

**WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND
OPPORTUNITIES OF LIBERALIZATION**

Montreal, 24 to 29 March 2003

**Agenda Item 2: Examination of key regulatory issues in liberalization
2.5: Product distribution**

**PRODUCT DISTRIBUTION, INCLUDING COMPUTER RESERVATION
SYSTEMS AND THE INTERNET**

(Presented by the Secretariat)

SUMMARY

This paper reviews the rapid and fundamental changes in the area of airline product distribution, focussing on computer reservation systems (CRSs) and the internet. It also discusses implications for consumer protection and competition, and assesses the applicability of the ICAO CRS Code.

Action by the Conference is in paragraph 6.1

REFERENCES

*Doc 9587, Policy and Guidance Material on the Economic Regulation of
International Air Transport*

1. INTRODUCTION

1.1 The term product distribution refers to the sale and marketing of air transport services. With the introduction of CRSs, airlines gained a new and valuable tool for their product distribution. CRSs provide travel agents, as intermediaries in the product distribution chain, with up-to-date information not only on airlines' flight schedules, fares, and seat availabilities but also on a range of travel and leisure services. They also facilitate the work of travel agents in making reservations and issuing tickets. In recent years, however, airlines' heavy reliance on traditional travel agent outlets through CRSs has gradually diminished as the internet has led to alternative outlets which are more cost-effective for the carriers. In response to the newly-emerged distribution channels using the internet, CRS vendors have pursued internet businesses aggressively, while a large number of third-party service providers (neither air carriers, travel agents nor CRSs) have also been entering into the market. Although the majority of airline ticket sales are still being made through travel agents, on-line sales through the internet are obtaining significant shares as consumers

become accustomed to on-line purchasing, especially in countries where internet and credit card use is high. For some low-cost carriers, on-line sales represent the primary distribution channel.

1.2 This paper reviews the rapid and fundamental changes in the area of airline product distribution, discusses recent industry and regulatory developments, as well as their implications, and draws some conclusions.

2. PREVIOUS ICAO WORK

2.1 The 1994 World-wide Air Transport Conference (AT Conf/4) recommended that the review of the then existing ICAO CRS Code, developed originally in 1991, proceed with a view to States using the Code as their basis for regulating CRS. In 1995, the 31st Session of the Assembly requested the Council to complete its review of the ICAO CRS Code in light of the experience of its application and the implications in relation to the General Agreement on Trade in Services (GATS) Annex on Air Transport Services, and to develop a model clause on CRS for use by States. In June 1996, the Council adopted both a revised ICAO CRS Code, replacing the previous Code in its entirety, and two alternative model clauses on CRS. As of September 2002, 31 States had indicated that they either followed the ICAO CRS Code or had CRS regulations which are consistent or compatible with it. These States represented approximately 60 per cent of international passengers on scheduled services, by departures.

2.2 In 2001, at the 33rd Session of the Assembly, the issue of airline product distribution was again considered, taking into account the new developments. The Economic Commission noted that some concerns have emerged from the increased use of the internet in airline product distribution, and recognized that there have been major developments in individual airline Web sites and other forms of on-line sales, in jointly operated airline Web sites and in major on-line travel agents. The Assembly also noted the need to address the issue within the framework of ATConf/5.

3. RECENT DEVELOPMENTS

3.1 Since the mid-1990s, the CRS industry has experienced concentration, expansion, and changes in ownership structure, while both on-line sales of air transport services to consumers and business transactions via the internet have experienced rapid growth. Regulatory efforts at the regional and national levels have focussed on revising existing CRS regulations and correcting specific problems.

3.2 **CRS industry.** In the past decade, the CRS industry has consolidated into four major global CRS vendors – Amadeus, Galileo, Sabre, and Worldspan. These global vendors have, in turn, actively acquired stakes in regional CRS vendors, set up joint ventures and concluded partnership agreements with local interests to expand their business overseas. Another global vendor, GETS Marketing Company (a cooperative CRS owned by airlines from developing countries), sold its agencies to Galileo in 1997. As their presence expanded, the four major CRSs have increasingly seen themselves as global distribution systems (GDSs), i.e. providers of comprehensive travel information and reservation capability not only on airlines but also on hotels, car rentals, rails and leisure tours etc.

3.3 Another change that has occurred in recent years has been the airlines releasing control of the CRSs. There was a steady overall decline in airline ownership of three of the four major CRSs. Sabre has been a publicly listed company since 2000. Galileo became a subsidiary of Cendant (a provider of travel and residential real estate services) in 2001. Amadeus is still controlled by three European airlines, but the public now holds over 40 per cent of its stake. Only Worldspan is owned entirely by three United States airlines.

