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AIRLINES AND AGENTS: CONFLICT AND THE PUBLIC WELFARE

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CURRENT POST DEREGULATION developments in the airline industry might result in a marked reduction in the number of major competitors. This reduction could be so marked as to be of concern to antitrust monitors in the government. This article addresses these deregulation developments and their effects, yet stops short of proposing answers to questions of actual legality of the specific steps now underway.

Deregulation does not mean that the government ceases to interfere in an industry's operations. In most cases, deregulation means that the government will regulate the industry through the standard rules applicable to all industries and will cease to regulate it through a specific set of rules tailored to the industry in question. When a "natural monopoly" exists, a special set of regulations is essential to protect the consumer from the monopoly. Where such a monopoly does not exist, rules are needed to prevent the development of a monopoly. Presumably, the government mandates deregulation of a previously regulated industry because some change has occurred in the industry to make deregulation possible.

Among closely regulated industries, the airlines were atypical. The original airline regulations were imposed

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not to protect against a "natural monopoly", but to insure the economic viability of the industry. In 1938, when the airline industry was originally given special regulation, a natural monopoly was not feared. At that time it was recognized that no airline could provide the desired services without government subsidy. The regulation was imposed to define what service would be offered and to limit the amount of subsidy. Shortly after the end of World War II it became obvious that technical developments had made unsubsidized airline operations possible. Thus, deregulation of the nation's airlines in 1978 was long overdue.¹ Whether the natural characteristics of the unregulated industry will prevent the development of an unacceptable concentration is yet to be determined.

I. THE INDUSTRY

The airline industry consists of the operating companies, the retailers of its product, travel agents and airline owned sales offices, and wholesalers. It is a part of the larger travel industry which also includes bus systems, railroads, hotels, and rental car companies.

From a marketing point of view, there are two sharply different segments: pleasure travelers and business travelers. These two types of travelers have quite different characteristics. For example, their sensitivity to price, sensitivity to selling effort, and sensitivity to destination differ a great deal.

A. *Potential Concentrations of Power*

Power could be distributed within the industry in three possible ways, each of which carries at least the potential for distorting the ability of the market place to protect the public. The first of these would place power in the hands of an oligopoly of five to ten major operating airlines. These operators would set the prices, the operating de-

¹ See generally S. BAYER, *REGULATION AND ITS REFORM* (1982) (discussion of regulation theories and their reform related to the Civil Aeronautics Board).

tails, and the margins of the separate channel members. This concentration of power approximates that which existed under regulation. Were it to continue under deregulation, it would set prices and operating standards at a level close to that which a monopolist would select. The system would be high priced, high service, dependable, and very attuned to its least price sensitive customer, the business traveler. However, the systems would need ways to prevent entry into the industry. This could occur, for example, through control of airport access, airway access, contractual control of the selling process, or through very high costs of entry to the industry.

A second concentration of power, similar to the first, would permit outside competitors to participate in selected segments of the industry without interference. For example, it would cede feeder and intra-small city traffic to the scattered control of specialized operators. High volume price sensitive travel on high pleasure travel routes would then be the province of low service, high volume, low image carriers. Such a development would tend to create a "two market" industry split along price elasticity grounds toward separate pleasure and business components. Systems would be needed to keep the two markets apart. These would include different service standards, different payment procedures for situations where pleasure and business travel was to the same place, and successful predatory price operations to keep interlopers out of major mixed travel markets. The current marketplace seems to be moving in this direction.²

The third possible concentration of power differs drastically from the first two. Under this plan, power would be transferred to the other channel members, primarily to travel agents. Ten to twenty large operating groups would control access to all markets, including ancillary ones (e.g. hotels). These operating groups would provide

² *Icahn Says Mergers Could Help to Stabilize the Airline Industry*, TRAVEL WEEKLY, Mar. 31, 1986, at 8. According to Carl Icahn, new Chairman of TWA, "What good are a lot of weak airlines?" *Id.*

service to big customers on a continuing contract, set margins selectively based on customer's buying power and service demands, and, eventually, dictate schedules and services. From an evaluation of the theory of marketing channels that considers today's technology, this is the structure that would have evolved had there been no prior special regulation.³ Barriers to the entry of new firms to such a structure would be high. Thus, antitrust monitors would need to watch carefully.

B. *Power Struggle Factors*

The process of airline deregulation is taking shape. Price and route structures are no longer controlled and entry and exit from the market are, with minor exceptions, in the hands of the competitors. The structure of the channel, however, has only recently been decontrolled. The problems of who can sell tickets, how payments will be allocated, and who will provide general schedule data are only now being worked out. These factors are, perhaps, the most important in determining the shape of the industry when the deregulatory process is complete. Some of these factors, however, resemble the older regulatory era. The final structure may thus be modified by "power in being", a remnant of the past. Five power factors will be discussed in the following paragraphs: (1) the existence of two markets, (2) the need for a sophisticated clearing system, (3) the use of automated information and reservation systems, (4) the lack of universality in any airline, and (5) the "power in being" advantage of the airlines.

First, although there are clearly two markets (business and pleasure), the Civil Aeronautics Board (CAB) persistently treats them as one. For example, for years the CAB

³ R. L. Thornton, *Channel Structures Changes and Passengers Air Deregulation*, PROCEEDINGS OF THE TWENTY-SECOND ANNUAL MEETING OF THE TRANSPORTATION RESEARCH FORUM 285 (1981).

effectively barred travel agents from selling group tours.⁴ As a result, the market is less developed in the United States than in Europe.⁵ A channel segment which can most flexibly provide the business and pleasure markets with the kinds of service each requires will have a competitive advantage.

