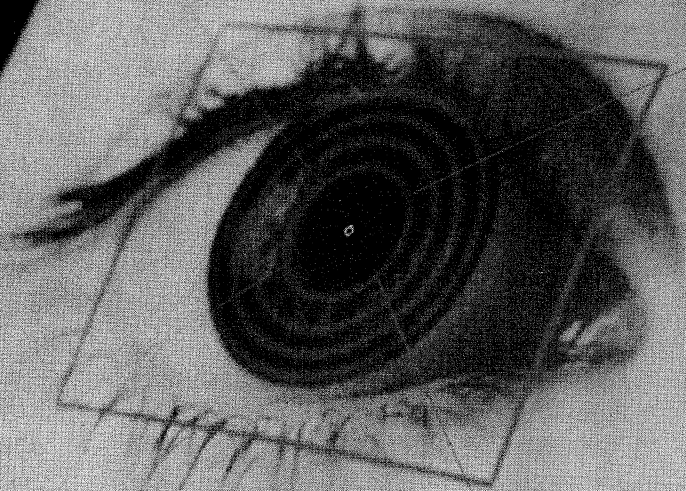


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# ANTITRUST

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**A Fresh Look at the Agencies**



# Orbitz: An Antitrust Assessment

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**O**RBITZ, THE ONLINE TRAVEL agency formed by the five largest airlines, was launched with considerable fanfare last June. Orbitz's founders—American, Continental, Delta, Northwest, and United—together account for about 80 percent of U.S. domestic air travel.<sup>1</sup> Approximately 40 other domestic and international airlines, accounting for a majority of the remaining 20 percent of the domestic market, have signed agreements to be Airline Charter Associates of Orbitz. Orbitz's launch was the biggest site launch since 1999 according to Nielsen/NetRatings—with traffic ten times greater than Orbitz had projected.<sup>2</sup> Orbitz has grown quickly since, claiming to be the third largest online travel agent site behind Travelocity and Expedia; according to Expedia, Orbitz is already the *largest* such site.<sup>3</sup>

In the period leading up to the Orbitz launch, serious antitrust concerns were expressed by major consumer groups, Southwest Airlines (the leading low-fare air carrier), the attorneys general of over twenty states, and competing online distributors. They argued that Orbitz could achieve a dominant position in online air travel distribution, through the unique advantage of preferential access to fare listings from its members, reinforced by high fixed (and sunk) costs and indirect network effects. Some also claimed that Orbitz could inhibit fare discounting and act as a “market power ringmaster” facilitating fare coordination among its member airlines.<sup>4</sup>

Orbitz, on the other hand, argued that it would provide consumers with better service at lower cost than the available alternatives, emphasizing a superior search engine, an unbiased display of fare information, and the broadest available fare coverage.<sup>5</sup> It also claimed that its entry would benefit consumers by increasing the competition faced by the two largest incumbent online air travel sites—Travelocity and Expedia—and challenging the position of the Computer Reservation System (CRS) operators.<sup>6</sup> Orbitz and others advocated that the government act only if evidence of competitive problems actually emerges over time.<sup>7</sup>

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The Department of Transportation (DOT) adopted this approach in April 2001, informing Orbitz that it would not “prevent Orbitz . . . from beginning operations or require it to change its business strategy at that time.” However, citing competitive concerns, DOT said it would review Orbitz's post-launch activities “to ensure that its actual operation will not be anticompetitive.”<sup>8</sup> Congress registered concern in December 2001, inserting a provision in the DOT appropriations legislation that requires DOT to prepare a report on the competitive impact of Orbitz by April 2002.<sup>9</sup> Across the Atlantic, in November 2001, the European Commission closed a year-long investigation of Opodo, an online ticket distributor owned by nine European airlines, requiring undertakings to resolve competitive concerns.<sup>10</sup>

## Overview of the Analysis

Orbitz is a joint venture devoted to the online distribution of air travel and related services, whose member airlines compete in providing air travel services (and account for nearly all domestic air travel). The federal agency Competitor Collaboration Guidelines<sup>11</sup> provide a helpful analytic framework. They emphasize the importance of assessing the potential anticompetitive effects of the “overall collaboration and any individual agreement or set of agreements within the collaboration.”<sup>12</sup> Individual restraints are analyzed separately unless their benefits and harms “are so intertwined that they cannot meaningfully be isolated.”<sup>13</sup> If this examination suggests that there is anticompetitive harm, “the Agencies examine whether the relevant agreement is reasonably necessary to achieve procompetitive benefits that likely would offset anticompetitive harms.”<sup>14</sup> They consider procompetitive benefits only if the restraint at issue is “reasonably necessary” to achieve them.<sup>15</sup>

Antitrust enforcement can itself interfere with efficient conduct in the marketplace, thereby harming consumers, and the government should exercise caution to avoid taking actions that might reduce consumer welfare. This is especially true in a market as dynamic, innovative, and high-tech as online distribution. Therefore the Guidelines' requirements must be applied with care. In particular, Orbitz argues that the joint venture as a whole offers potential benefits to consumers. It is important to examine whether the restraints Orbitz imposes are reasonably necessary to achieve these benefits. However, this assessment must recognize the complexity of market arrangements and the difficulty of determining the need for restraints.

The Charter Associate Agreement (Associate Agreement)—the basic agreement between Orbitz and its members—imposes various obligations on airlines and grants them discounts from Orbitz's standard fees in return. The most serious antitrust concerns are raised by two provisions of that agreement—the Most Favored Nation (MFN) provision and the promotional obligation.<sup>16</sup> The MFN is set forth in Section 2.1 of the Associate Agreement. Section 2.1(a) requires that each airline provide “complete, timely and accu-

rate information on its schedules, Published Fares and Seat Availability (together 'Air Travel Information') to [Orbitz] at no charge with the same frequency and no later than Airline provides Air Travel Information to its Airline Internet Site." The definition of "Published Fares" is quite broad.<sup>17</sup> Section 2.1(b) further requires that any airline special deals or promotions provided through an "Internet Travel Provider" (i.e., a third party Web site), including schedules, seat availability, various "Service Enhancements" and frequent flier opportunities must be offered to Orbitz on an MFN basis.<sup>18</sup> These requirements appear to ensure that, as a practical matter, all publicly available fares of Charter Associate airlines (who together account for nearly all domestic air travel) will be available through Orbitz.