3.4 **Internet.** Multiple parallel distribution channels now co-exist and the pace of acceptance of the new technology-led channel, the internet, varies amongst States and according to market segments. However, the use of the internet both through third-party providers and recently, in particular, directly to consumers and other businesses, has shown a dramatic increase. In the area of business-to-consumer (B2C), i.e. business that sells products or provides services to end-user consumers, four different types of Web sites have emerged: 1) traditional travel agents' Web sites which constitute a simple extension to "brick-and-mortar" outlets and business processes; 2) on-line travel agents which do not have conventional retail outlets (for example, Travelocity, Expedia, and Priceline); 3) airlines' own Web sites; and 4) Web sites jointly owned by groups of airlines which offer wider product choices than the ones offered by a single airline's Web site (notably, Orbitz in North America, Opodo in Europe, and Zuji in Asia/Pacific). The latter two types of B2C Web sites have enabled airlines to reach more consumers, reduce agency commissions (and a part of booking fees) and manage their inventory more effectively.

3.5 Public awareness of the internet with a large number of third-party providers in the B2C area has had a significant impact on the CRS business. The major CRS vendors have adapted to a challenge of translating their existing system designed mainly for the use of traditional travel agents into one applicable to any activity of business-to-business (B2B), i.e. business that sells products or provides services to other businesses, and business-to-business-to-consumer (B2B2C), i.e. transactions in which a company sells a service or product to end-consumers using other companies as intermediaries. As a result, all the major CRSs are now serving as a booking engine behind most B2C Web sites and as an on-line travel booking system for major corporations and airlines, and they are also providing participating travel agents with a customized Web-booking facility so that CRS vendors can reach consumers indirectly via their travel agents.

3.6 **Regulation.** There are both codes of conduct and regulations for CRS activities, including ones adopted by ICAO, the European Union (EU), the European Civil Aviation Conference (ECAC), the Arab Civil Aviation Commission (ACAC), Canada and the United States. Amongst them, EU, ECAC and the United States have revised their respective codes, regulations or rules since 1997.

3.7 The Council of the EU amended its 1993 Regulation on a code of conduct for CRS in 1999. ECAC adopted a recommendation on a revised ECAC CRS Code of Conduct in 2000, replacing its 1994 code in light of the amended EU Regulation. With few exceptions, both codes were essentially the same. Noteworthy changes were: 1) the inclusion of rail services in principal displays at the option of system vendors; and 2) an exemption for a group of airlines, such as alliances from the requirements to use a principal neutral display and to use the prescribed order of displaying flights. Also, to ensure that the codes would apply to the internet, the revised codes made the system vendor responsible for ensuring that any third-parties providing CRS services on its behalf comply with the codes, while the definition of subscriber was amended to "user of a CRS". Since 2000, the European Commission has been in the process of developing possible further amendments to its Regulation, and has examined several issues where implementation of the Regulation was proving difficult or where new developments, especially in the area of e-commerce, necessitated some revisions.

3.8 The United States Department of Transportation (DOT) amended its rules governing CRS operations twice in 1997. The first change was an adoption of a rule that airlines which are not CRS owners need not participate at the same level in all CRSs in which they choose to participate. The second change required each CRS vendor to offer one display that lists flights without giving all on-line connections a preference over interline connections; it also prohibited systems from creating displays that neither use elapsed time as a significant factor in selecting flights from the database nor give single-plane flights a preference over connecting services in ranking flights. The DOT also started a comprehensive review of the rules in 1997, which continues at the time of preparation of this paper. In 2000, the DOT sought comments

on whether the CRS rules remain necessary and effective in light of the airlines' diminishing control of CRSs, and whether new rules covering the internet should be adopted.

4. DISCUSSION

4.1 The regulatory responses on product distribution in recent years are indicative of the problem for regulators in this area, which is that finding appropriate regulatory formulae can be a long and complicated process, by which time competition, technology, selling and marketing of the air transport product have moved on and new regulatory issues may have emerged. Although a number of the original regulatory concerns with CRSs have diminished as ownership has moved away from air carriers, some other concerns have emerged from the rapid development of e-commerce, especially the internet. Since almost no Web sites are completely independent of CRSs, some of the concerns for the use of the internet for airline product distribution may be similar to those for CRSs before the codes or regulations had been introduced. Also, the amended EU Regulation, ECAC Code and the U.S. rules contain some issues that the ICAO CRS Code does not cover or specifically mention. The following discussion addresses the issue of regulatory responses to product distribution developments, focussing on the applicability of the ICAO CRS Code, and on the consumer, competition and participation aspects of the internet.