A second power factor arises from the need for sophisticated systems to allocate a traveler's payment among the several airlines or other service providers on a particular journey. One entity sells a trip; many entities provide the services of the trip. All must receive their calculated share of payment. The government may find it necessary to relax some of the antitrust rules to permit development of a satisfactory clearing system. Similar systems have been developed in other industries by an outside agency. The banking system externally developed the Master Charge and Visa networks.⁶ These networks have elements of a clearing system. Likewise, the banking industry and Federal Reserve Banks jointly operate the bank check clearance system.⁷ It is noteworthy that during the regulation era, the Air Transport Association, an industry trade group, ran the clearance system under legalized suspension of the antitrust laws.⁸ With this system, the air carriers developed power. For example, working under group approved rules, they saw to it that no carrier could be more or less lenient in granting credit. Thus, credit policy toward other channel members was not one of the tools of competition. Moreover, a refusal by the airline-dominated clearing system could absolutely prevent an aspiring travel agency from entering the industry.

⁴ *Id.* Technically, group tours could be sold. Restrictions, however, were so severe that the tours were not marketable. *Id.*

⁵ *Id.*

⁶ *Mastercard, Visa, and the New Kid*, AM. BANKING A.J. 45 (Aug. 1985).

⁷ See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM, PURPOSES AND FUNCTIONS 155-59 (3d ed. 1954).

⁸ Durbin, *Marketing Case Passes Milepost, Appeals Court Backs CAB's Stand*, TRAVEL WEEKLY, Mar. 21, 1985, at 1.

Although the CAB kept a close watch, there was no evidence of power abuse.

On January 1, 1985, deregulation of this phase of the industry was accomplished.⁹ The clearance system, intended for use in the future, places control solely in the hands of the airlines. The airlines will work under the newly established Airlines Reporting Corporation (ARC), whose Board of Directors consists of airline dominated members.¹⁰ The airlines unilaterally accepted this step. Travel agent groups, on the other hand, received it with mixed reactions.¹¹ The Association of Retail Travel Agents (ARTA) sued the Airlines Reporting Corporation under the antitrust laws.¹² The largest travel agent group, the American Society of Travel Agents (ASTA), supported the action despite some hesitation.¹³ The ASTA, composed principally of small travel agents, possibly preferred to be oppressed by the airlines rather than by a set of large corporate travel accounts.¹⁴ There is no evidence yet that the Department of Justice or the Department of Transportation intended to interfere openly with this airline-developed system.¹⁵

A third factor stems from the need to provide a sophisticated reservation and information system to all customers, airlines, and middlemen involved. Today, each major airline has developed such a system separately. Thus,

⁹ *CAB Sunset Bill Passes Despite Antitrust Question*, AV. WEEK AND SPACE TECH., Oct. 1, 1984, at 33.

¹⁰ *Airline Reporting Corporation Elects 20 Airline Officials to Board of Directors*, TRAVEL WEEKLY, Oct. 11, 1984, at 3.

¹¹ Durbin, *ATA Unveils Post-Immunity Plan*, TRAVEL WEEKLY, June 18, 1984, at 1.

¹² Durbin, *Court Sets March Trial Date for ARTA's Anti-trust Suit*, TRAVEL WEEKLY, Feb. 17, 1986, at 4. According to an ARTA spokesman, ARC is developing sophisticated systems that could be alternatives to the travel agency distribution system. *Id.*

¹³ Durbin, *ARC Moves Ahead*, TRAVEL WEEKLY, Aug. 16, 1984, at 1. ASTA continues its frustration. Joseph Hallisey, Chairman of ASTA is quoted as saying, "We are treated as the proverbial stepchild." Durbin, *Hallisey: ARC Ignores Society Interests*, TRAVEL WEEKLY, Dec. 12, 1985, at 2.

¹⁴ Smaller agencies sometimes complained bitterly. See *Ohio Agency Says it Signed ARC Pact Under Duress*, TRAVEL WEEKLY, Jan. 20, 1986, at 32.

¹⁵ Durbin, *ARC Drops 50% Rule, Branch Requirement For In-Plant Locations*, TRAVEL WEEKLY, Dec. 20, 1984, at 1.

American Airlines' Sabre system carries almost all other airline's schedules as well as its own.¹⁶ The smaller trunk and regional airlines do not always have a system.¹⁷ Most travel agents carry only one airline's system. Therefore, rivalry exists between airlines to mold their own system, preferably exclusively, to the travel agents. Each airline developer has absorbed much of the development costs of these systems. The airlines generally believe that the schedule display under one airline's system will be modestly biased in ways that make the travel agent more likely to select flights offered by the system developer than by competing airlines who list their schedules on the same system.¹⁸

There has been public concern over the bias inherent in airline developed reservation systems.¹⁹ An important bias arises from the preference shown for airline travel and for airline owned hotels.²⁰ Bus systems, cruise lines, non-airline owned hotels, and non-airline sponsored tours are all candidates for display on airline systems, yet they are sparsely represented. Travel agents are not provided needed information to expose adequately the customer to non-airline oriented travel.²¹ Thus, the travel agent is tricked into doing a poor job of meeting the customer's needs.

¹⁶ *UAL, AAL Face New Anti-trust Allegations*, TRAVEL WEEKLY Jan. 9, 1986, at 2 [hereinafter Anti-trust Article].

¹⁷ See *Charging Bias, Airlines Ask CAB to Change Reservations Systems at American United*, Wall St. J., Feb. 9, 1984, at 29, col. 4.

¹⁸ An anti-trust suit by ten of the "have not" airlines against American and United, the two major "haves", provides evidence that a small amount of bias can yield big trouble for the disadvantaged. The suit seeks damages possibly in the billions. The suit alleges that the two majors airlines offered prices below cost for their automated reservation systems to travel agents and acted in concert on fees. See Anti-trust Article, *supra* note 16, at 2. See also Comment, *The Antitrust Implications of Computer Reservations Systems*, 51 J. AIR L. & COM. 157, 180-83 (1985) (discussing system bias by computer reservations systems).

