant on airline ticket commissions than they were just a few years ago. For example, with the advent of reduced airline commissions, the financial relationship between travel agencies and their government and corporate clients has substantially changed. Rebating commissions to customers, popular before commission reductions, is quickly being replaced with management or transaction fees. Agencies are also consolidating, in part because larger agencies have proven to be more profitable. In 1997, for example, 92 percent of travel agencies with more than $5 million in sales made a profit, compared with 62 percent of agencies with less than $1 million in sales, according to a 1998 survey of travel agencies.[8] Moreover, many travel agencies have increased their business in areas that are more profitable than airline tickets, such as the sale of cruise packages. In 1997, the most recent year for which data were available, travel agencies' revenues totaled $126 billion, a 25-percent increase over 1995. Airline ticket sales accounted for 56 percent of this revenue, down from 61 percent 2 years earlier, according to the same survey.

Net Effects on Consumers Are Mixed

The effects of airline and travel industry changes on consumers are mixed and less apparent than the effect on travel agencies. Some portion of the airlines' $4.3 billion cost savings from reduced commission rates has likely been passed on to consumers through lower airfares. We could not quantify the extent to which cost savings have been passed on because many other factors also affect ticket prices, including changes in other airline costs, airline competition, and consumers' varying demand for air travel. However, to maximize their profits, airlines segment their passenger markets and are more likely to pass cost savings along through fare cuts to leisure travelers than to business travelers. This is because the demand for leisure travel is more sensitive to price change, and, as a result, the percentage increase in leisure travel resulting from a given fare reduction will be greater than the percentage increase in business travel. Therefore, cutting fares for leisure travel is more likely to increase airlines' profits than cutting fares for business travelers.[9]

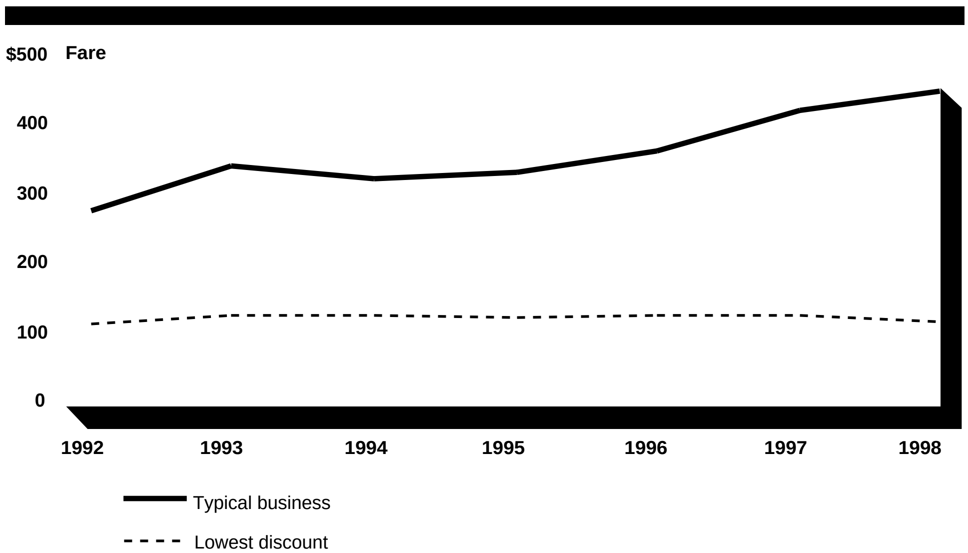
The differences in business and leisure airfares over the last several years demonstrate airlines' ability to segment leisure and business travelers. The typical one-way business fare (lowest published fare free of onerous restrictions) in 1998 was $454, compared with $121 for the lowest

[8] Travel Weekly, Aug. 27, 1998 (Vol. 57, No. 68) biennial survey of travel agencies conducted by Louis Harris and Associates, last published in 1998 based on 1997 industry results.

