

PARENT CARRIERS UNDER THE EU CRS CODE OF CONDUCT

A BTC Primer

July 2007

In a recent filing to a consultation paper issued by the European Commission, Amadeus advanced the argument that “parent carriers” to which certain key safeguards apply under the CRS Code of Conduct are confined to only those airlines that have “effective control” of a CRS. Therefore, according to Amadeus, no parent carriers are bound by the safeguards against abuses long embodied in that regulation.¹ Regrettably, it appears that some in DG-TREN are poised to accept the new legal construction of Amadeus without going through the normal legislative procedures.

This Amadeus argument is newly contrived. It is also contrary to the unambiguous text, historical application, and fundamental policies of the Code which are evaluated below.

In addition to being erroneous as a matter of law, such a reading of the Code would be in direct conflict with the reasonable expectations of all other stakeholders about the protections afforded by the Code and would effectively end the safeguards of the Code. It would, with a stroke of a bureaucratic pen, strip from consumers, travel agencies, airlines and CRSs long-standing protections against abuses by CRS-owning airlines that were rampant before the Code was strengthened in 1993. Such a rewriting would be even more disconcerting given the strong endorsement for such protections during the recent EU consultation process.

1. The Amadeus’ Contention is Contrary to the Clear Text of the Code

The text of the parent carrier definition is straightforward and plain. It is found in Article 2(i) and provides:

"parent carrier" means any air carrier which directly or indirectly, alone or jointly with others, owns or effectively controls a system vendor, as well as any air carrier which it owns or effectively controls;"

(Emphasis added.)

¹ Comments of Amadeus IT Group, S.A., April 27, 2007 at paragraph 34. To be clear, the bundle of ownership, governance, and contractual rights each airline owner of Amadeus has constitutes “control”. However, as an ownership stake in a CRS at any level is and has always been a sufficient condition for an airline to be considered a “parent carrier” under the code, it is unnecessary to analyze the issue of control in this paper.

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As is obvious from the text, “owns” or “effectively controls” are alternative tests, meaning either an ownership stake in or effective control of a CRS by an airline is all that is required to cause that carrier to be treated as a “parent carrier.” Indeed, to argue that a carrier with an ownership interest in a CRS is not a “parent carrier” unless it also “effectively controls” that same CRS is an outright attempt to rewrite the unambiguous regulatory text to say that which it does not -- namely, “owns and effectively controls” a CRS.

Of course, it is open to the Commission -- if it followed the appropriate and legally required processes such as obtaining the approval of the European Parliament and Council -- to amend the regulation to define parent carrier as Amadeus desires. Without Parliament and Council agreement, attempting to reach the conclusion Amadeus demands is so inconsistent with the existing text that it would constitute an illegal, *de facto* amendment of the central definition of parent carrier.

2. The Claim That Carriers That Own But Do Not Control A CRS Escape The Obligations of Parent Carriers Is In Direct Conflict With the Fundamental Policies Underlying the Code

The rationale behind the duty of mandatory participation, and the prohibitions on using CRSs to the detriment of competing airlines, was the recognition that an ownership and even a marketing relationship between an airline and a CRS create the incentive and ability to commit abuses in both the air transport and air transportation distribution markets. This incentive and ability had to be checked by *ex ante* rules. In short, whether an airline “controls” a CRS is simply not the relevant question for assessing the risks of misconduct and has never been. Rather, it is financial incentives that drive anti-competitive behaviour when airlines own stakes in CRSs.

A. Amadeus Filing:

From a public policy perspective the notion advanced by Amadeus -- namely, that regulators need only be concerned about anti-competitive behavior by airlines that might control a CRS -- is refuted by the many instances in which airlines that had only minority stakes in CRSs engaged in abuses that were meant to favor the CRS they owned. That this tortured construction is pure fiction is fully exposed by the prior public filings of Amadeus itself, as we show below.

The risks of competitive abuses by airlines which flow from any level of carrier ownership in a CRS that is more than *de minimis* is one attested to convincingly by Amadeus itself in a filing made with the US Department of Transportation on April 28, 2000 in the then pending US CRS rulemaking. In that proceeding, United Airlines, which then owned 17% of Galileo (roughly 75% of Galileo was owned by non-airline entities) had argued that it should be exempt from the US parent carrier (called “system owner”) obligations such as mandatory

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participation, because, United asserted, it did not “control” Galileo. Amadeus vehemently refuted United’s claim, noting that:

“In its December 13, 1999 reply to United’s prior submission on this issue, Amadeus pointed out that, to the extent that an airline retains more than a *de minimis* (i.e., 5% or more) ownership interest in a CRS, changes in the ownership structure of that system are irrelevant to the purpose and operation of the system owner rules. Even if such an airline does not ‘control’ the CRS, it has both the incentive and ability to alter *its* behavior to distort competition by favoring the system in which it holds an ownership interest.”²

(Emphasis in original.)