¹⁹ Clark, *Eliminating Bias Could Backfire on Proponents of Rulemaking*, TRAVEL WEEKLY, July 12, 1984, at 1, [hereinafter cited as Clark].

²⁰ Some of the major hotel networks are working on the problems by developing a system to obtain linkages to the major reservation systems. See *Hoteliers Design Data System to Link Airline's Computers*, TRAVEL WEEKLY, Feb. 17, 1986, at 1.

²¹ *AMTRAK on PARS/SABRE*, TRAVEL WEEKLY, Nov. 12, 1984, at 2.

When the airlines developed these systems, no non-airline private body capable of investing in the development of such a system existed. One company which tried, Tymnet, has found business difficult.²² While an airline could subsidize the development of such an important competitive tool and collect added revenues from preferential schedule displays, it was not practical for an independent company to do so.

The most logical channel member to develop the reservation system was the travel agent industry. The travel industry's failure to develop this system can be blamed on the legacy of the CAB. As mentioned earlier, the CAB thought it had the regulatory duty to increase the airlines' economic viability. To accomplish this task the CAB systematically limited the power of travel agents. As a result, the travel agents were fragmented, divided, and powerless. At the time Congress instituted deregulation, the travel agents had no power base capable of making the investment needed to create a reservation system.²³

The CAB has shown concern for the inherent bias arising from airline control of the reservation system. It has directed remedial action to de-bias reservation displays.²⁴ It is unlikely, however, that these steps will succeed because the pay-off of bias is high and the ways to achieve it are subtle.²⁵ If travel agents ran the system, and if the agents had been forbidden to integrate vertically, then the bias would have had little pay-off. In that situation, any resulting bias would have been random and, thus, less threatening.²⁶

²² According to *Travel Market Yearbook*, TRAVEL WEEKLY, December 31, 1985, Tymnet has about 1,000 reservation system CRTs in service versus American's Sabre with over 44,000 and United's Apollo with over 32,000.

²³ Godwin, *ASTA Automation Unit Proposes Criteria for Malfunction System*, TRAVEL WEEKLY, Nov. 15, 1984, at 110.

²⁴ *Board Moves to End Display Bias*, TRAVEL WEEKLY, Feb. 16, 1984, at 1.

²⁵ Clark, *supra* note 20, at 1.

²⁶ A "Small Airline" sponsored effort to develop a "Neutral Industry Booking System (NIBS) is said to have considered acquiring TWA's Pars as a basis for further development of an unbiased system. This occurred during the period while TWA was a takeover target of both Continental Airlines and of Carl Icahn. Settle-

The Department of Justice has expressed concern over the airline owned reservation systems as a competitive weapon. According to their Congressional report on airline automation, the development of Joint Neutral Booking Systems (NIBS) might falter due to high costs. The Justice Department further stated that such programs offer the best remedy for correcting any anticompetitive practices that exist.²⁷

A fourth industry factor is that no airline is universal. This factor is a carry-over from regulation. Under regulation, the CAB's policy was to prevent undue advantage from accruing to any one airline. Thus, no airline flew to all places, or even to most places. Such geographical specialization makes it likely that any flight will involve more than one airline. This may mean that the originating airline has an insignificant role in the total flight. Where possible, airlines will introduce a different form of bias. When an airline originates the ticket, it will tend to route the flight over its lines.²⁸ Again, a travel agent has less reason for bias because he is not tempted to maximize one carrier's revenue at the expense of the traveller's time or comfort.

A fifth factor is the residue of regulation. This factor manifests itself in a very large and powerful airline group, and a fragmented, powerless, and leaderless "other channel member" group. The underlying reason why the airline industry is structured in this way is because the financial community, the political structure, community leaders and government regulators presume this is the

ment of TWA's fate seems to have killed the proposal, if it was ever seriously considered. See *Analyst Michael Derchin Views the Match*, *Barrons*, Mar. 3, 1986 at 24.

²⁷ According to the Department of Justice, liquidated damage clauses contained in current vendor contracts may hurt the development of neutral systems. See *Poling Justice Dept. Says NIBs Could Falter Over Costs*, *TRAVEL WEEKLY*, Jan. 2, 1986, at 1.

²⁸ *Id.* The Department of Justice says that it receives complaints from nonvendor carriers about subtle forms of discrimination including "a preference for on-line connections over interline flights, even when the latter offers a better departure time and/or a short trip". *Id.* at 4.

way it should be. In general, a small company has few defenders, regardless of the logic of its case. The public does not care if a small company gets in trouble. By comparison, the whole nation worries if a major company is hurt. In addition, a large industry can amass a stronger and a well financed lobbying effort with the public, as well as to see that Congress gives full consideration to its desires.

II. WARS AMONG CARRIERS AND COLLEAGUES

With the arrival of post deregulation laissez faire attitudes, wars have broken out among the air carriers and between the carriers and their channel colleagues. These wars are fought among the trunk carriers, and between the trunks and interlopers. Interlopers, the second form of industry conflict, are new carriers. They have been described above as "outside competitors exercising power in selected segments of the market." They attack the heavily travelled pleasure and business routes by drastically cutting prices. They do not usually attack small markets and rarely attack primarily business markets. Interlopers do, however, attack primarily pleasure markets if the market is big enough. An example of this type of interloper is People Express Airline.²⁹

Another struggle occurs between major carriers and the commuters. The trunks co-opted the commuters, first by gratefully abandoning thin routes to the commuters and then by each of them enlisting as many minor operators as they could into segments of each trunk's hub and spoke system discussed below. This development is an added part of the second concentration of power mentioned earlier.³⁰

²⁹ People Express has lately shifted from its original "point to point" philosophy to one of being a full service airline. Levere, *People Express Moves Toward Full Service*, TRAVEL WEEKLY, May 5, 1986, at 1. The airline has found the change difficult. *Texas Air Said to be Pursuing People Express*, Wall St. J., July 3, 1986 at 3.

