

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Complaint of)
)
United States Travel Agent Registry)
)
against)
)
United Airlines, Inc.) OST-98-4785
American Airlines, Inc.) OST-98-4786
Delta Air Lines, Inc.) OST-98-4776
Continental Airlines, Inc.) OST-98-4836
)
(Violation of 49 USC § 41712,)
formerly Section 411 of the)
Federal Aviation Act))

REPLY AND REBUTTAL TO THE ANSWERS OF
UNITED AIRLINES, AMERICAN AIRLINES,
DELTA AIR LINES, AND CONTINENTAL AIRLINES
REGARDING UNFAIR METHODS OF COMPETITION
IN THE SALE OF AIR TRANSPORTATION

EXPEDITED TREATMENT REQUESTED

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1. Consolidation of Reply and Rebuttal

With the approval of the Department's Assistant General Counsel for Aviation Enforcement and Proceedings, and subsequent to USTAR's filing on 01 February 1999, USTAR consolidates its reply and rebuttal in the above captioned dockets to provide efficiency and paper reduction relief in pursuit of its complaint.

2. Relevant Law and Authority: 49 USC § 41712. Unfair and Deceptive Practices and Unfair Methods of Competition

"On the initiative of the Secretary of Transportation or the complaint of an air carrier, foreign air carrier, or ticket agent, and if the Secretary considers it is in the public interest, the Secretary may investigate and decide whether an air carrier, foreign air carrier, or ticket agent has been or is engaged in an unfair or deceptive practice or an unfair method of competition in air transportation or the sale of air transportation. If the Secretary, after notice and an opportunity for a hearing, finds that an air carrier, foreign air carrier, or ticket agent is engaged in an unfair or deceptive practice or unfair method of competition, the Secretary shall order the air carrier, foreign air carrier, or ticket agent to stop the practice or method."

3. Standing

Delta Air Lines (at 1) and Continental Airlines (at 3) allege that USTAR does not have standing to file a third party complaint with the Department in that it is not itself a ticket agent. The Department has a long history of recognizing the standing of travel agency associations, and USTAR is a nationally known non-profit association of bona-fide travel agents (ticket agents) which has dealt with the Department on other issues.

In 1984, during the "sunset" of the CAB, the Association of Retail Travel Agents (ARTA) filed suit in U.S. District Court regarding various elements in the creation of the Airlines Reporting Corporation (ARC). The airlines sought to prevent ARTA's suit by challenging ARTA's standing in the trade. Judge Louis Oberdorfer ignored the carriers' argument, citing ARTA's history and acceptance by the CAB.

USTAR, in a similar fashion, is the legitimate and duly elected representative of its travel agent members and brings the complaint of its members to the Department at their express direction. USTAR's members are sensitive to reprisals which they fear would be inflicted upon them by carriers seeking retribution for agent complaints to the Department.

Nonetheless, USTAR is willing to provide the Department with the names of agents seeking relief via USTAR's complaint, provided that USTAR be afforded the right to redact the public release of these names and keep such disclosure as proprietary and confidential. Carriers themselves have long responded to the Department on many issues with the request for privacy of information which may be commercially sensitive. USTAR feels that there is no greater need for privacy than the protection from unreasonable and arbitrary treatment in the conduct of its members' businesses.

4. The Agency-Principal Relationship

American Airlines (at 1 and 2), Delta Air Lines (at 2), and Continental Airlines (at 3) allege that it is a well settled issue that airlines are the principal in the agency-principal relationship and that as travel agents are true agents for the principal that there is therefore no competition possible between a principal and its agent.

In their answers to USTAR's complaints, the carriers all pointed to the McTravel case, stating that *"it is well settled in both DOT and federal case law that travel agencies are agents of and do not compete with airlines"* (stipulated by Delta Air Lines). *"One of the fundamental duties of an agent is a duty not to compete with its principal concerning the subject matter of the agency. As a result, travel agents have a legal duty not to compete with American in the sale of air transportation to the public"* (stipulated by American Airlines).

USTAR would raise two issues in regard to the answers of the carriers and the citation of the McTravel case:

Firstly, while there is no dispute on the factual presence of a true agency-principal relationship, the McTravel case in no way concludes that agents and principals do not compete. The sum and substance of McTravel is the obligation of an agent to follow the instructions of the principal. Moreover, with respect to the false conclusions by both Delta Air Lines and American Airlines that agents and air carriers do not compete, the McTravel case stipulates:

"McTravel's Response Brief at 22-23 (citing United States v. Masonite Corp., 316 U.S. 265, 62 S.Ct. 1070, 86 L.Ed. 1461 (1942); Sun Oil Company v. F.T.C., 350 F.2d 624, 633-34 (7th Cir.1965), cert. denied, 382 U.S. 982, 86 S.Ct. 559, 17 L.Ed.2d 473 (1966)). [FN6] Judge Getzendanner twice rejected this position, finding that although American does act as a travel agency for a substantial portion of its sales, "there is no true competition between the airline and the agent." Illinois Corporate Travel, Inc. v. American Airlines, Inc., 85 C 7079, slip op. at 10-11, on rehearing, slip op. at 8 (January 8, 1986) [1986 WL 891].