The Marketing Support (or promotional) obligation is set forth in Section 2.2 of the Associate Agreement. Charter Associates are required to provide "In-Kind Promotions" equal either to a dollar value or to a percentage of their travel revenues. The In-Kind Promotions include placing the Orbitz brand in ads, in-flight materials, or direct mail advertising; providing free or discounted supplements (e.g., points or upgrades) to Orbitz; and providing special promotions, such as exclusive fares (fares available only on the Orbitz site) or semi-exclusive fares (available only on Orbitz or the airline's own site). Thus, the promotional obligation creates an incentive to provide Orbitz with fares that are not available elsewhere.

The MFN provision of the Associate Agreement raises clear competitive problems and is likely to reduce competition in fare-setting and online ticket distribution. There is a serious risk that the MFN will inhibit selective or camouflaged discounting of fares, including discounting by members who feel forced to join to avoid discriminatory fees. The issues raised by the promotional obligation are more complex, especially since promotional arrangements can be procompetitive, and, indeed, are prevalent in the online ticket distribution market. However, the promotional obligations does not resemble individually negotiated promotions. Most troubling is that this obligation may be met by providing Orbitz fare listings, which are central to competition among distributors, on an exclusive or semi-exclusive basis.

These provisions are not "intertwined" with the establishment of an online distributor. Moreover, these provisions are not reasonably necessary to creating the benefits claimed by Orbitz. Both provisions give Orbitz a competitive advantage over rivals, but neither is reasonably necessary to enabling Orbitz to enter the market. And while the MFN does help Orbitz become a one-stop-shop, this claimed efficiency reduces incentives for fare cutting. These competitive concerns can be addressed without significant risk of reduced efficiency, by requiring Orbitz to modify the Associate Agreement to eliminate these competitively questionable provisions.

Beyond these two provisions, the ability of Orbitz to contribute to fare coordination or dominance is open to ques-

tion. While, Orbitz's members account for nearly all of the domestic air travel market, Orbitz is limited to online marketing, which accounts for just over 10 percent of its members' sales. Moreover, it is formally non-exclusive—any owner or Charter Associate is permitted to distribute tickets through other online outlets (although this is subject to limits placed by the MFN provision, as discussed below).

As a result, DOT is correct in permitting Orbitz to operate while monitoring Orbitz's conduct for signs of possible anticompetitive effects. Indeed, by reducing Orbitz's potential anticompetitive impacts, the actions recommended above will substantially reduce the competitive risks of DOT's approach. Nonetheless, monitoring should be rigorous. The antitrust authorities should check for signs of increased prices or reduced discounting, and for evidence of the use of Orbitz for collusive behavior. It should also keep close tabs on Orbitz's growth. If Orbitz quickly becomes the largest online ticket distributor, the potential for improperly obtained dominance increases.

It could be argued that such a "wait and see" approach should be adopted with regard to the MFN and promotional obligation. However, the likely competitive harm outweighs the small potential benefits. The interim harm to consumers, especially in the form of higher fares, could be quite severe, as could the impact of the exclusion of competitors. Monitoring fares pursuant to a wait-and-see approach may be of limited utility, due to the difficulty of empirically distinguishing between the effect of the MFN clause, the promotional obligation, and other market developments. And if Orbitz does achieve dominance, designing an adequate remedy could be difficult. Finally, the provisions do not appear to contribute appreciably to achieving significant efficiencies, so that eliminating them poses little risk.

A more detailed assessment follows.

### **Antitrust Assessment of the Orbitz Joint Venture**

**Applicable Standards.** Joint sales and marketing ventures among competitors can raise serious concerns under Section 1 of the Sherman Act. Exclusive joint sales agencies—i.e., where the competitors give up the right to sell in competition with the venture—have been held per se illegal.<sup>19</sup> Even where, as here, the venture is non-exclusive and there are plausible efficiency claims, joint marketing arrangements have been subject to careful review by the courts under the rule of reason. And any effort by owners to use an otherwise lawful joint venture for collusive purposes, such as reaching an agreement regarding prices or output, would of course be treated as per se illegal.

Cases applying the rule of reason to non-exclusive joint ventures whose members represented a large majority of market supply have generally involved very strong efficiency justifications. The best-known example is *BMI*, where the Supreme Court held that the formation of a music rights collective to monitor performances and collect royalties under

a blanket license was “necessary to market the product at all.”<sup>20</sup> It emphasized that the blanket license sold by BMI was both distinct from individual licenses and preferred by many consumers, and that BMI was therefore not a joint sales agency but rather the seller of an aggregated product.<sup>21</sup>

The courts have also been careful to require that the particular restraints at issue are reasonably necessary to achieve the proffered business justification. For example, in *NCAA*, the Supreme Court recognized that some horizontal restraints were necessary to create the product, but that the restrictions at issue were not well-tailored to serve that end.<sup>22</sup> This scrutiny is based on sound policy considerations. Even non-exclusive joint marketing can pose risks of anticompetitive information exchange, price or output coordination, or collective action to disadvantage other competitors, especially when its participants account for a large majority of market supply.