³⁰ *Deregulation Prompts Significant Shifts in Regional Airlines*, TRAVEL WEEKLY, Nov. 23, 1984, at 19. The major airlines have applied to their commuter link ups a set of identifying names. Thus "American Eagle" identifies American's slaves, "The

A. *Weapons of War*

The contestants have developed or adapted a set of operating procedures and marketing tools used in the various wars defined above. Most of them are selective to one war, but some of them have applicability to several struggles. The operative procedures and marketing tools are identified and discussed below.

The airlines have adopted as their first weapon, the creation and careful management of hub and spoke systems. A hub and spoke system consists of a set of "spoke" routes flying to and from minor markets into major "hub" cities. The major airline which creates the hub and spoke system flies some of these spokes itself. Commuter, local, or smaller airlines who the major airline has co-opted into the system fly other spokes.³¹ A set of much longer and heavier regional spokes connects major traffic hubs and are all operated by the creator of the particular system. Indeed, the their traffic potential of the regional spokes is the reason behind the creation of the system.

Ideally, at the hub city, all of the small and large spokes are centered in a small gate area of the airport. Scheduling calls for a coordinated arrival of flights from all the spokes at nearly the same time, followed at "baggage transfer time away" by similarly coordinated departures along all the spokes.³² Presumably, a passenger comes into the hub on one spoke and goes out on one of the other major spokes to his destination. He is locked into the hub which he enters because of the efficiency, reduced transfer time, and convenient schedules of that system of spokes.³³ Changing trunk carriers would probably entail a

Delta Connection", Delta's, and "Allegheny Commuter" to that of USAir. See *Two's Company*, TRAVEL WEEKLY Jan. 31, 1986, at 81 (article explaining these arrangements in the economic survey of the travel industry).

³¹ *AAL Eyes Commuter Network Expansion*, TRAVEL WEEKLY, Nov. 5, 1984, at 6.

³² For an example of the regional planning process in hub development, see Ott, *New Airline Hubs Boost Competition*, AV. WEEK & SPACE TECH., May 26, 1986, at 44-48.

³³ See Kaldahl, *Let the Process of Deregulation Continue*, 50 J. AIR L. & COM. 285, 292 (1985).

long walk with carry-on luggage and a poorly coordinated flight availability.

The hub and spoke system works.³⁴ It requires the ability to control a large number of starting gates on hub airports and a sufficiently broad route structure to other regional hubs. It results in the ability of the original trunk to keep other trunks from pirating its passengers at plane change stops and to limit the potential of smaller carriers to become trunks themselves. Smaller carriers cannot amass enough adjoining gates in sufficient amounts of airports. Obviously, other trunks try to minimize the advantage gained by the system initiator. The most obvious ploy is for a competing trunk to coordinate its schedule with the original trunk's schedule so that satisfactory connections are available on either trunk simultaneously. As a result, the situation has driven the Federal Aviation Authority (FAA), to desperate measures because all airlines want to land and take off at the same time. No one wants the in-between times.³⁵

In summary, hub and spoke systems are powerful weapons in the wars "among trunks." They prevent "near trunks" from becoming trunks, they eliminate friction between small carriers and trunks and they make the commuter carriers willing vassals of their protecting trunk. While these hub and spoke systems increase travel costs, travellers will not complain because the systems minimize travel time and energy. From a public policy point of view, hub and spoke systems are expensive in terms of air

³⁴ Kelleher, *Deregulation and the Troglodytes — How the Airlines Met Adam Smith*, 50 J. AIR L. & COM. 299, 312 (1985).

³⁵ Denver's Stapleton airport provides an excellent example of the problems which come with hubbing. Here, Continental, United, and Frontier all concentrate their intramountain operations each into its own hub. The resulting congestion strained the system to the breaking point forcing the airport to handle volume for which it was designed. See O'Lone, *New Competition Straining Resources at Denver's Stapleton Airport*, AV. WEEK & SPACE TECH., Mar. 24, 1986, at 40-46. As a result, other airlines have tried to steal traffic from the "Denver Triad". In a recent half page ad in the Wall Street Journal, Western Airlines used a cartoon of a secretary telling her boss "I have booked you through Denver, sir. Maybe you'd rather vote by proxy." Western then suggests a solution — its hub at Salt Lake City. Wall St. J., Feb. 11, 1986, at 27.

traffic controllers' salaries and airport construction costs.³⁶

A second weapon, reservation systems controlled by the major airlines, are primarily weapons in "among trunk" wars rather than in wars between trunks and interlopers. They pose significant barriers to information flow and permit less than optimum routing, pricing, and timing flexibility for the public.³⁷ These controlled reservation systems are possible only because of "power in being". A newly formed airline structure would not have the resources to create its own airline-owned reservation systems. Thus, the existence of reservation systems controlled by major airlines keeps the other channel members (including smaller trunks as well as travel agents) from developing power bases.

A third weapon, the "Financial Clearing House," is clearly a weapon for the airlines to use against the other channel members. Should the government look the other way, the airlines could use this clearing house to prevent entry of other competitors in several channel positions, to inhibit growth of other channel members, and to discriminate in selling methods. More seriously, it provides an information system for trunks to coordinate their marketing decisions; a system which would frighten any respectable anti-trust watcher.