[9] For additional information on the price sensitivity of business and leisure travelers, see app. I to Passenger Facility Charges: Program Implementation and the Potential Effects of Proposed Changes (GAO/RCED-99-138, May 19, 1999).

published discount (leisure) fare. Furthermore, in recent years, business fares have increased more quickly than have discounted leisure fares. Since 1992, the typical business fare has increased 61 percent, while the average lowest published discount fare has increased only 3 percent (less than the rate of inflation during this period). While many factors can contribute to this difference, these trends are consistent with airlines being more likely to have passed on savings from commission reductions to leisure rather than business travelers. Figure 6 depicts annual average business and discount fares in each of the last 7 years.

Figure 6: Average Published One-Way Airfares, 1992-98



Note: This figure reflects one-way fares in 215 domestic city pair routes. Fares shown are those published by the airline with the most service on each route. Routes were selected on the basis of the number of passengers or on the basis of geographic representation. The typical business fare is based on the lowest published fare that was free of onerous restrictions. The lowest discount fare represents the absolute lowest fare available and, given fare restrictions, is generally not useful for business travelers.

Source: American Express Domestic Airfare Index.

The introduction of service fees by many travel agencies offsets to some extent the benefit of any fare cuts for consumers that use those agencies. Between 40 percent and 60 percent of travel agencies now charge service fees for at least some types of transactions, typically ranging from $10 to $50 for their ticketing and other services. For example, American Express estimated that the 1998 reductions in international commissions would cost consumers $500 million in additional service fees.

Changes in the travel industry allow consumers to benefit from the emergence of new ways to buy tickets. The growth in Internet sales, for example, demonstrates that some consumers prefer this way of purchasing tickets. According to Jupiter Communications, a technology and consulting firm, Internet sales of airline tickets have already grown to $3 billion in 1999, or 4 percent of total sales. In another study by Forrester Research, an estimated 8.2 million leisure trips were booked on-line in 1998. By 2003, the company estimates that on-line sales will grow to 65.5 million leisure trips worth $29.5 billion. Some consumers are also benefiting from deeply discounted last-minute fares offered on airline websites that previously may not have been offered for sale.

At the same time, some consumer and travel agency groups argue that the continued viability of travel agencies is important to consumers. Travel agencies provide important price comparison and information services for some consumers. The complexity of airline ticket pricing—many different fares, itineraries, and restrictions; continuous fare changes; and airline linkages, such as frequent flyer and code-sharing arrangements—increases uninformed consumers' difficulty in completing their travel plans. Regarding price, for example, there is some evidence that a travel agency can find lower fares than can a consumer acting alone. In 1997, the U.S. Public Interest Research Group compared 2,160 price quotes for 73 airline routes and found that the lowest fares were more often obtained from travel agencies than from airlines.

Airline Policies Generally Apply to All Ticket Sales

Airlines generally apply the same ticketing policies to themselves and to travel agencies. The travel agency industry has alleged that airlines apply their policies more strictly to travel agencies than to themselves, intending to lure customers away from travel agencies. While admitting some unintentional lapses in the past, airlines argue that they have a strong financial incentive to enforce their rules—if they did not do so, business passengers would buy the lower-priced tickets intended for leisure travelers. Furthermore, airline representatives say, even if airlines did not have this financial incentive, airlines are not precluded from having different rules for travel agencies and for themselves.

Controversy Centers on Airline Ticketing Restrictions

The travel agency industry contends that airlines enforce their rules more strictly for tickets sold by travel agencies than for tickets sold directly by airlines. The industry's complaints center on three practices prohibited by airlines:

- Issuing "back-to-back" tickets. Back-to-back ticketing involves the purchase of multiple discounted round-trip tickets and the use of the tickets out of sequence. This practice is intended to circumvent the fare conditions normally applicable to discount fares, such as the requirement to stay over a Saturday night or to fly on a particular day of the week. For example, a traveler may attempt to buy two discounted overlapping round-trip tickets between Dallas and Miami—one ticket originating from Dallas on May 4 and returning on May 28, 1999, the other originating from Miami and departing on May 7 and returning on May 25, 1999. Using the tickets out of sequence, the traveler could create two round trips between Dallas and Miami for May 4-7 and May 25-28 and avoid (1) staying over on Saturday nights or (2) paying for the more expensive unrestricted business class tickets. In a complaint filed in September 1997, before the Department of Transportation,[10] the Association of Retail Travel Agents alleged that airlines allow their reservation agents to issue back-to-back tickets while at the same time penalizing travel agencies that do so.[11]
- Issuing "hidden city" tickets. Hidden-city ticketing involves the purchase of a less expensive ticket that is beyond the traveler's actual destination. For example, a traveler flying from Atlanta, Georgia, to Chicago, Illinois, may attempt to purchase a less expensive ticket for a flight that stops or connects in Chicago. Having obtained the ticket, the traveler would depart the plane in Chicago, and throw away the remaining portion of the ticket. Airlines prohibit travel agencies from booking hidden-city tickets, but according to travel agency representatives, airlines will issue these tickets to customers who call the airline directly.
- Refunding nonrefundable tickets. Airlines sell discounted nonrefundable tickets as another way to segment their market and to manage their seat inventory. The travel agency industry contends that airlines refuse to allow a travel agency to refund nonrefundable tickets, yet when contacted directly, refund the tickets themselves and bill the agency for any commission paid.

[10]Association of Retail Travel Agents v. American, Delta, Northwest, and United, OST-97-2908-1. The Department has not ruled on this complaint.

[11]We did not evaluate the extent to which airlines comply with their various ticketing policies. Such an evaluation, even if permitted by airlines, would require more time and resources than were available for this review.

Airlines Have a Financial Incentive to Apply Their Ticketing Policies Uniformly

Six of the seven largest U.S. airlines have policies that expressly disallow back-to-back ticketing, hidden-city ticketing, and refunding nonrefundable tickets.[12] Representatives of the six airlines said their policies apply both to travel agencies, as part of their agreements with airlines, and to airlines' reservation agents. For example, one airline official said that an airline reservation agent would be disciplined—and possibly terminated—for not complying with the airline's policies.

Airline officials acknowledged that in some cases their reservation agents have unknowingly issued back-to-back and hidden-city tickets. For example, a customer could buy back-to-back tickets through different airline reservationists or even through different airlines. However, airlines have a strong economic incentive to enforce their ticketing policies. This incentive revolves around airlines' approach to yield management—that is, maximizing the revenues from each seat on every airplane. To do this, airlines attempt to segment their passenger market between business and leisure travelers. For example, for leisure travelers, who tend to be more discretionary about their travel and, consequently, more sensitive to price—airlines offer some seats at lower prices. In return, airlines place requirements and restrictions, such as the need for advance purchase, restrictions on refunding tickets, and a requirement for Saturday night stayover for leisure fares. Conversely, business passengers tend to have less discretion in their travel and require greater flexibility to purchase tickets at the last minute or to change their flight times and therefore are willing to pay more for a ticket with no restrictions.

Airlines Can Apply Different Ticketing Rules to Travel Agencies

While airlines' ticketing rules apply to all ticket sales, an airline is free to apply different rules to and among travel agencies than it applies to itself. Airlines have historically carried out different ticketing practices among travel agencies—for example, offering special fares, booking privileges, and incentive payments to some favored agencies and not others. In addition, the courts and the Department of Transportation have upheld an airline's right to apply different rules on a travel agency than it applies to itself. In 1989, a federal court ruled that an airline, as the "principal" party

[12]The six airlines are American, Continental, Delta, Northwest, United, and US Airways. The seventh—Southwest Airlines—permits back-to-back and hidden-city tickets because Southwest does not attempt to segment its customer base between business and leisure travelers. Collectively, these seven airlines accounted for 85 percent of all domestic airline traffic in January 1999.

to the relationship, could impose different rules on its “agents.”[13] The Department of Transportation ruled in 1995 that an airline could require travel agencies to pay for discounted tickets within 24 hours of sale, even though the airline does not impose the same requirement on its customers.[14]

