The Great GDS Debates

What does the future hold for GDS regulation and distribution agreements in Europe?

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Global Distribution Systems (GDSs) or Computer Reservation Systems (CRSs) have been capturing the headlines in recent months, as two significant developments unfold in Europe. First, industry players are debating if and how the European Commission should update its CRS Code of Conduct, following an invitation to all stakeholders to comment on a list of key questions. Second, the spotlight has turned to new GDS distribution agreements, which in some cases translate into extra costs for corporate clients, particularly in the United Kingdom and Ireland. CWT Vision looks at these two critical issues and presents insights from the United States.

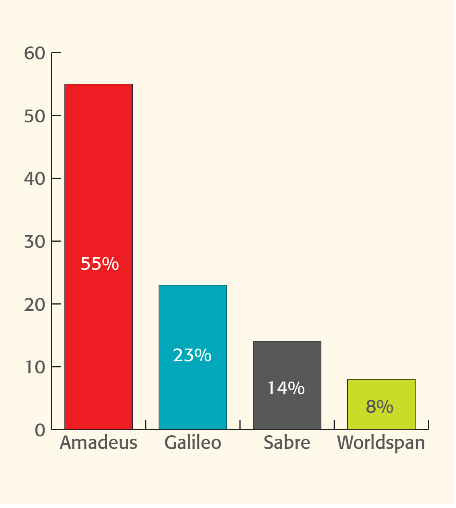
GDS deregulation: a hot topic in Europe

To deregulate, to partially deregulate or to maintain the status quo: those are the big questions travel industry professionals have been asking regarding GDSs in Europe. In February, important market developments led the European Commission to launch a two-month public consultation on the CRS Code of Conduct. These developments include airlines' complaints about "excessive" booking fees, competition from non-GDS sales channels, especially airlines' own Websites, and changes in GDS ownership since the original rules were drawn up. Another important change is deregulation in North America, which may be influencing the market in Europe.

At the heart of the debate, supporters of full deregulation say it would enable financially strapped airlines to **negotiate lower distribution fees with GDSs.** They also argue that the flat-rate fees currently applied by GDSs, regardless of overall volumes or ticket prices, are unfair and stifle price competition. This is particularly true of airlines' lowerpriced tickets, where the GDS distribution fee is the same as for higher-priced tickets. The airlines also contend that they are at a **competitive disadvantage** vis-à-vis low-cost carriers that do not participate in GDSs and therefore have lower distribution costs. As the argument for deregulation goes, with lower distribution fees, low-cost carriers might also consider providing their content to GDSs. Finally, proponents of full deregulation claim that travelers would benefit from enhanced content.

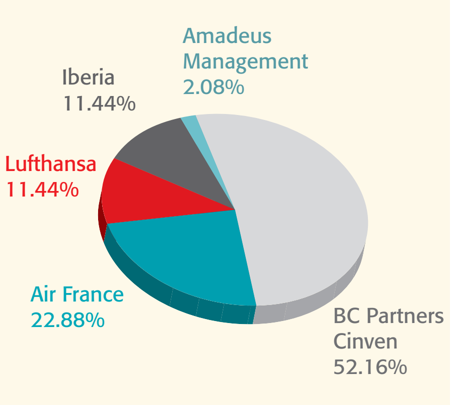
On the other hand, the majority of industry players argue that **deregulation should at best be partial.** They call for the elimination or simplification of certain rules while maintaining clauses that safeguard against anti-competitive practices. They believe that full deregulation would lead to unfair dominance by Amadeus, the leading GDS in Europe, which is still 46 percent owned by Air France, Iberia and Lufthansa. In other words, Amadeus could favor its parent airlines on certain strategic segments and limit distribution of competitive offerings. The parent airlines could also choose not to participate in other GDSs or threaten to withhold certain fares. Many players fear that this would lead to fragmentation of content, which would be more costly and less efficient for travelers and companies.