The "Financial Clearing House," the Airline Reporting Corporation, provides data for current override systems used by most of the major airlines. The override system provides added compensation to those agents whose sales share on a specific carrier is above the carrier's regional percentage. Inevitably the override system will cause added concentration of major airline power in the industry and may lead to calls for united action by some agents who are being whipsawed. This system unquestionably tempts agents to distort booking decisions against the best interests of the customer.

³⁶ Fink, *The ATC Crisis*, AV. WEEK & SPACE TECH. Mar. 31, 1986, at 11, 42-53.

³⁷ Blum, *Fighting the Battle of Bias*, TRAVEL WEEKLY, May 22, 1986, at 59.

A fourth tool involves the rapidly growing Frequent Flier programs. These provide free flights anywhere in the donor's system (called premiums in the airline business) in proportion to the number of cumulative miles flown by the particular passenger on the donor's airline. Frequent Flier programs are a form of legitimate price cutting. Their principal advantage is that their saving goes, not to the person who paid for the flight, but to the passenger. For business travellers the benefits from the program amount to a pay increase since the employer who paid is aware of the employee's windfall. This program is particularly attractive since the Internal Revenue Service (IRS) has not yet required that the benefit be reported as added income.³⁸

The scheme has proved to be most useful to airline passengers who have very large route structures to "pleasure travel" locations. Travel agents are aware not only of requests to travel "only Airline 'A'" where I need a few more miles before I take my wife to the Bahamas," but also of "route me through Keokuk, it's longer." Thus, it is a potent weapon for a selected few big operators, but a disaster for the small airline whose routes may not include pleasure travel cities. Unquestionably, these schemes tend to prevent entry into the system and to endanger the profitability of the smaller operators. These losing airlines have attempted to fight back by establishing jointly-owned schemes with non-competing airlines and travel industry members to offer premiums for travel on the joint systems.³⁹

A fifth tool arises from the elimination of price controls. Presently, travel agents and major commercial users of air travel are engaged in a cautious minuet over contractual systems for consolidating the travel management for a

³⁸ The IRS has not been ignoring the problems. It has "formally requested comments on how to tax frequent flyer benefits, but issued no specific proposals of its own." Virtanen, *IRS Seeks Comment on Flight-Bonus Tax*, TRAVEL WEEKLY, Dec. 16, 1985, at 3.

³⁹ *Frequent Flyer Update*, TRAVEL WEEKLY, Oct. 31, 1984, at 65.

corporate customer into a single middleman. A big customer can expect to get price breaks. A travel agent operating in all the customer's markets and consolidating a set of several big customers could place enormous price pressure on the airlines. Moreover, as several agent entities now claim, an agent could manage a company's travel program, solve enroute travel emergencies flexibly, provide managerial data, and make efficiency recommendations of considerable value to the customer.⁴⁰ For business travel, this particular development offers important possibilities. First, this kind of contractual arrangement requires agents to operate nationwide for large companies. Currently, several major nationwide travel agent groups are in operation. Woodside Group is an example of this type of group.⁴¹ Second, this development could destroy the airlines' "power in being" position, and their ability to dominate the industry. The airline counterploy is to exploit the divisions which exist between travel agent groups. Talk of travel agent power is frightening to the vast majority of agents. Most travel agents are small operators who see disaster with the growth of national travel agent entities. In a struggle between big agents and big carriers, small agents would perish first. The airlines play on the fear of this threatened group. Their Airline Reporting Corporation has, so far, been careful to cater to the needs of the little agent and less attentive to the needs of the growing agency chains.⁴² Since the major chains are business travel specialists, air-

⁴⁰ AT&T spokespeople, after a recent major planned consolidation of their travel and entertainment operations, stated that they expected to save \$50 million on a budget of \$500 million. Some of the savings were to come from management actions tied to but not caused by travel agent consolidation. Lassiter, *AT&T Sees Savings of \$50 Million from Consolidated Plan*, TRAVEL WEEKLY, Jan. 23, 1986, at 1. Governments, too were interested. The State of Michigan planned to consolidate its \$2 million account into one Detroit based agency. Virtanen, *Michigan to Award Government's First Fee-Based Contract*, TRAVEL WEEKLY, Jan. 13, 1986, at 1.

⁴¹ *Woodside Official Sees Handful of Members Buying Out Others*, TRAVEL WEEKLY, Apr. 11, 1985, at 1.

⁴² *ARTA Opposed; Mixed Reaction by Other Groups*, TRAVEL WEEKLY, Aug. 16, 1984, at 1.

line policy could split the agents into two non-competing groups, one for pleasure and one for business.

Presently, the major airlines are at a disadvantage when bargaining for price against a nationwide agent chain. The airlines' ploy to reduce agent bargaining power is to eliminate the middleman agent in commercial travel and to bargain directly with the customer corporation to provide all of that company's reservation service. Some airlines have discussed this possibility.⁴³ Their threat is blunted because in order for the airlines to achieve this result, the airline involved must manage almost all of the customer's travel. Currently there is no national airline. For this reason, big corporations could not expect to fly most of their travel on one airline's flights. The moment one airline schedules a traveler on another airline, its motives are suspect and its ability to manage an entire corporate travel program is less certain. The trade press has been hinting that there are strong movements by the big airlines to remedy this weakness. For example, an agency executive said that United Airlines plans to expand enough to "carry passengers from everywhere to everywhere."⁴⁴

There is a second and less manageable reason for airlines to be wary in proposing direct airline-to-customer corporation long term contracts. The airlines are not suited to manage the retail end of pleasure travel. Pleasure travel demands a much larger commitment to personal interaction with the customer and involves a wide variety of alternatives: cruises, foreign travel, cheap and expensive hotels, as well as escorted and free-range tours. The customer frequently needs advice, and will readily shift destinations, types of experience, or quality levels. If the airlines try to squeeze travel agents out of their commercial travel business, the travel agents could be very vindictive in personal travel reservations.⁴⁵ Thus, the air-

⁴³ Virtanen, *Negotiating Corporate Air Deals*, TRAVEL WEEKLY, June 2, 1986, at 35.