FN6. Despite more than one hundred pages of rambling text, the defendants made no mention of these two cases, relying instead on Judge Getzendanner's factual finding that American does not compete with travel agencies. Footnote 1 [repeated below] and the discussion below will hopefully clarify for the defendants the inadequacy of their responses.

Yet, Judge Getzendanner's finding at the preliminary injunction stage does not mean that there is no genuine factual issue on this score. McTravel has presented testimony of a number of competent witnesses that airlines do compete with travel agencies for sales. If, as McTravel contends, the agency exception does not apply when the principal competes at the same level of distribution as its agents, then McTravel *1493 has the right to have a jury resolve the factual dispute. (emphasis added)

FN1. In their memoranda for summary judgment, defendants rely extensively on Judge Getzendanner's factual findings in denying the preliminary injunction. That was wrong, and if the defendants' lawyers would like to know why, they should revisit their notes from first year of law school. See also *University of Texas v. Canenisch*, 451 U.S. 390-95, 101 S.Ct. 1830, 1831-34, 68 L.Ed.2d 175 (1981) ("[F]indings of fact and conclusions of law made by a court granting a preliminary injunction are not binding at trial on the merits.").

Thus, the court has stated that it is anything but well settled that airlines do not compete with their accredited travel agents and has left the issue open for further litigation.

Moreover, in a still-pending antitrust lawsuit filed by a consumer against Northwest Airlines for prohibiting the sale of hidden city tickets, in a motion proceeding on 24 November 1998 before the Honorable Gerald E. Rosen of the Eastern District of Michigan, Judge Rosen observes the following:

"Northwest would love to be able to sell a hundred percent of its own tickets and **eliminate the competition that travel agents provide, because what travel agents do** -- Look, this is a very real world thing. I call my travel agent and I say, "Ann, I need to get from Detroit to Tampa Bay: Find me if cheapest way to do that." Now, if I was required to simply call Northwest and say, "I need to get from Detroit to Tampa Bay," how do I know that Northwest would really find me the cheapest way to do that? I would have to rely on their good faith. Whereas with the travel agent, because I know Ann wants to keep my business, I know she's going to try to find me the very best price that she can to get me down to Tampa Bay. And that's what your little chart is missing there. **The travel agents do perform a very important market function here, which is a competitive function.** It's not simply that Northwest can -- that the travel agents have no impact on the market. They do. They have a very real impact." (emphasis added)

Secondly, if as the carriers asserted in the McTravel case, travel agents should not be permitted to unduly or unfairly compete with their carrier principals, then reasoning would hold that principals should not unduly or unfairly compete with their agents either. USTAR wishes to stipulate that it does not question the fact that airlines sell direct, nor does it suggest that carriers should be prevented from doing so. USTAR holds only that in the sale of air transportation, that principals and agents should have substantially equal access to products, prices, and inventory, and an economic and business relationship commensurate with the principal's underlying purpose in engaging the agent as its representative in the first place.

5. Expectation of a competitive relationship between airlines and travel agents through the ARC "Agent Reporting Agreement".

American Airlines (at 2) and Delta Air Lines (at 2) cite the ARC "Agent Reporting Agreement" as the legal contract which frames their agent-principal relationship.

The ARC "Agent Reporting Agreement", which is predicated on bestowing eligibility and authorization to sell air transportation on behalf of ARC participating air carriers (participants in ARC's Carrier Services Agreement), states that **"the purpose of this agreement is to facilitate the issuance of ARC traffic documents to the public by agents of carriers in a competitive and efficient manner"** (emphasis added).

While travel agents have long recognized that airlines sell direct to the public and through distribution channels other than appointed travel agents, the travel agent has relied on the implied and stated promise that they will contractually engage in the representation and sale of the carriers' products and services in a competitive environment.

It is nothing short of a double standard that these carriers would cite the ARC Agent Reporting Agreement, an agreement which in part emphasizes the promise of a competitive environment on the one hand, while on the other hand, the carriers provide:

- fares only available from a carrier's web site; not for sale through travel agents
- frequent flyer mileage incentives for the direct purchase of tickets from an airline; not afforded for sales via travel agents
- fare rule waivers by airlines; prohibited by travel agents
- cancellation/change fee waivers by airlines; prohibited by travel agents
- ticketing delivery mechanisms available only to the carrier; prohibited by travel agents
- schedule change reaccommodation/protection; prohibited by travel agents
- back-to-back, hidden city ticketing, throw away tickets; prohibited by travel agents

The agency-principal relationship between travel agents and airlines has evolved over many years. There is no question that as distribution issues become more significant for air carriers that changes in the distribution process will also evolve. However, the suggestion by the carriers that inequitable treatment of travel agents is neither anti-competitive nor discriminatory is simply ludicrous.