GDS market share in Europe



Source: CWT Travel Management Institute (based on MIDTs)

Amadeus shareholding structure



Source: Amadeus

How GDS regulation has evolved

GDS regulation was first introduced in North America and Europe in the 1980s and amended in the 1990s to ensure that airline-controlled GDSs could not discriminate against other GDSs or airlines. The main requirements, which were similar on both sides of the Atlantic, were for GDSs to:

- **Display flight and fare information in an unbiased manner.** The aim of this rule was to prevent GDSs from unfairly displaying their parent carriers' flights most prominently, given that 85 percent of tickets booked are selected from the first screen displayed.
- **Provide access to their systems to all carriers on a same-price, non-discriminatory basis.** One of the main objectives was to protect smaller carriers from higher prices, as they were already in a weaker competitive position.
- **Avoid imposing highly restrictive contract terms on travel agents.** In other words, GDSs should not abuse their market power by requiring travel management companies to sign exclusive agreements.
- **Provide participating carriers with available marketing information data tapes (MIDTs) on a non-discriminatory basis.** This booking and marketing data covers travel agents' sales by destination, airline and fare class, and enables airlines to monitor demand for route planning, yield management and marketing purposes.

Amendments to the original regulation included an obligation for parent carriers—airlines with shares in GDSs—to participate equally in all other GDSs, providing the same information within the same timeframe.

Since the creation of these rules, the market has evolved significantly. Notably, GDSs are facing increasing **competition from airline Websites** and Internet travel agencies in the consumer arena, while GDS ownership has mostly fallen out of the hands of airlines. This provided the impetus for the U.S. government to fully deregulate its market in 2004, after the last of the U.S. airlines divested their stakes in GDSs. The Canadian government also introduced partial, but far reaching, deregulation the same year.

In Europe, the CRS Code of Conduct has been revised twice since 1989, but still largely enforces the rules that were in place in North America until 2004. Indeed, the European Commission postponed its last attempt at revising GDS regulation, following a lack of consensus from industry stakeholders in a rapidly changing marketplace. This dated back to the fall of 2003, when it published a report[1] commissioned from the Brattle Group consulting company and Norton Rose law firm, which outlined three main options:

- **Option 1: Full deregulation** would eliminate the CRS Code of Conduct and rely on E.U. and national law to protect against anti-competitive behavior. The report argues

[1] *"Study to assess the potential impact of proposed amendments to council regulation 2299/89 with regard to computerized reservation systems,"* October 2003

that this would promote greater competition in terms of price and service and encourage innovation. It warns, however, that Amadeus, the largest GDS in Europe, and its parent carriers could abuse their power as market leaders. This is particularly true in the airlines' three home markets, where they are the dominant carriers. In France for example, Air France could choose to post its content on Amadeus only, while Amadeus could charge other carriers higher prices for participating and allocate them less prominent screen display. Such "double dominance" would be of real concern.

- **Option 2: Partial deregulation,** as proposed by the EU Directorate-General for Energy and Transport (DG TREN), would remove the obligation for GDS-owning airlines to participate in all other GDSs and for all airlines to provide GDSs with equally comprehensive information. It would also eliminate the rule that prevents discriminatory conditions (e.g., variable pricing), while simplifying the restriction on display bias. This option would create a more competitive marketplace, although concerns about anti-competitive behavior would persist.
- **Option 3: Partial deregulation** in this case is similar to Option 2, except that mandatory participation in all GDSs would be maintained for parent airlines in their respective home markets. In addition, airline-owned GDSs would be required to provide any improvements in service to all participating carriers on an equal basis in the owner airlines' home markets. The report underlines that this framework would largely address the concern over double dominance and encourage parent carriers to sell off their stakes in GDSs. Nevertheless, GDSs could still impose discriminatory fees in parent carriers' home markets.