***The Relevant Markets: Airline Ticket Distribution and Air Travel.***<sup>23</sup> Orbitz affects two related markets: the market for the online distribution of airline tickets (in which Orbitz operates) and the market for air travel services (in which Orbitz’s owners and Charter Associates operate). Airline tickets are distributed through multiple channels. Traditionally, travel agents have been the most important outlet. In addition, airlines distribute tickets directly for their own flights, thereby avoiding commissions to travel agents and booking fees (but incurring their own distribution costs). As discussed below, certain characteristics of online distribution give it special competitive significance.

To promote efficient collection and searching of flight and fare information, the airlines submit the vast majority of their flight and fare information electronically to the Airline Tariff Publishing Co. (ATP), a joint venture that serves as a clearinghouse for the data. A limited number of discounted fares, offered through the airlines’ own distribution systems or through selected agents, are not included in the information transmitted to ATP. The ATP data are downloaded into the computers of four competing CRSs, which provide data-searching services to traditional travel agents and others. While all the CRSs were initially owed by airlines, Sabre, which accounts for about half of bookings, and Galileo are now independent, while Amadeus and Worldspan still have airline owners.

The most recent innovation in airline ticket distribution has been online ticket sales, which accounted for about ten percent of ticket sales in 2001 according to PhoCusWright.<sup>24</sup> Kasper cites estimates that distribution accounts for as much as 20 percent of the costs of providing air travel.<sup>25</sup> Online distribution substantially reduces these costs, especially for travel booked directly on an airline’s own site. The most important online distributors are Orbitz, independent online travel agents (the largest of which are Travelocity and Expedia), the airlines’ own sites, and specialized sites (such as Priceline.com).<sup>26</sup> The airlines’ sites accounted for about 58 percent of online sales in 2001; while prior to the Orbitz

launch, Travelocity and Expedia together have accounted for somewhat over half of the non-airline sales. According to PhoCusWright estimates, Travelocity accounted for 32 to 39 percent of these sales and Expedia 20 to 24, and that Orbitz already accounts for over 14 percent of non-airline online sales.<sup>27</sup> As noted above, Expedia claims that Orbitz is already the leader.

These sites enable consumers to search a wide range of fare and flight listings to identify their preferred options, without the cost of consulting a human agent. Consumers can book the flight online or (with some exceptions) can use the information to make a purchase through more traditional mechanisms. For travel-agent sales, the airline pays a booking fee to the CRS and a commission to the agent; the consumer pays only for the ticket. Recently, the airlines have been using their own Web sites to offer their lowest promotional fares, known as Web-only or e-fares. Indeed, increasingly these fares (5–10 percent below the normal sale fares) have effectively become the standard selling price online.<sup>28</sup>

In light of the relatively small size of online ticket sales, there is reason to question the extent to which policies relating to online distribution are likely to have an overall effect on ticket distribution or air travel fares. Online distribution is, however, rising rapidly. Moreover, sales shares understate the importance of fare searching online, which travelers may use to locate their preferred flight and fare, even if they then book the flight through some other channel. These sales also lower distribution costs substantially. Finally, and perhaps most importantly, online distribution plays a key role in airline offers of reduced fares. Many price-sensitive consumers rely on it for access to very low fares, and it may be the only channel through which they can get access to these fares. As a consequence, online distribution is of considerable competitive significance for airline ticket distribution and fare setting.

***Orbitz’s Potential Anticompetitive Impacts.*** POTENTIAL IMPACT ON AIREFARES. Airlines typically make selective or camouflaged fare discounts available through limited channels, such as their own Web sites or special promotional arrangements with other distributors. This is an important source of discounting.<sup>29</sup> Airlines are more willing to offer discounts when they can do so selectively, because such a strategy permits the airline to target price-sensitive consumers while minimizing the diversion of customers willing to pay the normal fare (generally available through ATP). Moreover, because the discount is targeted, competitors are to match it quickly, which would reduce the benefit to the carrier making the initial price reduction.

By ensuring that all fares are immediately made broadly available to all consumers through Orbitz, with an inventory level equal to that available through the airlines’ own sites, the MFN reduces the airlines’ ability to use their Web sites to camouflage or target their discounts. This increases the likelihood of responsive matching or retaliatory fare cuts, and thereby undermines the incentive to offer discounts in

the first place. The MFN may enable consumers to find the lowest available fare more easily, but may also cause the airlines to offer fewer low fares.<sup>30</sup> The diversion of sales from the airlines' own Web site can also increase costs.

Orbitz argues that the MFN does not increase the ability of the airlines to coordinate pricing because the information on fares, including discounted fares, is already available from ATP data and the airlines' sites.<sup>31</sup> DOT also cited this argument in finding that there was insufficient evidence to conclude that Orbitz would contribute to fare coordination.<sup>32</sup> It is true that this information is available from ATP and individual airlines' sites, so that it is likely that the airlines can already effectively monitor each other's fares quite closely. However, even if the information is already readily available for monitoring by the airlines, the MFN changes the fare-setting environment by requiring that all publicly available fares be sold in the Orbitz marketplace. Orbitz's significance is not that it increases the airlines' ability to monitor each other, but rather that it ensures that e-fares will be immediately and widely known to consumers in the marketplace, and thereby can decrease incentives to discount.

Orbitz also emphasizes the limited extent of the promotional obligation and limited number of fares that Orbitz will obtain through the MFN.<sup>33</sup> It is true that the practical reach of the MFN is limited. Its principal focus has been on fares offered only on the airlines' own sites, which account for less than one percent of all fares.<sup>34</sup> However, exclusive fare listings raise particularly strong concerns, because access to the listings is central to the distribution function. The MFN ensures that Orbitz will be able to offer all publicly available fares, and the promotional obligation can provide Orbitz with some fares available nowhere else (other than an individual airline's site). Moreover, the airline Web site listings at issue include the very low e-fares that are of greatest interest to the most price-sensitive consumers.