⁴⁴ *Mass Agent Sees Evolution of Dealerships*, TRAVEL WEEKLY, July 26, 1985, at 1.

⁴⁵ See Banks, *The Start of Revolt*, FORBES, Oct. 7, 1985, at 41. Seventy-two percent

lines' ploy to reduce agent bargaining would succeed only if the airlines unanimously agreed to squeeze out the travel agents.

Consequently, a frantic race to nationalize has commenced between agent chains and trunk airlines. Central management of large parts of the commercial travel market is the victor's prize. Accordingly, from the viewpoint of government monopoly watchers, the question becomes which of the end points will be the best for the economy?

Prior to evaluating the conflict's impact, one needs to reexamine the pleasure travel side of the market. Unlike business travel, pleasure travel is extremely price elastic because this sector of the market involves discretionary income. For example, a trip to Florida is in competition with buying a new car, sending your child to Oberlin, or saving for retirement. Furthermore, pleasure travel is capable of very wide ranges of product differentiation including, but not limited to: a cruise, Las Vegas, a tour with friends, deluxe hotels, a Eurorail pass, or a knowledgeable agent. Given this elastic market and wide differentiation, monopoly is not a threat. A narrow travel agent oligopoly is probably the preferred industry structure from the agency point of view. Of course, while a one competitor situation is undesirable, the classical pure competition is a far worse alternative. For the purposes of this study one needs to worry only about the business travel market and its twin, the compelled personal travel market.

B. *The Possible Outcomes of War*

By identifying the contestants and recognizing the available weapons, one can not only follow the course of

of all airline tickets are sold by travel agents. Airlines' costs of doing business through travel agents continue to rise because airlines are afraid of "tackling the power of agents." *See id.* at 42. Frontier Airlines retracted from limiting agents' commissions when its load factor decreased. *See id.* United Airlines suffered a similar threat of agents shifting passengers. *See id.* United has become 100% committed to selling airline tickets through travel agents. *Id.*

the struggle, but also predict a possible outcome. From a public policy standpoint two possibly threatening outcomes can be suggested: (1) a major oligopoly of airlines which dominate the industry or, (2) a major oligopoly composed of very large integrated travel agents who exercise monopoly power.

1. *An Airline Oligopoly*

The hub and spoke concept seems to be a potent weapon, primarily where an airline possesses hubs located in key traffic generating cities combined with spokes that cover most minor destinations. A traveler would leave an airline's system only if alternatives were not available. As an airline grows in geographic coverage, it would be more likely to have originated the traffic. Due to the high entry costs to hubs, latecomer airlines would have difficulty in securing gates, takeoff-landing slots, and commuter partners. A maximum of two or three major airlines obtaining a hub in a major city would be the limit.⁴⁶ Of course, while there would be many more airlines than the major trunks, the former would be serving commuters by providing thin service to small places, even with using their patron airline's gates. However, these commuter-oriented airlines growing into major contenders would be improbable.

The picture changes, however, when one analyzes the way the hub concept affects today's environment. Today no airline runs more than two or three hubs. One airline maintains a hub in most high traffic cities. New entries, while big at some hubs, would face problems when they expanded. Due to the scarcity of gates, slots and commuter slaves, these new entries would find the expansion very expensive. In such cases, one would expect the growth seeker to search for alternatives. A hub is attractive because it has the following two traffic characteristics:

⁴⁶ See *supra* note 25 for a discussion of Denver's airport problems due to hub systems.

(1) volumes of direct traffic originating at one hub city and going to another and (2) a strong feeding of in-transit traffic from nearby small cities to the rest of the world. In most cases, which hub city a small community will send its traffic through depends on the quality of the hub's connections. An aggressive airline could probably use a less traffic intense city in which to establish a hub. Given several aggressive competitors developing alternate hubs at smaller cities, the original large hub could lose some of its small city "feed" to the new alternate hubs. In other words, the airline originally "owning" the large city "feed" would lose some of its traffic. An additional pressure would bear on the airline originally owning the "great hub." A direct hub-to-hub traffic would be fair game for a point to point oriented specialist such as Peoples Airline. Consequently, such a specialist would only cater to "one hop" passengers and would not need any specific times or gates.

The current situation in Atlanta illustrates the struggle for a prize location. In Atlanta, Delta Airlines, the originator of the hub concept, so completely dominates the Atlanta airport that it dominates the entire Southeast region. The major trunks, American and United, while desperately needing a successful Southeast hub have principally East-West oriented routes. If these two airlines are to become nationwide, they must obtain a Southeast region hub. Unfortunately, Atlanta is, at the moment, "too tough to crack". To solve its problem, American Airlines is setting up hubs at both Nashville and at Raleigh-Durham.⁴⁷ With American's strong overall market power, these hubs will inevitably draw traffic from Atlanta. It is possible American is hoping to weaken Delta's position sufficiently enough to attempt a future frontal attack on Atlanta. Surely American would prefer Atlanta if the cost was manageable. Currently, United is developing a hub at Dulles International Airport in Washington D.C. possibly

⁴⁷ Derchin, *Analyst Discusses Hubbing of America*, TRAVEL WEEKLY, July 25, 1985, at 1.

aimed at Southeast coverage.⁴⁸ However, Washington may be too far north and the Atlanta goal a long term objective.