6. The work of travel agents is demeaned by United Airlines

In its answer, United Airlines (at "United's Action", page 3) states that its commission cap affects international fares which exceed \$1250 and which represents sales which "generally do not require the level of travel agent time required to book international leisure travel."

United Airlines has not provided one iota of data to support any assessment or quantification of the human effort by or direct cost to travel agents in the sale of United Airlines' high end fare products. Its assumption that travel agents work less to sell "up" or service more demanding high end consumers is an affront to travel agents and a poor justification to limit their compensation for providing these services.

Would United Airlines only apply the same flawed logic to justify the excessive price difference between discount economy fares and first class fares by quantifying its actual cost and service differentiation in transporting front cabin passengers versus back cabin customers. We think not.

United Airlines insensitivity to the work, dedication, and service provided by travel agents is astounding.

7. IATA Resolution 016a - Canada

United Airlines (at 2) states that it did not violate IATA Resolution 016a, a requirement to pay Canadian travel agents a 9% commission with no cap, as Canada was deleted from the resolution (effective 01 October 1998) and that the resolution was accordingly deleted from the 1998 IATA Travel Agent's Handbook.

While it is true that the resolution was amended at the 21-25 July 1998 meeting of IATA's Tariff Coordinating Conference in Singapore, United Airlines fails to mention that it was already in violation of the resolution by virtue of its lowering commission on international sales by Canadian agencies to 8% (no cap) prior to the Singapore meeting.

Furthermore, the IATA Travel Agent's Handbook (Canada) was printed and distributed to travel agents in Canada in June 1998, more than a month prior to the meeting in Singapore (21-25 July 1998). Thus, IATA carriers, including United Airlines, sought to intentionally deceive Canadian travel agencies by removing, without authority, an IATA resolution which was still in effect and binding.

Moreover, at the Singapore meeting, only Canada was removed from IATA Resolution 016a, as several airlines voiced opposition to a complete rescission of the resolution.

Can it be anything but a "smoking gun" that IATA carriers unilaterally and collectively removed Canada from IATA Resolution 016a, effective 01 October 1998, with United Airlines' commission cap on travel agents in the U.S. and Canada following less than 45 days later?

As we alleged in our original complaint (USTAR at 4), U.S. carrier international commission caps on U.S. travel agents would not have been effective or even feasible without levying the same cap on commissions on Canadian travel agents due to the crossborder market proximity and ticketing capability.

8. SatoTravel

While USTAR is willing to withdraw those sections of its complaint dealing with SatoTravel due to the recent airline divestiture and sale of SatoTravel to a third party, USTAR wishes to emphasize two points:

Firstly, SatoTravel's former carrier-provided advantages in the marketplace are additional proof that airlines competed unfairly with travel agents. Please note the following from the SatoTravel web site:

"Nonrefundable tickets

If you wish you could take advantage of the low fares of nonrefundable tickets, but don't want to lose money if and when your plans change... you're not alone.

That's why SatoTravel makes it easy for you to always get the best fares -- but not be taken for a ride. If you need to cancel a nonrefundable ticket, just return the ticket to SatoTravel, and we'll record it into your traveler profile. And we don't just record the ticket: We record the validating carrier, the amount of the ticket and the ticket number.

So the next time you want to make reservations on that particular airline, your SatoTravel agent ensures that the money from the old ticket is used toward the new flight."

No other retail travel agency could make such an offer without first disclosing the assessment of an airline initiated cancellation or change penalty.

The following statement also appears on the SatoTravel web site:

"We are the only travel company that offers true "global ticketing" -- that is, ticketing across international borders. We can generate a ticket from a SatoTravel office, your installation or facility to satellite ticket printers established at virtually any location in the world you specify."

No other retail travel agency has the facility to offer the technology and ticketing solution which only SatoTravel could offer. Without the requirement to adhere to ARC ticketing rules, SatoTravel set itself apart from other retail travel agencies with technology prohibited at all other retail travel agencies by the carrier-owners of SatoTravel (and ARC stockholders) themselves.

Secondly, we believe the Department has justifiable reason to inspect and review the sales agreement between the former carrier-owners of SatoTravel and the new third party owners Ambassadors International Inc., Stuart Mill Capital Inc., and GE Pension Trust. A sale of this magnitude, with the distinct possibility that it may contain carrier-agreed promises, advantages, or conditions which preserve or widen SatoTravel's anti-competitive position in the marketplace vis-à-vis other travel retailers, bears reasonable scrutiny.