However, apart from the MFN, it is not apparent that Orbitz's airline owners and Charter Associates could find ways to use Orbitz itself to coordinate fare-setting generally.<sup>35</sup> The current system ensures that generally distributed fare information is quickly communicated to the market. It is possible that Orbitz might provide opportunities for the airlines to communicate regarding fares, as the Department of Justice alleged was done in the *ATP* case,<sup>36</sup> although we have not identified likely mechanisms through which this could be accomplished. Some attention to this possibility may be warranted, especially if Orbitz becomes a dominant one-stop online shop (discussed below), and online shopping continues to gain in importance.

It is also conceivable that Orbitz could be used to disadvantage discount carriers, e.g., by raising their distribution costs or interfering with their business models. This would be a serious concern if Orbitz became a sufficiently strong player that an airline would lose substantial sales if it were not listed in Orbitz—for example, if Orbitz was successful in becoming the broadly recognized one-stop shop. Even

Orbitz's discounted fees are likely to significantly exceed an airlines' cost of distributing on its own Web site. Moreover, to receive the discount, an airline must become a Charter Associate, and thereby become subject to the MFN and other provisions that would restrict sales from its own site.

Southwest, by far the leading discount airline (and airline Web site) apparently believes that Orbitz will operate to its detriment. Not only has it refused to join Orbitz,<sup>37</sup> it has filed a lawsuit challenging Orbitz's use of Southwest's trademarks and flight information and alleging that information on Orbitz about Southwest contained many errors or omissions. Orbitz was forced to stop listing Southwest flights, and the parties agreed to dismiss the suit without prejudice.<sup>38</sup>

**ANTICOMPETITIVE POTENTIAL IN ONLINE DISTRIBUTION OF AIRLINE TICKETS.** Orbitz faces two leading incumbents in online air travel distribution, Expedia and Travelocity, as well as some very successful individual airline sites. Each of these players had a significant head start; Travelocity and Expedia, in particular, have built up substantial consumer awareness and customer bases. However, the heavy media coverage associated with Orbitz's launch, its huge promotional campaign, and the promotional efforts discussed below quickly made consumers aware of Orbitz. Orbitz's rapid growth suggests that customers are willing to switch from other distributors. Thus, these advantages clearly do not preclude eventual dominance by Orbitz. If Expedia's claim that Orbitz has already become the largest online agent is correct, the possibility that Orbitz could become dominant becomes much more serious.

The concerns that Orbitz may achieve dominance other than on the merits are centered on the provisions in the Associate Agreement that give it a preferred position relative to other online distributors in obtaining fare listings. These advantages cannot be matched by other online distributors or the airlines themselves. The MFN ensures that Orbitz will have access to any fares and inventory of its owners or Charter Associates that are available on the carriers' own Web sites or offered to other online distributors. Other online third-party distributors will, therefore, not be able to compete with Orbitz by obtaining preferential access to listings of any of the Charter Associates. Furthermore, the promotional obligations also create incentives for carriers to favor Orbitz over other third-party distributors, particularly by offering Orbitz fares on an exclusive or semi-exclusive basis. Orbitz's owners and members may also find that these provisions make it difficult to compete effectively with Orbitz through distribution over their own Web sites.

Dominance in online ticket distribution would also be reinforced by two factors. The first is the high fixed (and sunk) costs associated with setting up and marketing a distribution Web site, which favor larger sites that can spread those costs over more consumers. The second is indirect network effects. As the number of airlines using a site increases, it will attract more consumers. Conversely, as more consumers use a site, it will attract more fare listings.<sup>39</sup> These con-



ditions can reinforce—and be reinforced by—Orbitz's advantages from preferential fare availability. The antitrust agencies should monitor Orbitz's growth carefully, and, if it quickly surpasses its competitors, examine whether its restrictive provisions may have contributed to this result.

Orbitz argues that competing online agencies can obtain low fares by offering similarly low prices. While its competitors can compete for listings, Orbitz will have the advantage of an MFN clause to assure itself of fare listings. Orbitz will also have the advantage of the promotional obligation, which creates incentives for the airlines to give it exclusive listings. If these provisions are eliminated, Orbitz and its competitors will all have the opportunity to compete for low fares. Orbitz also argues that these provisions will provide it with exclusives on only a small proportion of fare listings. However, as noted above, these fare listings are likely to be of interest to a large number of price-sensitive customers, and make Orbitz very attractive to them.

In addition, Orbitz maintains that the MFN has not been used by Orbitz to obtain fare listings,<sup>40</sup> claiming that the MFN consists solely of the member airlines' obligations to offer fare listings on the same terms offered other online agents (Section 2.1(b)), not their obligation to provide fare listings offered on their own sites (Section 2.1(a)). However, the airlines' MFN obligation includes both parts of Section 2.1.

**Orbitz's Potential Efficiencies.** Orbitz asserts that it will introduce important efficiencies and procompetitive benefits into the marketplace, including a superior search engine and software, unbiased displays, lower costs and increased competition, and reduced consumer search effort.<sup>41</sup> It also claims that the MFN and the promotional obligation have facilitated its entry. Orbitz's opponents dispute these efficiency claims and their significance.<sup>42</sup> The joint venture is clearly not necessary to successful online distribution. It does represent a new and potentially innovative participant in online travel distribution, implementing a possibly improved search engine and offering other enhanced services. These efficiency claims are plausible, although questions remain about their significance. Most importantly, the extent to which the venture is necessary to serving these efficiencies is somewhat unclear, and the claim that the MFN and promotional obligations are reasonably necessary to achieving these efficiencies is implausible.

The specific efficiencies claimed will be considered in turn.