The same filing by Amadeus also offers a chilling message about the true intentions of United in its efforts to escape its obligations as an owner of a CRS. It is a message that contains a stark warning about the dire consequences the EU faces if Air France, Iberia Airlines, and Lufthansa can evade their obligations as parent carriers under the Code. Amadeus admonished DOT as follows:

Eliminating these rules would allow United (which masks its own economic interests in this proceeding) to unfairly exploit its substantial market power, reduce its level of participation level in other systems or withdraw from such participation altogether to increase Apollo’s market share in areas where United is the dominant carrier. The resulting increase in United sales, through the halo effect alone, would distort airline competition, strengthen United’s superior market position in areas where it is already dominant, and fortify barriers to entry in those same areas. Moreover, where United chooses to participate, it could use its size and superior bargaining power to negotiate discriminatory booking fees that shift distribution costs to smaller, weaker carriers, thereby harming those carriers ability to compete and further strengthening United’s market power. The elimination of these rules would also limit consumers’ access to information.

Of course, moving to 2007, all of the three owners of Amadeus hold dominant positions as air carriers in entire Member States as opposed to just areas of a country. Thus, the very perils for competition and consumers if United, with a 17% share of Apollo, were relieved of its duties as a parent carrier under the US CRS rules loom even larger for Europe and European consumers and airlines if Air France, Iberia and Lufthansa were given the *carte blanche* they seek to discriminate in favor of Amadeus.

² Response of Amadeus Global Travel Distribution, S.A., to Supplemental Reply of United Air Lines, Inc., Docket No. OST-97-2881, at p.1

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B. Brattle Group:

On the topic of financial incentives, in its study for DG-TREN, the Brattle Group concluded:

Airlines that own a CRS have an incentive to use the CRS to engage in anti-competitive conduct in both the airline market and CRS market. The incentive is greatest when both the parent carrier and the CRS have a large market share of their respective markets and when one or both are in a position to maintain or expand market power. Understandably, several European airlines are concerned that the proposed elimination of certain rules will allow Amadeus and its parent carriers to engage in exclusionary practices in their home markets. Sabre and Galileo have expressed similar concerns.

The incentive to engage in CRS abuse remains even if an airline and a CRS are affiliated through a contract, rather than ownership. Nonetheless, all else equal, the incentive for an airline and a CRS to engage in anti-competitive behaviour is less when they are affiliated only through a contract.³

3. Regulatory History of the Code Further Undermines Amadeus

The clear text of the Code should be more than enough to end any debate and to dictate the outright rejection of the Amadeus' assertion. In this case, the regulatory history of the Code likewise refutes the newly-contrived theory that parent carriers subject to the mandatory participation and other safeguards of the Code are really only those airlines that effectively control a CRS.

A. Commission Press release

On September 23, 1992, the Commission issued a press release explaining the amendments it was proposing to the original Code that had been adopted in 1989 in order to strengthen it against parent carrier abuses. We direct the reader's attention to page 1, where the Commission commented:

"... [T]he Commission today adopted a proposal for an amendment to the regulation on a code of conduct for computerized reservation systems (CRSs). The aim of the proposal is to adapt the current code of conduct so as to improve competition between air carriers and to provide users with better information by taking measures which will ensure that:

- airlines owning CRSs do not exploit their privileged position in a discriminatory way to the detriment of other airlines using their CRSs;

³ Id., at p.44.

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- airlines owning CRSs comply with the requirements of non-discrimination against other companies as regards information displays on their computer system.”

(Emphasis added.)