In keeping with their right to impose different ticketing requirements, airlines apply rules for Internet-based electronic ticket agencies that are different from those that they apply to other travel agencies and to themselves. For example, airlines impose more stringent rules on the number of passengers and flight segments that electronic agencies can book as well as the length of time that they can hold a reservation. Airlines also require electronic agencies to provide more passenger and payment information than traditional agencies are required to provide. Electronic travel agencies also receive a lower commission—5 percent, capped at $10 per transaction—than do traditional travel agencies. Electronic agencies, and traditional agencies that would like to sell electronically, contend that these differential policies and the lower commissions limit the growth of electronic agency sales while providing airlines with an advantage in selling tickets through their own websites. Airlines argue that more stringent requirements are necessary for electronic agencies to protect the airlines’ inventory of seats from abuse and to prevent fraud that could harm airlines or undermine consumers’ confidence in booking on-line; the lower commissions, they say, are due to cheaper processing costs for electronic agencies.[15] In April 1999, the American Society of Travel Agents asked the Department of Justice to take action against alleged antitrust violations by airlines; the allegation of antitrust violations is based in part on the lower commissions paid to online agencies. Justice is reviewing the complaint.

[13]In 1989, a federal court found that travel agencies are “agents” of the airline they represent and that the restrictions placed on the operations of travel agencies by an airline are lawful under antitrust laws, just as when restrictions are placed on one’s own employees. Illinois Corporate Travel, Inc. (“McTravel”) v. American Airlines, 889 F.2d 751 (7th Cir. 1989).

[14]Pacific Travel International, Inc. v. American Airlines. Department of Transportation Order 95-1-2, docket 49808, Jan. 4, 1995.

[15]These ticket agencies are like traditional travel agencies in that they provide comparative fare information and allow travelers to make reservations and purchase tickets. However, because their business is conducted electronically, they typically have lower costs than traditional “brick and mortar” travel agencies.

Airlines Restrict Access to Deeply Discounted Fares

U.S. and some foreign airlines offer special discount fares that are available only through their Internet websites. Airlines have developed these websites to lower their costs, increase sales, and better manage their inventory of airline seats, according to airline officials. Travel agency representatives assert that airlines have developed these sites to drive travel agencies from Internet sales. Travel agencies and Consumers Union, a consumer advocacy group, contend that airlines should make all their fares equally available through all ticketing channels. Currently, airlines are not required to make their fares equally available.

Some Internet Fares Are Available Only Through Airline Websites

The travel agency industry, particularly electronic agencies, are concerned that they do not have access to all airline fares, especially heavily discounted fares. According to industry representatives, airlines are acting anticompetitively in reserving these special fares exclusively for their direct sales. Consumers Union has also voiced concern that only people with access to a computer can obtain the discounted fares since they are typically available only through airlines' websites.

So far, the special fares on airlines' websites have generally applied to heavily discounted weekend fares on near-term flights that airlines believe are unlikely to sell out—a small percentage of all fares. These fares are announced via e-mail to consumers who subscribe to the announcements and can be obtained by booking on-line through an airline's website (and in some cases by calling the airline, but typically with an additional surcharge). Previously, many of these seats were likely to have gone unsold. Airline officials stated that because these tickets are so deeply discounted and short-term, it is not cost-effective to pay (1) computer reservation systems to list these fares or (2) travel agency commissions. As a result, many airlines choose to sell their deeply discounted, last-minute seats exclusively through their websites—airlines' least expensive method for selling tickets. According to a 1999 Merrill Lynch study, on average, it costs America West $6 to process a ticket through its website compared with $13 through the airline's own reservation agents, $20 through independent electronic agencies, and $23 through a traditional travel agency.[16]

Airlines' website sales account for a small percentage of all airline ticket sales but are expected to grow dramatically. Merrill Lynch estimates that airlines' Internet sales account for only 1 to 2 percent of total airline revenues, though some low-fare carriers may derive as much as 8 percent

[16]"e-Commerce: Virtually Here," Merrill Lynch, Apr. 8, 1999.

of their revenue from Internet sales. As Internet sales have grown, the market share of independent electronic agencies has declined because of faster growth in airlines' website sales. Electronic agencies' market share has fallen from 80 percent to about half of Internet-based sales in the last several years.