■ **Superior Search Engine and Software.** Orbitz maintains that its search engine is faster, because it is based on parallel processors rather than on the mainframe technology used by the traditional CRSs,<sup>43</sup> providing a potential justification for the joint venture. There is evidence that the search engine is superior to other products, although the matter is the subject of considerable dispute. The technology may well have been implemented without an industry-wide joint venture, because the basic search engine was developed and success-

fully demonstrated independent of the joint venture and then licensed to it.<sup>44</sup> Orbitz did implement the new technology, and claims that the established firms would not have done so, because they are invested in the CRS model. Moreover, the joint venture may have contributed to the ability of the parties to undertake the investment by enabling them to spread fixed costs over a larger volume of transactions. However, the MFN and the incentives for favoring Orbitz with fare listings and other advantages do not serve to promote these efficiencies. The same basic benefits would be obtained if the search were conducted purely over fares available through CRSs.

■ **Unbiased Displays.** Orbitz claims that it offers a display of available flights that is based on objective consumer-selected factors and is less subject to bias than other displays, due to the contractual guarantees it provides. The joint venture may have provided a framework for agreeing on rules governing displays, although an independent agent might have done so as well. Moreover, it is not clear that Orbitz offers consumers a significant improvement over other available displays in terms of bias. CRSs are already subject to regulations to prevent display bias, and two—Sabre and Galileo—are no longer owned by airlines, greatly reducing concerns regarding display bias.<sup>45</sup> Travel agencies, online and off, are not subject to these regulations, but Travelocity uses the ordering it receives from its CRS, which meet anti-bias requirements. Finally, in any event, the MFN and promotional obligation clearly do not contribute to Orbitz's ability to provide an unbiased display.

■ **Reduced Costs.** Orbitz claims that it will enable airlines to reduce their distribution costs, through improved technology and by providing an alternative to what it claims are excessive and uncompetitive CRS booking fees. Reducing distribution costs could provide a substantial consumer benefit, if passed on to consumers. Orbitz emphasizes that the Associate Agreement provides a rebate on the CRS booking fee to all airlines that adopt it.<sup>46</sup> DOT has cited this rebate as a potential consumer benefit.<sup>47</sup>

As discussed above, it is clear that online distribution, especially over an airline's own site, can reduce distribution costs. If Orbitz promotes additional online distribution, it could contribute to cost reductions. But any claimed savings would depend critically on how tickets that Orbitz distributes would otherwise have been distributed. A large portion of Orbitz's sales are likely to be to customers who would otherwise have purchased from the airlines' own Web sites (now accounting for 58 percent of online sales); many additional sales will come from other online agents. As a result, it is likely that many sales over Orbitz could cost Charter Associates more than they otherwise would have.

The claim that Orbitz will counter the market power of CRSs is also suspect. Orbitz emphasizes Sabre's approximately 50-percent share, CRS fee increases, and various statements by the Department of Justice and DOT over the past twenty years expressing the belief that CRS vendors do pos-

sess market power vis-à-vis airlines.<sup>48</sup> However, economist Jerry Hausman argues this claim is contradicted by evidence on CRS profit margins, competition among CRSs, and new competition from airline sites.<sup>49</sup> While Orbitz has been able to negotiate a significant rebate for its members from one CRS, in late 2001 it imposed a five-dollar transaction fee on consumers. This fee greatly reduces the likelihood that Orbitz offers real savings in total costs for ultimate customers.

Finally, as mentioned above, even if the new technology benefits consumers, it is questionable whether the joint venture is necessary to introduce it. Moreover, the MFN and the promotional obligation are clearly not reasonably necessary to achieve these cost reductions, even though Orbitz requires that the airlines agree to these provisions to receive the discount. Orbitz argues that the superior technology and avoidance of excessive CRS fees make the savings possible, not the MFN and promotional obligation. While each provision might enable Orbitz to market more effectively, it does so at a cost to the airlines. Thus it is unclear whether there are any net savings. Furthermore, as discussed above, even if these provisions do contribute to the success of the venture, this does not make them reasonably necessary to achieve these cost reductions. And, as explained below, they are not necessary for Orbitz's successful entry.

■ **One-Stop Shop.** Consumer search costs could be reduced, and efficiency increased, to the extent that Orbitz is able to assemble all or nearly all fares in one data base. The MFN and the promotional obligation, taken together, ensure that Orbitz's coverage will be superior to that of any other online distributor, if all airlines participate in Orbitz. We note, however, that the airlines have already collaborated through ATP to create a comprehensive data base of flight and fare information that is disseminated through the CRS system to online agents. The primary significance of the MFN and promotional obligation is that they force airlines to provide Orbitz with access (perhaps on an exclusive or semi-exclusive basis) to those few fares the airlines choose not to distribute generally through ATP and would otherwise choose not to give to Orbitz.

MFN clauses can provide information and reduce bargaining and search costs. However, in this context, the potential benefits to consumers are quite limited. Southwest Airlines sued to prevent Orbitz from listing its flights, so Orbitz will be missing a significant amount of information about low-price flights even with the MFN. And in the online distribution context, it is relatively easy for consumers to make multiple searches for information; using several distributors will not require the consumer, for example to pay multiple fees. Finally, the only fares that Orbitz would miss without the MFN are those that the airlines would choose to market elsewhere. Airlines have every incentive to make their flight information conveniently available to consumers; the MFN prevents airlines from making independent judgments as to whether the benefits of listing fares with Orbitz are outweighed by other considerations.

■ **Facilitating Entry.** Orbitz's claims that the MFN and promotional obligations, by promoting its "one-stop-shop strategy," serve the procompetitive purpose of facilitating entry—providing Orbitz with a "marketing advantage" against "existing, entrenched competitors."<sup>50</sup> DOT gave some credence to this explanation, citing exclusive deals that independent agencies have with major Internet portals.<sup>51</sup> New entry is presumptively procompetitive, but the claim that these provisions are reasonably necessary to facilitate entry and overcome barriers is not supportable. Even though Orbitz is a new firm, it was formed by the major players in the industry, endowing it with considerable financial and operational strength. Moreover, Orbitz repeatedly touts the superiority of its search technology, software, and other features. The MFN clause should not be required to attract customers if Orbitz has even a portion of its claimed benefits.