Main regulatory options identified in the Brattle report

	Parent carriers must participate equally in all GDSs	All participating carriers must provide equally comprehensive information to all GDSs	All GDSs must provide neutral screen display	All GDSs must provide non-discriminatory conditions (e.g., pricing)	All GDSs must avoid restrictive contract provisions with TMCs
Regulation (Status quo)	Yes	Yes	Yes	Yes	Yes
Full deregulation (Option 1)	No	No	No	No	No
Partial regulation (Option 2)	No	No	Streamlined rules	No	Yes
Partial regulation (Option 3)	Yes: in each parent carrier's home market	No	Streamlined rules	Yes: all service improvements provided equally in each parent carrier's home market	Yes

Source: CWT Travel Management Institute

In February 2007, the European Commission published a public consultation paper, which summarized the current regulation and main evolutions in the market, and asked for stakeholders' comments on a number of areas. These ranged from general questions on whether the Code of Conduct should be maintained, revised or abolished, to more specific questions on pricing freedom regarding booking fees, parent carrier obligations, CRS ownership, MIDTs, CRS display and rail services.

The Commission's findings could lead to new draft regulations at the end of this year. These could be **implemented at the end of 2008** or later if, for example, the Commission adopts a "sunset" approach, applying new rules only once GDSs are completely divested of airline shareholdings.

Evolving GDS distribution models

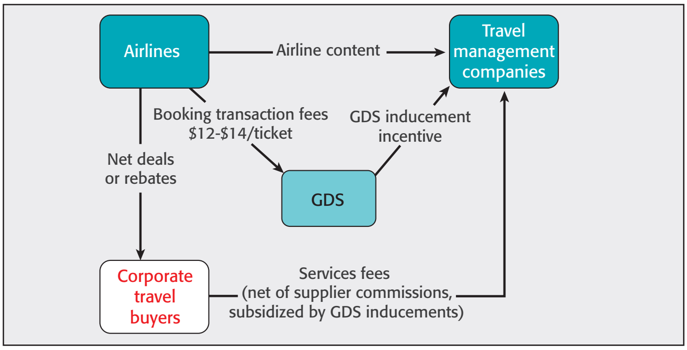
As the debate surrounding deregulation continues, the economic model is evolving with **airlines renegotiating their expiring GDS contracts.** Important new agreements were reached in the United States in August last year and were also signed in the United Kingdom and Ireland this spring.

In the United States, the GDSs' previous three-year distribution agreements with airlines expired in the spring and summer of 2006. During renegotiations, the airlines put pressure on GDSs to reduce their distribution fees in return for continued access to full content. As a result, two economic models were introduced to the U.S. market along the lines of those that had already appeared in Australia, Canada and the United Kingdom:

- **GDS opt-in model.** This means that in return for lower distribution fees (typically US$6 to US$8 compared to US$12 to US$14 previously), airlines continue to provide full content to GDSs. TMCs can access this full content by opting in to a "preferred supplier program" and paying the corresponding US$0.80 per segment "opt-in" fee to the GDSs. This opt-in fee is usually simplified for the customer as a US$2 per-transaction flat fee, based on an average of 2.5 segments. In effect, this system pushes costs down the supply chain to the corporate customer: airlines pay lower distribution fees to GDSs, GDSs compensate by asking TMCs to pay a per-transaction fee, which TMCs must either absorb—generally, this is not considered a viable option—or bill to the customer. This model guarantees that full content remains in the GDSs and that the booking system remains efficient.
- **Airline surcharge model.** If the TMC does not opt in, it does not have guaranteed access to the airline's full content and at the same time must pay a surcharge on each transaction. This represents the most expensive option for companies. In the United States, the typical surcharge is US$3.50 per segment, compared to an opt-in fee of US$0.80 per segment.