Airlines Can Choose Their Methods for Selling Tickets

The Department of Transportation has supported airlines' efforts to establish new ticket sales channels, provided they do not unreasonably discriminate and are not deceptive. For example, in September 1996, the Assistant Secretary for Aviation and International Affairs, in responding to travel agencies' complaints about Microsoft's Internet sales of airline tickets, stated that the Department is unwilling to interfere with airline ticketing methods as long as they do not harm the public. Furthermore, he noted that airlines' development of more efficient sales methods should promote airline competition. Moreover, in April 1999, the Department of Transportation dismissed a 1996 complaint by the Association of Retail Travel Agents against several foreign airlines.[17] The complaint alleged deceptive practices, unfair methods of competition, and antitrust violations against the International Air Transport Association (an international rates-setting body) and three foreign airlines for the sale of tickets below international rates through the Internet. In dismissing the complaint, the Department's Office of Aviation Enforcement stated that its policy is to allow airlines the same freedoms to choose their terms and sales methods that firms in unregulated industries have.

The Department is also considering a petition for rulemaking—filed by a lone petitioner—regarding airlines' disclosure of their special discount fares.[18] The petition alleges that airlines do not reveal Internet fares to customers seeking the lowest fares through computer reservation systems or airline reservation agents and, as a result, that airlines discriminate against customers without Internet access.[19]

[17]Order 99-4-19, Docket OST-96-1995-6, issued Apr. 29, 1999. Association of Retail Travel Agents v. International Air Transport Association, Cathay Pacific, Aer Lingus, and Icelandair, OST-96-1995-1, Dec. 2, 1996.

[18]Donald Pevsner's Petition for Rulemaking, OST-97-2061-1, Jan. 13, 1997.

[19]14 C.F.R. 255.7(b) requires that any airline with significant ownership of a computer reservation system that chooses to list its commonly available fares on its computer reservation system must also list those fares on all the other systems in which it participates. The major airlines—most of which have an ownership interest in one of the four main systems—choose to list the majority of their available fares. Airlines that do not have an ownership interest in a computer reservation system are not required to list, or post, their fares on computer reservation systems used by travel agencies.

Airlines' sale of tickets via the Internet is not unique. For example, AMTRAK offers discount fares exclusively through its website. The fares must be purchased online and are not available for sale at AMTRAK ticket locations or reservation counters, on board trains, or through travel agencies. Car rental agencies, hotels, and cruise lines also sell discount products exclusively through the Internet. Manufacturers and suppliers of other products, from clothing to automobiles, are also beginning to sell their products through the Internet, in some cases reserving some products for sale only through the Internet—a practice that has angered traditional retailers.

Airlines' Use of Travel Agency Sales Data Is Permitted by Current Regulations

U.S. airlines obtain data on travel agency sales from computer reservation systems and other sources and use the data to determine their market share and the shares of other airlines. Airline officials told us that the airlines also use this information to manage their incentive programs for travel agencies. Airlines' incentive payments to travel agencies, called commission overrides, are a controversial practice in the airline industry because they could encourage travel agencies to steer travelers toward more expensive fares. The travel agency industry contends that these data are proprietary. Airline representatives, however, state that sharing travel agencies' sales data is permitted.

Commission Overrides Are Controversial

Each airline combines data from several sources to develop the information it needs to manage its commission override program. One source is the computer reservation systems, which provide airlines' sales data to interested airlines, as authorized by federal regulations. The data provide transaction details on each reservation, including the travel agency that booked the ticket. According to Department of Transportation officials, the Department will consider whether its rules should be amended to bar systems from making travel agencies' booking data available to all airlines in its pending rulemaking on computer reservation systems.[20] Another source is the data airlines receive on their travel agency sales from the Airlines Reporting Corporation.[21] When airlines combine these two sources of data, they can determine the market share for each travel agency. Typically, an agency will earn a commission

[20]The Department of Transportation is currently revising computer reservation system rules under a rulemaking filed Sept. 10, 1997, 62 Federal Register 47606.

[21]Under the ARC agency agreement, travel agencies must report their sales on a weekly basis. ARC, in turn, transmits the sales data to the respective airlines. An airline is not provided with sales data for competing airlines.

override payment if an airline's share of an agency's sales exceeds the airline's share of all travel agency bookings in that area.