The specific claims that it was disadvantaged due to lack of reputation and access to online advertising are contradicted by market facts. Orbitz had an enormous pre-launch media buildup. It opened with a record number of site visits—ten times the number expected. It has grown rapidly and is already in third place among online agencies. Late last year, Orbitz entered into a deal with Comet providing the first use of software that automatically searches and displays Orbitz fares whenever a computer user searches for fares on Travelocity or Expedia.<sup>52</sup> "Orbitz's ubiquitous pop-up windows" are becoming "familiar," and Orbitz "accounted for 44 percent of all online travel advertising the week after Thanksgiving."<sup>53</sup>

Finally, an MFN clause covering virtually the entire industry is truly unwarranted and ill-suited to address supposed entry barriers. The MFN, in particular, gives Orbitz a unique marketing advantage not available to other distributors, rather than facilitating brand identification. Moreover, the MFN obligation has no time limit; it is not designed to terminate once Orbitz has overcome the supposed entry barriers. Orbitz's immediate success has made it clear that no such "marketing advantage" is needed to facilitate its entry, and, indeed, that it never was.

### **Concluding Thoughts: Opodo and Over-Regulation**

In contrast to the very cautious approach of the U.S. authorities, the EC's recent action regarding Opodo may reflect an excessively regulatory approach to competition enforcement. Rather than eliminate certain contractual provisions, it required the parties to provide various undertakings. Some appear similar to our recommendations.<sup>54</sup> But others use broad and vague language, making their content unclear and their coverage potentially excessive. Exclusives must be "individually negotiated" and "commercially justifiable," while any MFN must be "commercially justifiable."<sup>55</sup> Opodo also made a broad commitment that it "will not discriminate against non-shareholders but will offer fair and open access," and to abide by relevant industry codes regarding "non-discrimination, transparency and neutral display of

information.”<sup>56</sup> Such a broad set of directions and prohibitions will inevitably require ongoing administration for interpretation and enforcement. Moreover, they cover a wide range of Opodo’s competitive conduct. As a result, they may well interfere with Opodo’s ability to deliver benefits to consumers.

In contrast, this article recommends a more “surgical” approach to the competitive questions raised by Orbitz. The government need merely require that Orbitz modify two aspects of the Associate Agreement—eliminating the MFN and limiting the reach of the promotional obligation—while continuing to monitor future developments. This will greatly reduce antitrust concerns, without risking undue interference with the Orbitz’s ability to benefit consumers. ■

<sup>1</sup> See AVIATION DAILY, Jan. 24, 2001, at 8.

<sup>2</sup> See Greg Sandoval, *Flying Through Early Turbulence*, CNET News.com, Oct. 1, 2001, <http://www.orbitz.com>; see also *Orbitz Bookings Soar*, WASH. POST, June 5 2001, at E2.

<sup>3</sup> Letter from Mark S. Britton, Senior Vice President and General Counsel, Expedia, Inc., to Norman Y. Mineta Secretary, U.S. Department of Transportation 2 (Dec. 6, 2001).

<sup>4</sup> See Statement of Professor Jerry Hausman, Department of Economics, MIT, at 11 (Mar. 27, 2001), submitted in *In re Computer Reservations System (CRS) Regulations*, Dockets OST-97-2881, 3014, 4775, Additional Information of Interactive Travel Services Association (March 27, 2001); see also American Antitrust Institute Press Release, 25 Consumer Groups Ask Justice to Modify Orbitz Launch Vehicle (May 22, 2001), available at <http://www.antitrustinstitute.org/recent/121.cfm>. The groups opposing Orbitz include the American Antitrust Institute, the Aviation Consumer Action Project, the Consumer Alliance, the Consumer Federation of America, and Consumers Union. See also *In re Computer Reservations System (CRS) Regulations*, Dockets OST-97-2881, 3014, 4775, Comments of the American Antitrust Institute (Sept. 18, 2000); *In re Computer Reservations System (CRS) Regulations*, *supra*, Reply Comments of Travelocity.com; Statement of Terrell B. Jones, President and Chief Executive Officer, Travelocity.com, Before the Committee on Commerce, Science and Transportation, United States Senate (July 20, 2000) (available on the Commerce, Science and Transportation Committee Web site <http://www.senate.gov/~commerce/hearings/0720jon.pdf>).

<sup>5</sup> See, e.g., Testimony of Jeffrey G. Katz, Chairman, President, and CEO, Orbitz, Before the Committee on Commerce, Science and Transportation, United States Senate (July 20, 2000). Orbitz has posted a number of papers written by Orbitz or its consultants on its Web site at <http://www.orbitz.com/App/about/pressroom/whitepapers/whitepapers.jsp?>.

<sup>6</sup> See, e.g., *In re Computer Reservations System (CRS) Regulations*, *supra* note 4, Reply Comments of Orbitz, L.L.C. (Oct. 23, 2000), available at <http://www.dot.gov>; Gary Doernhoefer, General Counsel, Orbitz, White Paper Submitted to the Iowa Attorney General (Nov. 8, 2000), available at <http://www.orbitz.com> [White Paper].

<sup>7</sup> This position was supported by economists Steven A. Morrison, Clifford Winston, and Robert Litan, who argued that Orbitz “has the potential to enhance consumer welfare” and poses little risk since industry conditions that make anticompetitive action unlikely. See, e.g., Steven A. Morrison, Clifford Winston & Robert E. Litan, *The Competitive Potential of the Orbitz Online Travel Agency* (Oct. 2000), and Statement of Daniel M. Kasper, LECG (Sept. 22, 2000), submitted as Exhibits A and B, respectively, to *In re Computer Reservations System (CRS) Regulations*, *supra* note 4, Reply Comments of Orbitz, L.L.C. (Oct. 23, 2000), available at <http://www.orbitz.com>.