There are other strategies which a major airline might use to secure a hub. First, an airline might persuade the government to enlarge the target city's airport as this would reduce gate pressures. However, this solution is dependant on the government's money.⁴⁹ Second, one might merge with an airline already in place on the target hub. For example, the putative TWA-Continental merger⁵⁰ would have provided Continental with a New York hub, now owned by TWA. Furthermore, the in-process merging of Eastern with Continental⁵¹ automatically joins Continental's attractive western hubs, with Eastern Airlines eastern hubs, including a prized one in Atlanta.⁵² Third, an airline might buy or trade for a hub. The TWA-Continental merger might have rendered TWA's St. Louis hub useless because Continental already had hubs at Houston and Denver.

Regulators will recognize that in a well developed system of hubs, the cost of entry for a new trunk airline (not a specialist) would be prohibitive.⁵³ Failure to obtain strategic hubs might even remove a strong airline from competition, by either failure or, more likely, merger.⁵⁴ The

⁴⁸ *New Airline Hubs Boast Competitor*, AV. WEEK & SPACE TECH., May 27, 1986, at 44.

⁴⁹ Denver's Stapleton Airport is scheduled to be replaced by a new one in about 1995.

⁵⁰ Levere, *TWA, Texas Air OK Agreement to Merge, Thwarting Icahn Bid*, TRAVEL WEEKLY, June 20, 1985, at 1.

⁵¹ *DOT Calls Off Hearing on Texas Air-Eastern Link*, TRAVEL WEEKLY, June 16, 1986, at 5.

⁵² Donlan, *Preparing for A Take-off: Eastern Will Lift Texas Air Into the No. 1 Slot*, Barrons, Mar. 3, 1986, at 9.

⁵³ According to Barrons, the value of one slot (the right to a period of time sufficient for one take off or one landing) at Washington National is \$400,000; at O'Hare, \$200,000. Donlan, *Golden Gates: Landing Slots a Windfall for the Airlines*, Barrons, Feb. 24, 1986, at 13.

⁵⁴ Systems for allocating new slots are the subject of a lot of attention from government monitors. The Justice Department opposing the planned Northwest-Republic merger, stated that it would leave the merged line with control of 80% of the 63 gates at Minneapolis. Koten, *Justice Department Objects to Proposal of*

process may take ten years or more, but it is possible that the number of major competitors might be reduced to four or five. If the number of major competitors went below ten, the concentration of power might have unfortunate results on the price and quality of service.

A second weapon, airline-owned reservation systems, also needs examination. As these systems develop, it is clear that two or three of them are slowly driving out the others.⁵⁵ The aggressors are Pars (TWA), Sabre (American), and Apollo (United); the other systems are on the defensive. While the offensive systems undoubtedly give their owners a lead, the lead is not "survival threatening". Were the lead to become "survival threatening", the dynamics of the system might correct it; agent power, if developed, could counter with non-airline owned systems, protection agency clients from getting less than optimum routings. Airline-owned reservation systems are a threat both in the war between agents and airlines and in the struggle between airlines.

The "Financial Clearing System" weapon is significant in the war between airlines and channel members. It should be neutral among airlines unless intentional, blatant conspiracy is involved. The "Frequent Flyer" weapon provides certain airlines with advantages over their competitor airlines. As the programs were originally set up, they could threaten the existence of several trunks on a long term basis. They unquestionably help the competitor with the biggest system and can destroy a smaller

Purchase to Republic, Wall St. J., Apr. 1, 1986, at 8. The Journal then editorially said that a similar concentration would occur at St. Louis (56 of 74 available gates) if the TWA-Ozark Airline merger were to be completed. *Id.* The Senate entered the arena. 132 CONG. REC. 53292 (Daily ed, Mar. 25, 1986) (statement by Sen. Kas-sebaum). The Senate has recently approved an amendment to a Transportation Department rule that will bar an air carrier's sale of slots. McGinley, *Senate Acts to Bar Air Carriers Sale of Landing Rights*, Wall St. J., Apr. 14, 1986, at 14. The House Aviation Committee chaired by Rep. Leon Mineta (D. California) will next consider the amendment. *Id.*

⁵⁵ Pan American has recently given up on its Panama Reservation System and will adopt American Airline's SABRE system. Chipkin, *Pan Am Will Use Sabre, Share AAL's Bonus Plan*, TRAVEL WEEKLY, Apr. 28, 1986, at 1.

airline's viability, at least where business travel is concerned. They depend on a sympathetic Internal Revenue Service,⁵⁶ first, for their power, and then on airline domination of the channel. If this system is threatened, frequent flyer programs could lose their potency. To illustrate, presume the current skirmishes between the airlines and the travel agent groups is decided in favor of allowing one travel agent entity to contract with a particular corporation to handle all of its travel at a reduced price. The corporation staff member handling the contract would almost certainly trade away the frequent flyer bonuses for better overall prices from the travel agent. A powerful agency chain could then defeat the airlines' frequent flyer weapon.

To summarize, the probability of the development of an airline cartel so narrow as to threaten the consumer's best interest is reasonably high. On the other hand, should an agent oligopoly develop, it might serve to limit the risk through its countervailing power.

2. *An Agent Oligopoly*

An agent oligopoly would have to establish its market place advantages over an airlines dominated system. There are several reasons why the agent offers the consumer a better service. The most important of these is the inherently consumer orientation of an agent. He is not bound by the need to maximize one form or one means of travel. His success depends on his ability to please his clientele, regardless of where, when, or how they travel. He has no mode preferences, no place preferences, no time preferences, or status hang-ups. The travel agent is universal in almost all dimensions. Such generalization would be difficult to develop in an airline run system, and even more difficult to maintain. A traveler's lack of built-in bias can be a prized attribute.

⁵⁶ According to Travel Weekly, "some airline executives have said that taxation of program benefits would mean the end of the programs." *IRS to Propose Rules on Taxing Bonuses for Frequent Flyers*, TRAVEL WEEKLY, Apr. 23, 1985 at 1.