4.2 **Applicability of the ICAO CRS Code.** In general terms, the current text of the ICAO CRS Code can provide a basis for addressing some issues as it is without changes. The ICAO definition of a CRS refers to a system which "provides displays of schedules, space availability and tariffs of air carriers, and through which reservations on air transport services can be made". This is an accurate description of Web sites on the internet, which sell air transport services. From a definitional standpoint, therefore, the ICAO CRS Code applies to the internet marketing of air transport services. The problem relating to the applicability is who would apply the ICAO CRS Code to internet marketers of air transport. The State in which such companies have their headquarters would be an obvious choice although, in an environment of global multi-national companies, this may be more difficult than it appears. Also, even if a State tries to apply the Code, it may not be easy for it to determine the place where the contract was concluded between internet marketers and users. With respect to specific detailed provisions, there exist some instances where the ICAO CRS Code does not always meet the conditions used in internet activities and where it does not have comparable provisions with the regulatory decisions taken by the ECAC, EU and the United States in recent years (for example, the exemptions for groups of airlines for the marketing of airline alliance services in the EU Regulation and the ECAC Code, and DOT's decision on levels of participation by an airline which is not an owner of a CRS). However, given the speed of the changes in e-commerce business as well as the unclear consequences of ongoing review in the European Union and the United States, where the major CRSs are based, attempting to revise the detailed provisions in the ICAO CRS Code at this time may not be productive. Moreover, since the ICAO CRS Code already potentially applies to the internet, States can take this up at their discretion according to their particular circumstances. It should also be noted that there is no conflict between obligations of States that follow the ICAO CRS Code and are also parties to the GATS.

4.3 **Consumer aspects of the internet.** There is a potential risk that consumers are less protected when shopping on-line than they are when they buy from traditional outlets. As the internet matures, the search function, traditionally performed by travel agents on behalf of consumers, is being shifted in part to the consumers who may need to consult various Web sites by themselves to get what they want. While the traditional CRSs provide a comprehensive source of neutral information on air services, this is not necessarily the case with Web sites on the internet, though the latter can provide consumers with additional choice of travel options with a greater variety of new products such as internet-only fares and auction fares. One other consumer concern is the use and disclosure of personal information on the internet. To protect consumers from incomplete and misleading information and improve consumer confidence, several States have

addressed the issue under the umbrella of airline passenger rights; other States have applied general consumer protection laws/rules to the internet transactions.

4.4 **Competition aspects of the internet.** The primary issue regarding competition and the internet is whether certain practices associated with the use of the internet are likely to undermine competition and consumers' benefits, despite a competitive impetus carried to the marketplace by the internet. On the one hand, the use of the internet may provide greater opportunities for more vigorous competition and for new businesses, resulting in the rapid growth of new products and services and more dynamic technological innovation. On the other hand, some areas of the internet business may give rise to anti-competitive behaviour, where market incumbents seek to sustain or enhance their market power at least for a certain period. For example, B2B and B2C Web sites jointly owned by horizontal competitors holding dominant positions in the relevant markets may have a potential anti-competitive effect, because the owner and participating airlines could possibly use these sites to collaborate and coordinate their prices and services indirectly by signalling, or directly, thereby stifling competition. Also the owner airlines can discriminate against competing airlines, travel agents and service providers by refusing access to their internet-based systems on fair and reasonable terms. The current regulatory focus on Web sites jointly owned by groups of airlines (namely, Orbitz and Opodo) reflect these competition concerns.

4.5 **Participation aspects of the internet.** Ready access and practical use of the internet for making airline reservations is by no means universal. For example, communications costs make extensive use of the internet prohibitive in many developing countries, and foreign exchange and credit card restrictions can inhibit or proscribe the use of direct sale. In this regard, it is noteworthy that, as yet, there is no Web site jointly owned by airlines in Africa, Latin America/Caribbean or Middle East to parallel those of Orbitz in North America, Opodo in Europe or Zuji in Asia/Pacific. Thus air carriers in many developing countries are, at least in their home regions, likely to continue to have to use the more traditional distribution outlet of CRS, usually combined with a travel agent intermediary. CRS booking fees are not insignificant and are almost always expressed in a hard currency which, combined with the restraints on reducing commission payments, may put carriers in many developing countries at a cost and competitive disadvantage.

5. CONCLUSIONS

5.1 The Conference is invited to conclude that:

- a) while there exist several instances where the ICAO Code of Conduct for the Regulation and Operation of CRSs has no applicable provisions as a result of industry or regulatory changes, the scope of application of the ICAO CRS Code already potentially applies to the internet, and States may take this up at their discretion according to their particular circumstances;
- b) States should consider the need to ensure that internet-based systems provide consumers with comprehensive and non-deceptive information and airlines with a comparable opportunity to use these new systems as they have with conventional global CRSs, where necessary; and
- c) although it is not yet clear whether new regulations covering airline product distribution through the internet should be adopted, some States have been actively examining this issue under the existing CRS rules/regulations, consumer protection laws and competition laws. ICAO should continue monitoring developments closely and

disseminating information on this issue, and keep the effectiveness of the ICAO CRS Code under review.

6. ACTION BY THE CONFERENCE

6.1 The Conference is invited to:

- a) note the recent developments and the discussion on product distribution in paragraphs 3 and 4; and
- b) review and adopt the conclusions in paragraph 5.

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