<sup>8</sup> Department of Transportation Press Release (Apr. 13, 2001),

<http://www.dot.gov/affairs/dot3401.htm>; Letter from Susan McDermott and Samuel Podbersky, U.S. Dep’t of Transportation, to Jeffrey G. Katz, Chairman and CEO, Orbitz, at 5–6 (Apr. 13, 2001).

<sup>9</sup> Robert MacMillan, *Congress Wants Report on Orbitz, Airline Competition*, NEWSBYTES (Dec. 19, 2001), <http://www.newsbytes.com/news/01/173118.html>.

<sup>10</sup> Opodo’s owners are Aer Lingus, Air France, Alitalia, Austrian Airlines, British Airways, Finnair, Iberia, KLM and Lufthansa. Online Travel Portal, Case COMP/38.006, 2001 O.J. (C 323) 03 [hereinafter *Opodo*], available at [http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c\\_323/c\\_32320011120en00060008.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2001/c_323/c_32320011120en00060008.pdf). See also Adam Coulter, *Trade Fears Net Threat to Competition*, TRAVEL TRADE GAZETTE UK & IRELAND (July 2, 2001).

<sup>11</sup> Federal Trade Commission and Department of Justice, Antitrust Guidelines for Collaborations Among Competitors (Apr. 2000) [Competitor Collaboration Guidelines], available at <http://www.ftc.gov/opa/2000/04/collguidelines.htm>.

<sup>12</sup> *Id.* § 2.3.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* § 1.2.

<sup>15</sup> *Id.* § 3.36(a).

<sup>16</sup> Concerns about these provisions were raised by the present authors at that time. See William F. Adkinson, Jr., & Thomas M. Lenard, *Revise Orbitz’s Flight Plan: Serious Competitive Risks Outweigh Questionable Benefits* (The Progress & Freedom Foundation, June 2001), available at <http://www.pff.org>.

<sup>17</sup> “‘Published Fares’ means all Fares, including, without limitation, (i) CRS fares, (ii) Airline Internal Reservation System Fares, (iii) Internet Fares, and (iv) Promotional fares . . .” Associate Agreement, Exhibit A, at 13.

<sup>18</sup> This is defined to mean “commercial terms and conditions equal to or better than the most favorable terms offered by Airline to any other Internet Travel Provider Site.” Associate Agreement, Exhibit A, at 12.

<sup>19</sup> See, e.g., *Virginia Excelsior Mills, Inc. v. FTC*, 256 F.2d 538 (4th Cir. 1958) (jointly-owned exclusive marketing arrangement held per se illegal); cf. *United States v. American Radio Sys. Corp.*, 1997-1 Trade Cas. (CCH) ¶ 71,747 (D.D.C. Jan. 31, 1997) (consent decree).

<sup>20</sup> *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 23 (1979).

<sup>21</sup> *Id.* at 21–22.

<sup>22</sup> *NCAA v. Board of Regents*, 468 U.S. 85 (1984).

<sup>23</sup> For an overview of the development of the current distribution system, with particular regard to CRSs, see generally Aimee Minick, *Computer Reservations Systems, Airlines, and the Internet*, 65 J. AIR, L. AND COM. 891, 894–901 (2000).

<sup>24</sup> Susan E. Fisher, *Market Turbulence Puts Online Travel on Alert*, INFOWORLD, Oct. 29, 2001, at 34.

<sup>25</sup> Kasper, *supra* note 7, at 17.

<sup>26</sup> See *id.* at 15–17. Travelocity is majority-owned by Sabre, while Expedia is majority-owned by Microsoft.

<sup>27</sup> See *id.* at 17; *In re Computer Reservations System (CRS) Regulations*, *supra* note 4, Reply Comments of Travelocity.com, at 5; William Glanz, *EU Action Puts New Pressure on Orbitz*, WASH. TIMES, Nov. 29, 2001, at C9; Press Release, Airline Web Sites to Account for Almost 60% of Air Travel Bookings in 2000 (Oct. 2, 2000), <http://www.phocuswright.com/press/release.html?id=75>.

<sup>28</sup> See Kasper, *supra* note 7, at 8.

<sup>29</sup> See Alfred E. Kahn, Summary of Oral Statement on Antitrust Issues in the Airline Industry Before the Senate Committee on Commerce, Science and Transportation 3 (July 27, 2000).

<sup>30</sup> The potential for MFNs to decrease incentives to discount has long been recognized in the economics literature. See, e.g., Steven C. Salop, *Practices that (Credibly) Facilitate Oligopoly Coordination*, in NEW DEVELOPMENTS IN THE ANALYSIS OF MARKET STRUCTURE 265 (Joseph E. Stiglitz & G. Frank Mathewson eds., 1986); Carl Shapiro, *Theories of Oligopoly Behavior*, in 1 HANDBOOK OF INDUSTRIAL ORGANIZATION 330, 356 (Richard Schmalensee & Robert D. Willig eds., 1989); Charles Holt & David T. Scheffman, *Facilitating Practices: The Effects of Advance Notice and Best-Price Policies*, 18 RAND J. ECON. 187 (1987).



<sup>31</sup> Orbitz White Paper, *supra* note 6, at 34.

<sup>32</sup> Letter from Kenneth M. Mead, Department of Transportation Inspector General to Jeffrey G. Katz, Chairman, President and Chief Executive Officer of Orbitz (Apr. 13, 2001) (stating "we cannot conclude that Orbitz will operate in ways that will reduce price competition . . . [since] the majority of fares and availability are already displayed on a real-time basis in CRS systems" and "carriers can already monitor competitive responses through various web channels . . .")