The payment of commission overrides is a controversial practice in the airline industry. Such payments are intended to reward travel agencies that sell a particular airline's tickets. In 1996, we criticized the practice of paying overrides as anticompetitive.[22] In a survey of 9 of the top 10 travel agencies, accounting for one-third of all ticket sales, we found that commission overrides are an important consideration by travel agencies in selecting an airline, especially when all other things are equal. According to the 1998 Travel Weekly survey, 52 percent of agencies received override payments in 1997. Two-thirds of the agencies receiving these payments said they usually or sometimes book a particular airline in order to receive them. In March 1999, the Department of Transportation's Inspector General reported that these overrides change the relationship between passengers, travel agencies, and airlines.[23] Specifically, the Inspector General concluded that overrides transform the role of travel agencies from a neutral seller of airline tickets to a direct distribution agent for a particular airline. While the Inspector General found no direct evidence of travel agencies misleading their clients, he was concerned that travel agencies do not disclose their override agreements and therefore recommended that travel agencies disclose the existence and nature of these agreements.

Rulings Support Airlines' Use of Travel Agencies' Sales Data

While the travel agency industry has long complained about airlines' access to travel agencies' sales data, the Department of Justice and an independent mediation panel reviewed the practice and did not find it to be unlawful. In 1984, the Department of Justice reviewed ARC's formation, including the travel agency reporting requirements, and concluded that the efficiency benefits of a common ticket clearing system outweighed the potential for the restraint of trade. Specifically, Justice found that the ARC agreement, including the requirement for travel agencies to submit weekly sales reports, is related to maintaining airlines' financial integrity and administrative efficiency. In 1990, the Association of Retail Travel Agents requested that ARC stop sharing data on travel agencies' sales. ARC declined, and the Association and the American Society of Travel Agents

[22]Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets (GAO/RCED-97-4, Oct. 18, 1996). See also, Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, Jun. 28, 1989) and Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990).

[23]Office of Inspector General Audit Report, "Report on Travel Agent Commission Overrides," CE-1999-060, Mar. 2, 1999.

appealed to an independent arbitration panel.[24] In 1991, the arbitration panel denied the appeal, determining that the alleged misuses of the data had not been demonstrated.

Agency Comments

We provided a draft of this report to the Departments of Transportation and Justice for their review and comment. The Department of Transportation provided editorial and technical comments, which we incorporated as appropriate. Justice had no comments on the draft report. We also provided relevant sections of the report to the Air Transport Association, the American Society of Travel Agents, the Association of Retail Travel Agents, and the Airlines Reporting Corporation. Each of these organizations provided technical comments, which we incorporated as appropriate.

Scope and Methodology

To assess how changes in the way airlines sell tickets have affected travel agencies and consumers, we met with airline and travel agency representatives, consumer groups, and officials from the Departments of Transportation and Justice. We also collected and analyzed financial and other information on airlines and travel agencies. To estimate the amounts of travel agencies' reduced commission revenues, we obtained and analyzed historical data on commissions and fares and projected commission revenues, assuming those commission rates would have remained at their historical highs with no change in ticket prices. Furthermore, we evaluated studies on the role of travel agencies in serving consumers, including finding the best fares. Finally, we reviewed relevant complaints before, and rulemakings and orders by, the Departments of Transportation and Justice.

To compare airlines' policies and practices for the sale and use of airline tickets sold by travel agents with those sold directly by airlines, we reviewed complaints before the Department of Transportation and other relevant case law and spoke with airline and travel agency representatives. We contacted the seven largest domestic carriers, which account for about 80 percent of passenger traffic, to obtain their ticketing policies.[25] We did not audit airlines' actual adherence to their policies.

[24]The arbitration panel had been established as part of a settlement agreement arising from an antitrust lawsuit brought by the Association of Retail Travel Agents against the Air Transport Association and ARC.

[25]The seven airlines are American, Continental, Delta, Northwest, Southwest, United, and USAirways.

To determine airlines' policies and practices for making their airfares, particularly their discounted fares, accessible to travel agencies and consumers, we met with airline, travel agency, and consumer group representatives; obtained airlines' policies; examined practices in other industries; and reviewed relevant legal materials. We also obtained information from the seven major domestic airlines on how airfares are made available to the public and travel agencies, especially discounted fares and fares available on airlines' websites. Moreover, we met with consumer groups and travel agent organizations to discuss their concerns about access to airfares. Finally, we contacted representatives of organizations that publish airfares and operate computerized reservation systems.