9. The Department's position on commission issues and commission impact on consumers

In each of their responses, the carriers questioned the Department's jurisdiction or oversight in matters of commission and/or the compensation of agents (American Airlines at 5, Continental Airlines at 2, Delta Air Lines at 2, United Airlines at "United's Action").

The carriers would have us believe that the Department should turn a blind eye to matters of compensation as a free marketplace should not be regulated in internal matters of distribution.

The Department, however, has a history of being in tune to commission issues, particularly as they may affect the travel agent's relationship to the consumer. Examples of commission concerns shared by the Department are those commission pacts between carriers in alliances or joint marketing agreements, commission rebates on international transportation, and commission tying agreements in CRS contracts.

While USTAR does not suggest that the Department should regulate commissions on their face, USTAR feels that where airline commission or compensation plans either impact the consumer directly or inhibit the agent from providing unbiased, objective services, the Department needs to intervene.

There is already a body of relevant data and evidence to support the impact on the traveling public of commission cuts on travel agents. Take for example, the following portions of testimony of ASTA (American Society of Travel Agents) Chief Operating Officer Paul Ruden before the Transportation Research Board on 20 January 1999:

"Armed with motive and opportunity, the airlines have now embarked on a campaign to reshape the market in their own image. Their deliberate course of conduct, described below, has substantially reduced competition in the market for travel services and injured consumer welfare.

If successfully consummated, this strategy will make it much harder for the public to learn about all of the fare and service options available to them and thus increase the likelihood that they will, on the whole, spend more for air travel than they otherwise would.

By restricting access to unbiased and comprehensive information from independent sources, the airlines expect, rightfully, that they will be able to increase the average price consumers pay for air travel.

Travel agents quote schedules and fares, and provide ticketing services, to consumers on major U.S. airlines, small U.S. airlines, large and small international airlines, and start-up airlines. Travel agents are the only efficient, independent and comprehensive neutral sources of information for airline travel options. Travel agency sales of air travel alone exceed \$80 billion annually.

If the airlines can divert any meaningful amount of this business to themselves, the potential gain to them is enormous, not merely in commissions avoided, but in the higher overall prices that consumers will pay for air travel. Deprived of easy access to independent sources of comparative price and service information, consumers inevitably will end up paying more, on average, even if the airlines never raised another fare.

Nor are the changes the airlines are aiming at the distribution system in furtherance of their strategy occurring under conditions of a level playing field in which consumer preferences ultimately control the outcome. Instead, the airlines are using market power, collective activities and other devices to undermine the distribution system to achieve their goal of reducing the public's access to independent comparative price and service information.

These actions include: reducing commissions to below compensatory levels, discriminating against agency transactions originating on the Internet with non-compensatory commissions, discriminating against agencies with respect to fare policies in ways that interfere with agency-client relationships, and using the Airlines Reporting Corporation and other collective activities to compete unfairly with travel agents.

The first action in the airlines' anti-consumer campaign began in 1995, when the major airlines, save only Southwest Airlines, capped travel agency commissions at \$50 per round-trip ticket. This was followed in September, 1997, with across-the-board reductions in the domestic base commission rate from 10 percent to 8 percent.

In dollar terms, the total compensation reduction to agents is more than 30%. At this time, consumers have overwhelmingly elected to continue to do business with travel agents, but millions of consumers now pay transactions fees to agents, fees which agents have been forced to adopt to off-set airline commission cuts. Consumers who are unwilling or unable to pay travel agent transaction fees must contact airlines directly and often pay higher fares as a result. As airlines continue to reduce agency commissions, many consumers may be willing to pay higher fees for the right to do business with agents, but millions of other consumers will be forced to deal directly with major airlines.

This puts the consumer right where the airlines want him, bereft of a neutral source of information to deal with a bewildering array of complex air fares and services. As travel agents are forced out of the industry and airlines secure more direct consumer business, consumer alternatives will continue to decrease resulting in significantly higher consumer travel costs. **This "revenue squeeze" has made entire segments of airline ticketing activity non-remunerative for agents, a major factor in the exit of 12 percent of independent U.S. travel agencies from the industry during 1995-98, as well as in a shifting of resources by the remaining agencies to non-air sales. This is the first decrease in the number of travel agencies since World War II, and more closings are expected as agency operating reserves are exhausted."**

(emphasis added).

So, while United Airlines (at 1) questions the impact on travel agency survivability after commission caps and suggests that agents did not go out of business, the facts prove otherwise.

