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AA's Next Offensive – Court Action

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The Facts

American Airlines has filed suit in a Texas District Court against Travelport and Orbitz. The suit alleges substantial breaches of US competition law and seeks an injunction to control the behaviour of the two defendants as well as compensatory and punitive damages.

The Analysis

American Airlines appears to be single-handedly taking on the entire system of airline distribution that has evolved over the last forty years. It is not the first airline to take on the market power of the GDSs. Northwest Airlines famously tried to break their grip in 2004 but backed down rapidly in the face of a concerted response from the distribution companies. In Europe Lufthansa has taken on Amadeus in its domestic market with some success and even in Central Asia, Air Astana similarly attempted to rebalance the market power in another tussle with Amadeus (*FirstView: The Battle of Kazakhstan: 18 February 2011*).

The difference with American is that it has doggedly pursued its course over an extended period, using its market power and its lawyers in equal measure. (*FirstView: A judge agrees with AA but the fight is still on: 17 January 2011*). Although superficially the various disputes have been centred on American's "Direct Connect" strategy the latest lawsuit makes it clear that the real prize is a fundamental realignment of the market for airline distribution.

To summarise the current position:

- There are three major, and several regional, Global Distribution System (GDS). T2RL research shows that in 2009 around half of the world's airline bookings were made by travel agents using GDSs.
- GDSs charge fees to airlines and in many cases share that fee revenue with the travel agents making the bookings.
- Most travel agents use a single GDS to do their business. If an airline wishes to be available to all travel agents it must participate in all the GDSs. This means that the GDSs compete fiercely for travel agency contracts but have no competitive pressures whatsoever on the airline side of the business. This has historically enabled them to set airline booking fees at arbitrary levels and to increase them more or less at will.
- American Airlines has developed a piece of technology – Direct Connect - in conjunction with Farelogix, that could enable travel agents to access AA flights directly without using a GDS at all.
- The GDSs have taken actions that American alleges are direct retaliation for its deployment of Direct Connect. These include changes to flight displays to make AA flights less attractive and even less visible to travel agency subscribers.

With this background it is possible to examine the suit that American has filed in the Fort Worth Division of the Northwestern Texas District Court. The suit invokes the Sherman Act. This is a law passed in 1890 that forms the basis of all United States antitrust legislation. Its provisions cover two main categories of activity that are held to be illegal restraint of trade and hence subject to penalties in the courts.

- Section One prohibits agreements between companies that unreasonably restrain competition in interstate commerce
- Section Two prohibits the maintenance of a coercive monopoly, that is a monopoly that is maintained by restrictive contracts or penalties.

The suit names Travelport, a GDS, and Orbitz, an online travel agent, as defendants although only one of the five claims it makes is directed at Orbitz. In a 37 page document American's lawyers use 111 paragraphs to describe the recent history of American Airlines distribution strategy, the nature of the market and the actions of the other market participant including the defendants. They then list five claims:

Claim 1 invokes Section 2 of the Sherman Act and claims that Travelport maintains a monopoly of supply to a section of the US travel agency community, estimated at 34% by booking volume, and that it maintains that monopoly by means of restrictive terms in its contracts. For example it ties agency productivity payments to the agency maintaining a certain level of bookings in the Travelport GDS and penalises agencies that fail to meet their productivity targets.

Claim 2 also invokes Section 2. It alleges that Travelport, Orbitz and others have conspired to retaliate against American Airlines for its introduction of Direct Connect in order to attempt to maintain the coercive monopoly that they currently hold.

Claim 3 is based on Section 1 of the act. It alleges that Travelport's contracts with both airlines and travel agencies contain terms that restrict interstate commerce. Specifically the claim is that these contractual terms prevent the development of price competition in the market for airline distribution, effectively perpetuating the monopoly position enjoyed by the GDSs, including Travelport.

Claim 4 alleges tortious interference by Travelport with pre-existing contracts between American Airlines and Orbitz. Orbitz at one time was a subsidiary of Travelport and is still 48% owned by the GDS company. American submits that it had existing contracts with Orbitz that required the use of Direct Connect links between the online travel agency and the airline. Travelport and Orbitz subsequently entered an agreement that required Orbitz to renege on its existing contracts with AA.

Claim 5 alleges that Travelport's retaliatory actions against American Airlines constitute tortious interference with the contracts between AA and all travel agents using Travelport's GDSs. Specifically, by penalising American in flight displays and by misrepresenting American's fares, Travelport placed obstacles in the way of the travel agents fulfilling their contracts with American Airlines to sell its tickets.

In the light of these five claims American Airlines is asking the judge to make a permanent injunction against Travelport which will dictate how it – and by extension other GDS companies – must act in the future. It is also seeking damages to compensate it for the financial losses it claims are due to the actions of the defendants as well as punitive damages to be set at the discretion of the court.

The Speculation

T2RL is not a legal firm and claims no expertise in legal matters so our view of the prospects of this case must be seen as coming from a lay perspective. We see AA as having managed this process from the start of hostilities with Orbitz and then Travelport, culminating in this court action

The claims under the Sherman Act could equally apply to all GDS companies operating in the US market and to all airlines. If this case ever gets to a decision in court they are likely to be regarded as concerning principles that apply to the whole market. Assuming that happens there will be a general debate on the ground rules that underpin the entire GDS model. It is likely that the other major GDS companies will get involved and that they will produce counter arguments that show that the GDS system is actually very good at fostering airline competition and is worthy of being preserved.

Both sides of the case can make valid arguments and the eventual judgement may turn out to be finely balanced. If the court should come down on the side of American Airlines the consequences for the business practices could be significant and include:

- Preventing GDSs subscriber agreements from including restrictive practices such as incentives and penalties that require travel agents to use a specific GDS for most or all of its bookings
- Reintroduction of some form of neutrality requirement for GDS displays of participating airlines
- Requirements for GDSs to open their Applications Programming Interfaces (APIs) to Farelogix and other providers of Direct Connect technology
- Limits on the level and rate of increase of airline booking fees

The final two claims for tortious interference should be more clear-cut, especially Claim 4. The court should be able to make a decision on this claim based only on the text of the contracts involved and without reference to wider philosophical issues.

In our opinion AA has little to lose. It is determined to change distribution, just as it helped invent the model as it stands today. The timing is particularly bad for Travelport. Its owners Blackstone and One Equity Partners have tried to offload once and failed. They will want to sell the asset. This dispute will not facilitate the sales process.

American Airlines is one of the elder statesmen of the US airline industry. It is the only major network airline in the USA not to have used the provisions of the Bankruptcy Code to improve its financial position. As a result it is now performing less well than its competitors that did avail of Chapter 11 protection, in some cases for many years. Perhaps as a result of that American more than any other carrier needs to make structural changes in its cost base and it sees distribution as an area where this is possible. The urgency of its financial position is perhaps driving it to take a more forthright approach than others that tried to initiate reforms earlier. If it is successful the effects will be felt across the whole of the airline industry in the USA and eventually further afield.