To determine airlines' policies and practices regarding the use of data on travel agency sales, we spoke with officials representing airlines, computer reservation systems, ARC, travel agencies, and the Departments of Transportation and Justice to obtain relevant information and documentation. Finally, we reviewed prior GAO and Department of Transportation reports, relevant court cases, complaints, and legal opinions.

We performed our review from December 1998 through July 1999 in accordance with generally accepted government auditing standards.

We are also sending copies of this report to appropriate congressional committees; the Honorable Rodney Slater, Secretary of Transportation; the Honorable Janet Reno, Attorney General; the Honorable Jacob Lew, Director, Office of Management and Budget; and other interested parties. We will send copies to others upon request.

If you or your staff have any questions about this report, please call me at (202) 512-2834. Other contacts and acknowledgements are listed in appendix II.

Sincerely yours,

John H. Anderson, Jr.

John H. Anderson, Jr.
Director, Transportation Issues

Contents

Abbreviations

ARC	Airlines Reporting Corporation
GAO	General Accounting Office

Summary of the Department of Transportation's Dockets

Table I.1 lists requests, petitions, and notices of rulemakings filed before the Department of Transportation relating to various aspects of airline ticket sales. The Department has completed its review and issued orders on two of these requests, while seven others are still pending.

Table I.1: Department of Transportation's Dockets on Various Aspects of Airline Ticket Sales

Docket number	Date	Parties	Nature of complaint	Departmental status
OST-49808	10/3/94	Pacific Travel International, Inc. v. American Airlines, Inc.	Request for restraining order against American Airlines for engaging in unfair business practices against complainant (requiring 24-hour payment for discounted tickets).	Order 95-1-2, Jan. 4, 1995, dismissed.
OST-1996-1995-1	12/2/96	Association of Retail Travel Agents v. International Air Transport Association, Cathay Pacific, Aer Lingus and Icelandair	Request for enforcement proceedings with respect to Internet offers of international passenger air transportation below tariff rates.	Order 99-4-19, Apr. 29, 1999, dismissed.
OST-1997-2061-1	1/13/97	Donald Pevsner	Petition for a rulemaking to prohibit carriers from discriminating against non-Internet users.	Pending.
OST-1997-2622-1	6/16/97	Consumers Union	Petition for a rulemaking to require commercial passenger carriers to disclose directly to consumers, and make available to computer reservation system vendors, the most recently available average airfare and lowest fare charged by the carrier for the route and class quoted to the inquiring party.	Pending.
OST-1997-2881-1 62 Federal Register 47606	9/10/97	Advance notice of proposed rulemaking	Advance notice of proposed rulemaking to solicit comments on whether the Department of Transportation should continue or modify its existing rules governing airline computer reservation systems. Unless extended, the existing rules will expire Mar. 31, 2000 (64 Federal Register 15127, Mar. 30, 1999).	Pending.
OST-1997-2908-1	9/16/97	Association of Retail Travel Agents v. American Airlines, Delta Airlines, Northwest Airlines, and United Airlines	Request for an enforcement proceeding and petition for rulemaking, with respect to alleged unfair and anticompetitive practices, that is, "back-to-back" ticketing.	Pending.

(continued)

Docket number	Date	Parties	Nature of complaint	Departmental status
OST-1998-3713-1	4/8/98	Request for comments by the Department of Transportation	Request for comments on the Department's enforcement policy regarding unfair exclusionary conduct in the air transportation industry.	Pending.
OST-1998-4775-1	11/18/98	Association of Retail Travel Agents	Emergency request for a rulemaking to establish travel agency rights to renegotiate or arbitrate computer reservation system contracts when airlines reduce commissions.	Pending.
OST-1998-4776-1 4785-1 4786-1 4836-1	11/18/98 11/18/98 11/18/98 12/01/98	United States Travel Agent Registry v. Delta, United, American, and Continental Airlines	Request for the Department to rescind commission reductions on international airfares.	Pending.

GAO Contacts and Staff Acknowledgments

GAO Contacts

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