At the same time, airlines are squeezing travel agents which have done just what the airlines have recommended: explore new opportunities, take hold of new distribution technology, and bring added-value to the consumer in the marketplace.

USTAR refers to the testimony of Reid Detchon, Executive Director of the Interactive Travel Services Association, a coalition of online travel agencies using the Internet to reach consumers, also before the Transportation Research Board on 20 January 1999:

"Since the association was formed one year ago, it has sought to draw attention to the unfair and anticompetitive practices of the major airlines - not against the smaller carriers, but against online agents - and the adverse impacts these actions have on consumers. One of the keys to a properly functioning marketplace is access by the buyer to comparative pricing information.

Online travel agents put this information directly in the hands of the consumer, 24 hours a day, 7 days a week. That has been good for consumers, who can monitor rapidly fluctuating air fares and comparison shop in real time, and it has been good for competition. It has been particularly good for smaller carriers trying to gain a larger share of the market. At Preview Travel, for example, Reno Air gained twice the market share it had elsewhere, because Preview Travel offers shoppers a choice of lower-priced alternatives for any given itinerary. This service has shifted traffic onto smaller carriers that consumers would not have considered otherwise. You have heard, and you will hear, plenty about the way major carriers respond to new market entrants, and you will have to judge whether these actions cross the line from aggressive competitive tactics to predatory practices.

In the case of online travel agents, airlines have responded not by embracing a new service that promotes and distributes its product with unparalleled efficiency, but by taking steps at every turn to disadvantage online agents and impede their success. I have attached more detailed information about these practices, but in short:

The airlines have cut commissions to online agents by more than half, to the point where an online agent loses money on most air tickets sold. US Airways, for example, has a commission cap of 4 percent on domestic round trips, up to a cap of \$10. This compares to a rate for most airlines of 8 percent and a cap of \$50 paid to bricks-and-mortar agents. Is this discrimination related to any plausible economic rationale? Not at first blush. It costs airlines more to process conventional agent transactions exclusive of commissions, yet they reward them more. To be more specific, one airline reported to us that its non-commission costs for handling a ticket transaction with a traditional travel agency average \$18, compared to just \$8 for an online agency with immediate ticketing.

In economic terms, this discriminatory commission policy represents a taking back by the airlines of savings that otherwise would flow to the consumer, at least in part. If online agents received the same commissions as their bricks-and-mortar counterparts, the greater efficiencies of online booking would allow them to offer financial incentives to consumers - discounts, frequent flyer miles, and the like. The airlines effectively have kept those savings (and more) for themselves. While the figures may vary from case to case, consider the cumulative effect on consumers:

The airlines, as indicated above, save \$10 a ticket in processing costs when dealing with an online agent.

Traditional agents get an average commission that is \$15 or more higher than an online agent and still have begun charging an additional service fee - typically around \$15 - to cover their costs of doing business.

The commission costs are incorporated into the ticket price. For airlines to charge the same price to online agents and not pay the same commission is functionally equivalent to a private-sector tax on online transactions.

Putting that all together, consider an alternative scenario. What if airlines split their transaction savings with online agents - offering them a \$5 discount - and paid them the same commission as any other travel agent? The likely outcome is that the online agents would pass along all of the direct savings and some portion of the commission - totalling perhaps \$15. That would mean a saving to consumers of \$30 on a typical ticket transaction, compared to traditional travel agents - a non-trivial amount that would add up to hundreds of millions of dollars annually.

Price is not the only basis upon which airlines discriminate against online travel services. **There is a whole array of non-price discriminatory practices - an array so pervasive that the Airlines Reporting Corporation publishes a guide to them. This matrix lists 11 categories of discrimination - ways in which the 22 airlines involved place more restrictions on online agents than traditional agents without any legitimate economic justification.**

For example, conventional travel agents can book same-day travel; online agents cannot - despite the availability of electronic tickets and the security of credit-card purchasing. Conventional agents can book up to nine persons and 99 segments per passenger record, online agents only four persons and six segments. Conventional agents can hold a ticket for later payment; online agents are required to secure payment at the time of booking. What explains this behavior? It doesn't take a detective to figure that out. Airlines want the online business for themselves. Before the Internet, they needed travel agents to provide the physical distribution of their tickets to consumers.

Now, with e-tickets, they don't. But they don't want consumers just to go online - they want them to go online to their own branded sites. If they can get consumers to buy their tickets on proprietary airline sites, they can lower their transaction costs, encourage brand loyalty, reduce the likelihood that the buyer will find a better fare, and discourage competition from new market entrants. By cutting commissions to online agents differentially, airlines strike a blow against comparative pricing services and deter conventional agents from going online at all. To enforce their discriminatory policies, airlines are requiring agents to post a special number - an Electronic Reservations Service Provider, or ERSP, number - on all Internet tickets sold. This "scarlet A" of the airline industry is administered, once again, by the Airlines Reporting Corporation, which is, we believe, going well beyond its legal authority in facilitating airline commission policies.