Evolving GDS distribution models (U.S. terms)

Historical



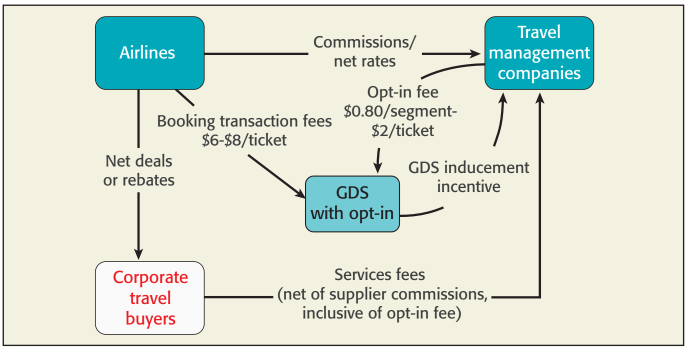
SUMMARY	
Full Content	Yes
GDS Access Fee	No
Airline Surcharge	No
Agency Incentive	Yes

These agreements expired in the United States on September 1, 2006.

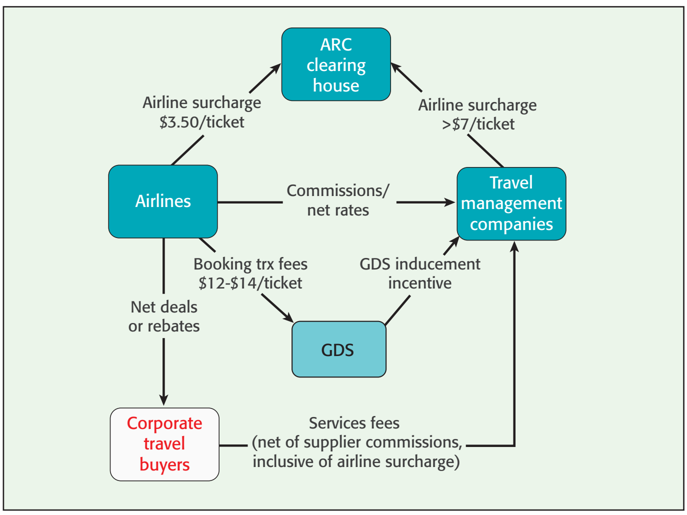
Opt-in

SUMMARY	
Full Content	Yes
GDS Access Fee	Yes
Airline Surcharge	No
Agency Incentive	Yes

Airlines pay significantly lower fees to the GDS, while agencies pay a new opt-in fee in return for access to full content.



Surcharge



SUMMARY	
Full Content	No
GDS Access Fee	No
Airline Surcharge	Yes
Agency Incentive	Yes

This is the model imposed by airlines if an agency does not choose a GDS opt-in model. Airlines impose a high fee on tickets issued by agencies and may limit content.

In Europe, where contracts are beginning to expire, airlines have been leading similarly tough negotiations with GDSs. Notably, British Airways (BA) has been renewing its three-year distribution contracts with the main GDSs in the United Kingdom and Ireland and causing controversy by **threatening to withhold some content** and apply new surcharges—£1 (US$6) per segment—if its new terms are not met. The carrier has been arguing that the cost of distributing through GDSs is higher than via alternative channels, and that it should therefore only display higher yield fares, introduce a surcharge or apply higher opt-in fees to cover this extra cost. At the time of press, the carrier had announced agreements with Sabre, Galileo and Worldspan, and was still in talks with Amadeus. These deals ensure that TMCs avoid surcharges and continue to access full content by paying higher opt-in fees. For example, Worldspan is now doubling the existing opt-in fee for BA discounted economy flights to £1 (US$2) per segment.

In other European countries, the surcharge system has also been a subject of debate. In February, when Brussels Airlines tried to impose a €5 (US$6.79) per-segment surcharge on certain GDS-booked fares, strong industry criticism led it to back down to half the amount. The main objection was the fact that the airline would clearly make booking through a GDS more expensive than booking through its own Website.