On the other hand, the travel agent has little to offer the regular traveler who goes from New York to Boston every Tuesday and Thursday. Such a traveler may not need the extra expense of versatility. Ticketron, telephone, and pay on board sales are also viable ways to cut an agent out of the picture. Nevertheless, there is no reason why the agent, if sophisticated enough, cannot tailor his service to handle different demands with lower or higher costs of production.

Both agents and airlines will have problems in providing geographical dispersion of sales offices. Airlines will have to depend on agencies for their dispersed location sales. All airlines should not set up sales offices in Butte, Montana. Central ownership of a nationwide chain with owned outlets would be most efficient, but the cost to cover all locations would be unmanageable. To date, two separate types of chains have appeared. One chain is centrally owned while the other is contractual.⁵⁷ Mixtures of the two forms of chains are less common.⁵⁸ Pragmatically, a major chain could become a group of outlets, some owned, some franchised, and some unattached. Agent system managers may be concerned, however, with the risk of anti-trust problems if they bargain jointly for franchised members of a chain.

The travel agents' most important weapon in the war against the trunk airlines is their offer for centralized corporate travel management. The services that a universal travel agent could offer a corporation and the bargaining power that such a major chain could wield against the suppliers of travel services is impressive. The agencies are rapidly going nationwide.⁵⁹ The agencies offer attractive services such as twenty-four hour availability, guaranteed lowest cost, quick emergency traveller

⁵⁷ Schleier, *Will Consortiums Combine?*, TRAVEL WEEKLY, May 16, 1986, at 40 (a survey of business travelers).

⁵⁸ Data on major chains, both consortia and owned, are contained in TRAVEL MARKET YEARBOOK (Travel Weekly 1985).

⁵⁹ *The Big Get Bigger*, TRAVEL WEEKLY, May 22, 1985, at 14.

reprogramming, and auditable travel decisions. Given the importance of centralized reservation systems, agency chains would develop their own bias-free reservation system once they are big enough to afford the cost. Agencies have nothing to gain from providing less than the best to their customers.

Finally, an agent oligopoly would turn the financial clearing system upside down. When small and widely scattered agents disappear, a clearing system less complex than the Airline Reporting Corporation will be needed. Recently, the airlines have shown signs of using their control of the financial system to influence the character of the agency system. Their approach is to favor the small agent in order to make it difficult for agency chains to gain the universality they need.⁶⁰ Even today, acting without collusion, agents can unintentionally destroy an airline.⁶¹ With seven or eight major agency chains, effective control of the financial system will no longer be an airline prerogative.

A travel world dominated by a set of travel agents may not present a grave risk to the public. Diverse kinds of advice are needed, and the complexity of the demand is such that many different types of services would be possible. Specialization in areas of travel would develop. The result could be a progress creating a kind of monopolistic competition rather than an unimaginative and indifferently price fixing oligopoly.

III. CONCLUSION

The possibility of consumer threatening concentrations of power within the travel industry is predictable. First, it is possible that the number of airline competitors could be reduced enough to threaten the general welfare of the industry. Entry into the airline industry can no longer be

⁶⁰ Pestronk, *The Hidden Hand of ARC*, TRAVEL WEEKLY, May 22, 1985, at 14.

⁶¹ *Retailers Welcome Braniff Trust Fund but Question Effects*, TRAVEL WEEKLY, June 14, 1984, at 1. Braniff Airlines has blamed travel agents for some of its problems. *Id.* The airline claims that certain agents avoided booking their flights. *Id.*

assured except in special cases. An industry newcomer would face violent price competition on his few target routes, subsidized for the oligopoly by comfortable profits on unthreatened routes. A classically unimaginative, technically stagnant, and dangerous oligopoly could result.

Likewise, an agent concentration could develop, particularly in the commercial travel market. This concentration might not be a dangerous one because there is product differentiation. Indeed, the result might provide high quality, cheap service to consumers. Thus, of the two concentrations, one is likely to develop and would be dangerous if it did, while the other is less likely to develop but would not be threatening should it occur.

Although the risk of unsatisfactory concentration in the airline industry exists, it is unlikely to develop soon. No airline to date has achieved universality, since it would be expensive and would require extensive investment and rights negotiations. On the other hand, should the universality goal be reached it will be difficult to undo.

While no direct recommendations have been made in this article, there is a variety of ways in which to prevent the dangerous cartel. These preventative techniques include denial of merger proposals and removing reservation and payment systems from airline control. The time to act upon these is now, before irreversible developments make deregulation of the industry necessary to protect the consumer.

The Justice Department has shown more concern about the developing merger movements within the industry than has the Department of Transportation.⁶² Unfortunately, the Justice Department has based its analyses on a market study of the effect of proposed developments. This analysis is similar to the one used by the CAB when

⁶² *Congressman: Airline Mergers Ought to be Decided by Justice Department*, TRAVEL WEEKLY, May 16, 1986, at 98; see also, *DOT Unit Backs Planned Merger of Northwest and Republic*, TRAVEL WEEKLY, June 5, 1986, at 53.

they evaluated mergers.⁶³ However, such an analysis is not viable. When market entry or exit is uncontrolled, determination of an undue concentration of power can only come from a macro study of a corporation's ability to suppress competition and gain its ends when unfettered by other corporate or government power.

The Department of Transportation, the final judge of the merger movement, has yet to show how it will analyze the problem. The merger movement within the industry is advancing at a rapid pace. For this reason, it seems time for the Department of Transportation to act. If they fail to act soon, the number of effective competitors in the airline industry may fall below the point from which deconcentration is possible without a major crisis.

⁶³ *CAB Find Competition Needed on Miami-Los Angeles Route*, Wall St. J., Jan. 24, 1978, at 16, col. 1.