We are also concerned about the "Recommended Practices for the Providers of Electronic Reservations Services" promulgated last May by the Air Transportation Association. These guidelines recommend the use of an ERSP number - already implemented through ARC. The guidelines also recommend that online service providers assign a unique identifier to each user of the service, track that individual's usage of the system, and send to the airlines a user's name, address, phone number, and passport number, where applicable. Consumer travel itineraries, in addition to passenger contact information, could be gathered by the airlines, either to help market their own web site or for sale to other direct marketers. In addition to being unfair and anticompetitive toward the online service providers, these practices would constitute a gross assault on personal privacy and would deter consumers from using independent online services at all.

The only reason the airlines can get away with these actions - and this is the critical issue for this Committee to consider - is that they have substantial market power. In many markets, individual airlines have the upper hand on consumers because of a monopoly or near-monopoly on service, and in every market airlines have power over travel agents, because agents can't simply choose to offer one airline and not another, the way a restaurant could choose Coke over Pepsi or Miller over Bud. Why should this Committee recommend action in this area?

Because discrimination against online travel services will damage the growth and development of electronic commerce in an important market segment. Treasury Secretary Bob Rubin said last month, "Commerce on the Internet needs to receive the same treatment as traditional commerce." The industry is one of the largest segments of electronic commerce today, with 1997 sales of \$911 million, and is defining the leading edge of our nation's transition to an electronic economy. The Internet is an enormously powerful new force for competition. The benefits which consumers can realize through the purchase of travel online have already been diminished and are seriously threatened by the air carriers actions.

Because airline service is not a freely fungible commodity like soft drinks or computers. If a computer store is being mistreated by IBM, he or she can switch to selling Compaqs. Travel agents can't change suppliers - thus, they need external intervention to protect them. What should the Committee recommend? **Simply that the Department of Transportation require the airlines to offer their product on the same terms and conditions to anyone selling it, barring both price and non-price discrimination against online agents.**

We ask not for preferential treatment, only a level playing field. With that, we are confident we can compete and thrive - and, most importantly, consumers will reap the benefits." (emphasis added)

Craig Stoltz, Staff Writer for the Washington Post supports Mr. Detchon's point of view in excerpts from a Post article which appeared on 15 November 1998:

"While airline reps at PhoCusWright [conference in Phoenix] denied trying to put online travel agencies out of business, their actions make it difficult to infer otherwise. In one of those episodes of brow-raising coincidence that give anti-trust lawyers reasons to keep on living, most major airlines recently decided to cap the commissions they pay online travel agencies at 5 percent, or \$10 maximum per ticket. The online agencies say this is less than it costs them to sell the average ticket (reportedly around \$21).

And they also point out that this \$10 cap is even less than the airlines pay "real" ("face-to-face") travel agents, who themselves are squealing that the airlines' 8 percent/\$50 commission caps on most round-trip domestic tickets are killing them.

Meantime, we learned, many major airlines are doing plenty to encourage their best customers to book online--but at their own Web sites, not the online agencies'. United has announced a bonus of 20,000 frequent-flier miles (nearly enough for a round-trip ticket!) to customers who use its Web site to book 10 trips in the next year. Northwest is luring frequent fliers to its Web site by making frequent-flier award travel bookable online. Delta has floated the idea of Net-only discounts for certain trips booked exclusively at its Web site.

So: Airlines are offering incentives for customers to book directly on their Web sites. And they are lowering commissions they pay to independent online agencies. You don't need a Stanford MBA, or even a Silicon Valley polo shirt, to connect these dots. Airlines want to sell tickets online to their most lucrative customers themselves--not via independent agents who may steer their best customers to a better deal. (emphasis added)

Yet another perspective on the impact of travel agency commission cuts on consumers come from the following article in the The Philadelphia Inquirer, 23 November 1998, by staff writer Tom Belden:

"Airlines' commission cuts could increase the cost of flying:

Major airlines in recent weeks have made sharp cuts in the commissions they pay travel agents to book international tickets, a move that will take a big chunk of revenue out of some agencies' pockets. And despite airline assertions to the contrary, the move could push up the cost of flying for many business travelers.

United Airlines, the largest U.S. carrier, led the way in the cutback, reducing the agents' commission on international tickets from 8 percent on all fares to 8 percent with a cap of \$50 for each one-way segment of a ticket.

As of last week, American and Delta, the second- and third-largest U.S. airlines, respectively, were the only carriers that had matched United's new commission structure.