The Commission elaborated on “airlines owning CRSs” by naming them in the following passage:

“The computer reservation system is favoured by travel agents, who are currently responsible for the distribution of 80% of tickets sold in the Community. These highly sophisticated systems are owned by large airlines. They afford easy access to information on flights, fares and seat availability, make reservations and, in some cases, issue tickets. There are currently four main CRSs: SABRE (American Airlines); APOLLO (United Airlines); AMADEUS (AF, SAS, Lufthansa, Iberia); and GALILEO (BA, KLM, TAP, Sabena, Swiss Air, Alitalia, Aer Lingus).”⁴

Importantly, several of the carriers that the Commission explicitly identified as the airline owners to which the new duties would apply had quite small ownership positions in Galileo. To be blunt, no one could seriously contend that TAP, Sabena, Swiss Air, Alitalia or Aer Lingus, “effectively controlled” Galileo in 1992 - or at any time for that matter. And, of course, nothing in the release suggested that any condition for being subject to these new duties existed other than that of holding an ownership stake in a CRS.

The intended reach of the parent carrier protections of the Code to all carriers owning an interest in a CRS is given further clarity by the last paragraph of the release, which describes certain new protections against abuses and says:

4. Specific safeguards.

This involves built-in computer protection facilities between the reservation system of the companies that own CRSs and the CRSs themselves so as to avoid the owners taking advantage of their situation in order to give information on their own flights more quickly than other participating companies. This measure is also intended to protect confidential information supplied by companies that are members of CRSs (e.g. list of frequent travellers, etc.).

⁴ While not the focus of this paper, we would note that in 1992, 80% of ticket sold in the Community were sold by travel agencies and that this figure is quite similar to the Commission’s finding in its Consultation Paper of February 25, 2007 (paragraph 35) that 80.3% of the revenues of European network carriers came from travel agencies. Hence, the contention that there have been vast changes since 1992 in the extent to which airlines distribute their services via CRSs would not seem tenable.

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It would be illogical to argue that the Commission intended that carriers that had an ownership stake but did not “control” the system were being excluded from the obligations to neither favor themselves with superior information loading procedures nor to access the confidential information concerning the bookings and passengers of other airlines.

To underscore this central point, if the argument now being made by Amadeus that it has no “parent carriers” under the Code were accepted by DG-TREN, then there would be nothing in the Code today that would stop Air France, Iberia or Lufthansa from mining the Amadeus CRS to view the reservations of passengers booked on other airlines.⁵

B. Commission Report:

The Commission’s press release refers to a report that the Commission was issuing on the proposed amendments to the Code. That report further undermines any argument by Amadeus that when the Commission said it was applying these new obligations to “airlines owning CRSs” it actually meant only those airlines that “effectively controlled” a CRS.

In responding to concerns expressed by some about the potential added costs of mandatory participation for airlines, the Commission described its approach as follows at page 18:

The revised code of conduct aims to establish a balance between the different interests concerned. The relevant provision in Article 3 *bis* is restricted to parent carriers and their affiliates. It will require such an air carrier to provide a competing CRS, on request, the same information on schedules, fares, and availability on its services as it provides to its own CRS and to accept bookings on its flights from these other CRSs. As participation in other systems may impose a severe economic burden on small and medium size carriers the costs which they may be required to pay have been limited to the costs for the reproduction of the information to be provided and the booking fees. In this way it will be ensured that the economic viability of small carriers is not endangered.

(Emphasis added.)

⁵ The prohibition described by the press release is found at Article 6.3 of the Code, which states, “A system vendor shall ensure that the provisions in paragraphs 1 and 2 above are complied with, by technical means and/or appropriate safeguards regarding at least software, in such a way that information provided by or created for air carriers can in no way be accessed by one or more of the parent carriers except as permitted by this Article. (Emphasis added.)

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Of course, the “small and medium size carriers” to whom mandatory participation and the other heightened safeguards would apply, and for whom the Commission was making provision to limit the potential costs, were the same moderate-sized carriers referenced in the press release of September 23, 1992 (that is, TAP, Sabena, Swiss Air, and Aer Lingus). As noted previously, all of these airlines had small stakes in Galileo, and it is hard to see a way to think that any of them “effectively controlled” Galileo.

C. Block exemption

[The origins of the definition of parent carrier also prove that the term “parent carrier” has always meant any airline that either had an ownership stake in a CRS or effectively controlled a CRS.

At the very same time that DG-TREN was amending the Code of Conduct in 1992-1993 to strengthen it to curtail competitive abuses by airlines that were owners of a CRS, DG-COMP was engaged in a parallel exercise that modified the block exemption that had been issued in 1989 to allow the many EU-based airlines that owned Amadeus and Galileo to operate without undue risks under competition laws. On December 22, 1993, within weeks of the adoption of the final revisions to the Code implementing a mandatory participation duty, the Commission issued Regulation 3652/93, modifying the block exemption. As is apparent from the face of both the Code (see fourth “Whereas” clause) and the revised block exemption (see Whereas Clause 6), the two regulations were the end product of that collaborative process between TREN and COMP.