<sup>33</sup> See Orbitz White Paper, *supra* note 6, at 29–33, 36–39.

<sup>34</sup> See, e.g., See Statement of the Honorable Kenneth M. Mead, Inspector General, U.S. Dept. of Transportation, before the Committee on Commerce, Science and Transportation, United States Senate 3–4 (July 20, 2000).

<sup>35</sup> Hausman, *supra* note 4, at 11.

<sup>36</sup> In *United States v. Airline Tariff Publishing Co.*, 58 Fed Reg. 3971 (Jan. 12, 1993) (Competitive Impact Statement), the Department of Justice brought a complaint alleging, inter alia, that airlines had used non-public portions of the ATP format to communicate pricing signals, e.g., to indicate that a particular fare responded to another airline's move and to signal fare increases that, if not followed, would be withdrawn without taking effect. See also Jonathan B. Baker, *Identifying Horizontal Price-Fixing in the Electronic Marketplace*, 65 ANTITRUST L.J. 41, 51–53 (1996).

<sup>37</sup> Indeed, econometric studies of airline pricing have confirmed that Southwest's presence at an airport leads to systematically lower airfares. See Steven A. Morrison & Clifford Winston, *The Remaining Role for Government Policy in the Deregulated Airline Industry*, in *Deregulation of Network Industries: What's Next?* at 5–7 (AEI-Brookings Joint Center for Regulatory Studies, Sam Peltzman & Clifford Winston eds., 2000), available at <http://www.aei.brookings.org/publications/books/deregulation.pdf>.

<sup>38</sup> See Troy Wolverton, *Orbitz Hit with Trademark Suit*, CNET News.com, May 4, 2001; *Southwest Sues Orbitz Travel Site*, L.A. TIMES, May 5, 2001; *Southwest Airlines to Drop Orbitz Suit*, TULSA WORLD, Nov. 17, 2001; *Southwest Airlines Co. v. Orbitz, LLC*, Civ. Action No. 01-04068 RSWL (CTX), Amended Complaint of Southwest Airlines Co. (C.D. Cal. May 29, 2001).

<sup>39</sup> For an insightful discussion of such network effects, see Michael L. Katz & Carl Shapiro, *Antitrust in Software Markets* 32–34, in *COMPETITION, INNOVATION AND THE MICROSOFT MONOPOLY: ANTITRUST IN THE DIGITAL MARKETPLACE* (Jeffrey A. Eisenach & Thomas M. Lenard eds., 1999).

<sup>40</sup> Letter from Jeffrey G. Katz to Norman Y. Mineta (enclosure) (Nov. 15, 2001), available at <http://www.orbitz.com>.

<sup>41</sup> See, e.g., Orbitz White Paper, *supra* note 6, at 16–23.

<sup>42</sup> Hausman, *supra* note 4, at 14 (finding that Orbitz contributes little to efficiency, and that "the speculative potential for minute cognizable efficiencies becomes dwarfed by the potential consumer harm in the form of higher prices").

<sup>43</sup> Orbitz plans to develop the technological capability to enable consumers to search the airlines' own Web sites directly, dispensing with the services of a CRS. The extent to which this would actually reduce the real costs of obtaining and searching flight and fare information is difficult to determine. Orbitz will be able to avoid paying CRS fees, but will incur costs in doing so. While airline collaboration may be useful to create a comprehensive and compatible search protocol, it is not clear that this requires joint marketing and selling rather than simply creating and licensing software.

<sup>44</sup> Craig Stoltz, *New Web Site Beats Rivals at Finding Low Air Fares*, L.A. TIMES, Dec. 26, 1999 (observing that in 1999, the ITA software used by Orbitz was "in search of a commercial home," and quoting an ITA official as saying it "may develop its own site" and may sell or license the technology).

<sup>45</sup> For a more detailed discussion of the screen bias issues surrounding CRSs, see Minick, *supra* note 23, at 901–05. Orbitz suggests that under the CRS regulations "more subtle forms of bias" can occur. See Orbitz White Paper, *supra* note 6, at 19 n.51.

<sup>46</sup> *Id.* at 22–23.

<sup>47</sup> Statement of Kenneth M. Mead, *supra* note 34, at 3–4.

<sup>48</sup> Orbitz, *Want to Enlist in the Effort by the Most Powerful Monopoly in Air transportation to Block Any Possibility of New Competition?* (June 2000), available at [http://www.orbitz.com/App/about/pressroom/whitepapers/whitepapers\\_competition.jsp?](http://www.orbitz.com/App/about/pressroom/whitepapers/whitepapers_competition.jsp?)

<sup>49</sup> Hausman, *supra* note 4, at 21–27.

<sup>50</sup> Orbitz White Paper, *supra* note 6, at 33.

<sup>51</sup> McDermott and Podbersky Letter, *supra* note 8, at 4–5.

<sup>52</sup> Bob Tedeschi, *E-Commerce Report; A New Feature Turns a Cursor into an Automatic Price-Comparison Service*, N.Y. TIMES, Dec. 3, 2001, at C7.

<sup>53</sup> *Online Travel Companies Gaining Altitude; Internet Growth, Bargains Spur Comeback After Sept. 11*, BERGEN RECORD, Dec. 31, 2001, at 105.

<sup>54</sup> Opodo may not require a MFN clause as a condition of entering into the "industry standard agency agreements with Opodo." Each airline is prohibited from offering Opodo MFN status regarding e-fares available only through the airline's site.

<sup>55</sup> Opodo, ¶¶ 12–13.

<sup>56</sup> Opodo also agreed that upon becoming an accredited member of International Air Transport Association, it would, "to the extent possible," apply the standard provisions of that agreement and not "utilize principles different to those employed by sites of offline agents." This requirement is vague and could potentially interfere with Opodo's ability to take advantage of the special benefits offered by the Internet.

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