Industry observers estimate that if all major airlines were to reduce their commissions, collectively they would save about \$450 million a year. United spends about \$1.5 billion a year on commissions, and cutting the international commissions will save it about \$100 million annually, the airline said in a statement.

United said it needed to reduce costs in the face of economic uncertainty, which has already reduced travel to Asia and could depress business elsewhere. Besides, the airline said, the lower commissions won't change the price consumers pay for overseas travel -- it's only your travel agent who will be making less money.

There is more to the cuts than that, however.

They are part of a rapidly changing landscape in the airlines' distribution system, defined as the ways airlines sell tickets and how they get those tickets, or the paperless, electronic version of tickets, into the hands of travelers.

And don't bank on the airlines' contention that the commission cuts will cost consumers nothing. As agents' commission revenue has declined in the last few years, more of the burden of paying for agency services has shifted to the customer. That trend is likely to accelerate now that the commission revenue will fall even more, industry watchers say.

The cap on international commissions follows the major airlines' move in 1995 that set a cap of \$50 on the commission an agent gets for each round-trip domestic ticket. Before mid-1995, airlines paid agents a 10 percent commission on all tickets. Commissions on international tickets stayed at 10 percent from 1995 until last fall, when they were trimmed to 8 percent.

For an agent who sells mostly discounted international leisure-travel tickets, the most recent cut may not hurt much. On a \$700 round-trip fare, for instance, an agent earned a \$56 commission, and that has not changed under the new scheme.

But for an agent who had been making a \$400 commission on a \$5,000 business-class round-trip ticket to Europe, the pain is much greater: The commission on that ticket just plunged to \$100.

Travel agents sell about 80 percent of all airline tickets, a figure that has not changed much in recent years, despite their lower revenue for each ticket sold and the growth of the Internet as a marketplace for selling tickets directly to consumers.

Travel agents and others say that, given the bewildering array of ticket prices available on most airlines, both business and leisure travelers depend on them to find the lowest cost for a trip.

"Consumers use travel agents because they don't like to be put on hold and then talk to an airline employee who's indifferent to their needs," said Kevin P. Mitchell, president of the Business Travel Coalition, the Lafayette Hill consumer advocacy group. With an agent, consumers also "get comparison shopping for fares. And with the airline they don't get all the other services they need, like shopping for hotels and rental cars."

Though the Internet offers consumers an array of travel information, and a relatively easy way to book an airline trip, it's not necessarily the place to find the lowest fares, another expert says.

Terry Trippler, a Minneapolis-based travel newsletter publisher and a former travel agent, has said that in hundreds of tests he has run checking fares on the Internet and asking an agent to research the trip, the agent has found a better fare almost every time.

The falling revenue from selling tickets since 1995 has driven some agencies out of business and required others to assess clients service fees on each ticket sold, according to the American Society of Travel Agents, a trade group.

Many agencies now avoid selling ordinary airline tickets altogether, focusing instead on selling cruises and tour packages that include air travel, a hotel room, and ground transportation. Those kinds of leisure travel still pay agents a commission of 10 percent or more.

To make up for the most recent loss of commission revenue, agency service fees may have to go up, or agencies that don't charge fees now may have to start, officials of the travel agents' trade group say.

The airline customers who will wind up paying the highest price for the commission cuts are corporations that have contracts with travel agencies to share in the agencies' commission revenue and then pay a set fee for each ticket the agency books for them.

Some of these companies are among the airlines' best customers, spending millions of dollars a year on first-class and business-class travel. The companies count on getting a cut of the commission revenue to offset their air-travel bill. Now they're in the same boat as the travel agent whose revenue on a \$5,000 ticket to Europe just plummeted from \$400 to \$100.

If airlines do, indeed, save \$450 million by capping international commissions, "the initiative represents a \$450 million indirect price increase to airline customers," *the Business Travel Coalition's Mitchell said." (emphasis added)*

10. Airlines' use of interline ticketing procedures competes unfairly with their agents

All the carriers responded that they had no direct knowledge of the intricacies of interline ticketing procedures, an understanding of the impact on their directives on code-share partners, or first hand knowledge of fare construction rules which frame through fares and conceivable "through commissions" (United Airlines at 6, Continental Airlines at 8, Delta Air Lines at 3, and American Airlines at 6).

It would seem that the carriers intend to cloud the truth surrounding the realities in ticketing and fare construction with their astonishing lack of understanding or clear cover-up of their own industry revenue accounting procedures. As an example, both United Airlines and Continental Airlines cite IATA Resolution 850x (selection of validating/ticketing carrier) in their reply, suggesting that the travel agent is permitted to validate the ticket involving Biman Bangladesh Airlines with Biman's ticketing identification, and thereby qualify the agent for a higher commission (USTAR example at 8 and 9).