Significantly, the revised block exemption used the same operative definition of “parent carrier” as that in the 1993 amendment to the Code. Under the block exemption a parent carrier meant any carrier that “owns or effectively controls” a CRS. (See Article 2(g)). The use of the same definition in the two contemporaneous and related regulations dictates two conclusions.

First, as a number of smaller airlines (TAP, Sabena, and Aer Lingus) were owners of Galileo when this exemption was issued, any airline that “owned or controlled” a CRS was both subject to, and afforded the protections of, a “parent carrier” under the block exemption. Indeed, carriers who had any ownership stake would have demanded that the block exemption apply to them to shield them from complaints under Article 81 of the Treaty of Rome (then Article 85). It would have been perverse logic indeed for the Commission to have afforded the comfort of the block exemption only to airlines that “effectively controlled” a CRS but deny it to carriers that simply held an ownership stake.

Second, since DG-TREN and DG-COMP used the exact same definition in two parallel and related proceedings, it would be very strange if, without a word to the contrary ever being said by the Commission, the term “parent carrier” was intended to mean something radically different in the Code than the very same

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words in the block exemption. This conclusion is especially compelling given that the substantive obligations imposed on “parent carriers” under Article 1(a) of the block exemption not to discriminate against other CRSs were identical in substance to those imposed under new Article 3(a) of the Code.]

4. More Recent Comments By DG-TREN or its Representatives Confirm An Ownership Interest In a CRS Is All That is Required to be a Parent Carrier

On more recent occasions, DG-TREN or its representatives have issued reports in which they made clear that ownership in a CRS alone causes an airline to be a “parent carrier” under the Code, without any added requirement that the carrier also control the CRS. For example, on November 22, 2002, Mr. Ludolf Van Hasselt, who was then head of Unit for the air transport at DG-TREN issued a Preliminary Report, in which he noted the following about the duty of mandatory participation:

“The obligations of airlines vis-à-vis system vendors, including those obligations imposed on carriers who have a stake in the ownership and control of a CRS whereby parent carriers have to treat all CRSs in the same way as the one in which they have interests.”

(Emphasis Added.)

This statement by the Head of Unit confirms that simply having a “stake in the ownership and control of a CRS” as opposed to having actual control over that CRS has long been the standard employed by the Commission in determining who was a “parent carrier.”

Nor is this interpretation by DG-TREN an isolated statement. On January 30, 2004, DG-TREN released a study on CRS matters by the Brattle Group. That study was, as the cover page noted, “Prepared for the European Commission Directorate General for Energy and Transportation.” This study was specifically commissioned by DG-TREN to assess the impact of then proposed amendments to the Code including amendments to the duty of mandatory participation. In an illuminating passage discussing meaning of “parent carrier” under the Code, the study reported:

“According to DG TREN, airlines that market a CRS, including airlines that own some or all of a national marketing company fall within the definition of ‘parent carrier’ under the EC’s Code of Conduct.”⁶

It is impossible to reconcile the view by DG-TREN that a parent carrier includes any airline that “markets” a CRS or “owns some or all” of a national marketing

⁶ Fn. 24 at p.14.

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company with the late-conceived argument that a parent carrier can only be a parent carrier if it has “effective control” over a CRS.

Conclusion

Since its adoption over a decade ago, the Code of Conduct has served the vitally important role of restraining airlines that own an interest in a CRS from engaging in the sorts of competitive abuses – to the detriment of consumers and competition – that history has taught us are inevitable whenever airlines hold ownership stakes in a CRS -- unless they are restrained by bright-line rules.

There should be no mistake about the grave implications if, under cover of “interpreting” the definition of parent carrier, the Commission were to rewrite the Code in the manner requested by Amadeus. Doing so would give license to Amadeus and its three large owning airlines owners to exploit travelers, travel agents, airlines and competing CRSs with the very sort of anti-competitive practices that the Code was meant to bring to a well-deserved end.

If Amadeus and its Commission supporters believe that such a change is justified, they should be willing to subject such a dramatic change to the complete legislative machinery of the European Union. We believe such a process would allow full consideration of the impact of this dramatic change by the European Parliament and Council and ensure that any final decision on this matter protects consumers.

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