The opt-in and surcharge models may at first appear to benefit only the airlines, which enjoy greater returns by pushing costs down the distribution chain. On the other side of the argument, few would deny that guaranteed **access to full content is critical to efficient transactions** and therefore, the additional costs associated with opt-in may be a fair price to pay for this important benefit. Some observers also suggest that lower distribution fees for airlines could ultimately lead to more competitive pricing and better service to end customers.

Amid this controversy, a key question is: will other airlines follow the example of BA and negotiate new opt-in fees? This remains to be seen, as each airline has a unique market context; profile; and relationship with GDSs, agents and the corporate customer that will influence negotiations. Changes in the regulatory context are also likely to have an important impact on the GDS landscape over the next few years.

"Maintain efficient access to full content": an expert's view

Mike Koetting, executive vice president, CWT Global Supplier Management, was recently named one of "The 25 Most Influential Executives of the Business Travel Industry, 2006" by *Business Travel News*, a leading industry publication in North America, for his role in guiding CWT customers through the introduction of the opt-in charge imposed by GDSs. CWT Vision asked him for his views on the evolving GDS landscape and the potential impact on companies.

CWT Vision: **Why has CWT chosen the "opt-in" model in the United States and what impact has this had on customers?**

Mike Koetting: We chose to participate in the new opt-in programs to maintain efficient access to content and minimize the cost of surcharges. We also decided to offer clients a choice in how to pay the new opt-in fee. Some clients decided to pay the actual US$0.80 segment fee, while others preferred the simplicity of paying a flat US$2 for all air transactions. Although no one likes the idea of imposing or paying new charges, the fee structure CWT implemented was widely adopted by the industry. Most corporate travel managers agree that the extra transaction fee costs less than the impact of content moving out of GDSs and the inefficiency that would doubtless result as travelers and travel agencies struggle to consolidate content from multiple sources.

CWT Vision: **Why is it important for content to stay in GDSs? What about alternative systems?**

Mike Koetting: We believe it is in TMCs' and our clients' best interest for all airlines to participate fully in GDSs: taking content out of GDSs creates inefficiency in the marketplace. For the moment, no single alternative system can provide the full range of content and services we find in GDSs, and integrating many alternative systems would involve considerable technology costs. Airlines are developing their own commercial Websites, but they currently cannot provide the same array of important pre- and post-trip services as GDSs. In addition, a number of GDS New Entrants (GNEs) have appeared, offering lower-cost connections to airline content. While these suppliers have been successful to a certain degree, they are limited by not offering access to hotel, rail or car content. They are therefore useful as a partial solution but cannot alone replace the traditional GDSs. In North America, for example, the *CWT Symphonie* system allows us to work with GNE G2 Switchworks for some of our air transactions.

CWT Vision: **What do you think should happen in Europe? Should Europe follow the same model as in the United States?**

Mike Koetting: The situation is different in Europe, where Amadeus is still owned by three major European airlines, so any new legislation should continue to protect against anti-competitive behavior while aiming to maximize market efficiency. By that I mean travel management companies would have access to comprehensive content via their GDSs. TMCs and their clients would benefit if more suppliers participated in GDSs and if those that already participate provided equal content and functionalities across all systems. This applies not just to airlines but to rail as well, as it is so widely used in Europe.

GDSs and TMCs are valuable in providing efficiency and improving competition in terms of price, service and choice. We must continue working together to ensure an efficient, competitive market place for the benefit of companies and their travelers.

CWT Vision: **What will the next steps be in Europe?**

Mike Koetting: All options appear to be open at this stage and the regulatory process will take time to play out, whatever the outcome of the current debate. CWT would welcome deregulation within the industry when the appropriate protections are in place to ensure fair, competitive practices in the interests of travelers and their companies. Until then, we believe it is in the best interests of CWT, our clients and our travelers to maintain the current regulations, which allow us to have efficient access to comprehensive supplier content through global distribution systems. ■