IATA Resolution 850x is not applicable in the United States. Furthermore, even if it were, Biman is not a member of ARC's Area Settlement Plan. The travel agent has no choice but to ticket the interline transportation on Biman with the U.S. carrier's validation, resulting in a substantial loss of commission on Biman's services for the issuing travel agency.

Moreover, the interline accounting relationship between carriers would provide a windfall to the ticketing airline as Biman would have to pay the U.S. carrier a 9% uncapped "interline service fee", in effect, a commission to the ticketing carrier in accordance with IATA Resolution 780d (IATA Multilateral Agreement for Passenger Interline Service Charge - United States), an agreement for carriers to pay each other a 9% service charge for selling, handling, servicing and processing transportation ticketed on behalf of other airlines.

By way of another example, consider the code-share transportation and joint marketing agreement between American Airlines and its partner Canadian Airlines:

American Airlines offers air service to many destinations around the world. Canadian Airlines offers air service to many destinations around the world as well. While American Airlines and Canadian Airlines promote and sell air service on thousands of routes between hundreds of destinations, they do not provide by themselves all of the air transportation they sell.

On many international routes, American Airlines provides only part of the air transportation on the route, with the remaining portion of the air service being provided by other carriers like Canadian Airlines. Likewise, on many international routes, Canadian Airlines provides only part of the air transportation on the route, with the remaining portion of the air service being provided by other carriers. Such combined, multi-carrier transportation is called "interline transportation".

For example, American Airlines does not fly on its own to many points in Asia. However, American Airlines is able to promote and sell air service from American's hub in Dallas to cities in Asia, such as Beijing, because of a code-share and joint marketing relationship that American Airlines has with Canadian Airlines, which offers substantial air service to Asia from Canadian Airlines' hub in Vancouver. Thus, a consumer flying with American Airlines from Dallas to Beijing will fly on American Airlines from Dallas to Vancouver, where the passenger will change to a Canadian Airlines' flight from Vancouver to Beijing.

Similarly, a passenger flying on American Airlines from San Francisco to Shanghai will fly on American Airlines from San Francisco to Vancouver and on Canadian Airlines from Vancouver to Shanghai. International, interline service provided jointly by American Airlines and Canadian Airlines is referred to herein as "American-Canadian international service" and tickets for such service are referred to herein as "American-Canadian, international tickets".

Both Canadian Airlines and American Airlines are members of IATA. IATA's members (including American Airlines and Canadian Airlines) have agreed to IATA Resolution 780d, the IATA Multilateral Agreement For Passenger Interline Service Charge - United States agreement (the "IATA Service Charge Agreement"). Whenever a ticket for interline transportation is issued, one of the carriers listed on the route is designated as the "Issuing Carrier" or "Ticketing Carrier". Pursuant to the IATA Service Charge Agreement between Canadian Airlines and American Airlines, the "Ticketing Carrier" for an international, interline ticket is entitled to assess or charge the other carrier a fee equal to 9% of the value of the transportation provided by the other carrier.

As stated further below, carriers on an interline route, such as American Airlines and Canadian Airlines each want to be designated as the "Issuing Carrier" for as many international, interline tickets as possible. This is because for each international, interline ticket sold in which American is designated as the "Issuing Carrier": (a) American Airlines is allowed to keep 9% of Canadian Airlines' revenue from such tickets and (b) American Airlines avoids paying 9% of its ticket revenue to Canadian Airlines, which would be the case if Canadian were designated as the "Issuing Carrier". The 9% of Canadian Airlines' revenues that American Airlines receives for issuing the tickets, plus the 9% fee that American Airlines avoids paying Canadian Airlines, equal, in total, 9% of the overall ticket price.

The process described above is exemplified by a situation in which American Airlines issues a \$5,000 ticket for international, interline service which is provided equally by American Airlines and Canadian Airlines. Absent IATA Resolution 780d, Canadian Airlines would receive \$2,500 for the air service it provided and American would keep the remaining \$2,500. However, under the terms of the IATA Service Charge Agreement between American Airlines and Canadian Airlines, Canadian receives only \$2,275 for the half of the air service it provided and American receives \$2,725. Thus, there is a \$450 differential (9% of the total ticket price) between what the two carriers receive depending on which carrier is designated as the Issuing Carrier.

While the distribution fee that the Issuing Carrier receives is 9% of the total ticket price, it can actually constitute 50% (or more) of extra revenue to that carrier, depending on how much of the interline transportation the Issuing Carrier actually provides. For example, in the scenario discussed above, the additional \$450 that American Airlines receives as the Issuing Carrier constitutes approximately 20% more revenue than it would otherwise receive if it were not designated the Issuing Carrier. However, as the Issuing Carrier's portion of the interline service decreases, the additional revenue constitutes an even greater percentage above what it would otherwise receive.

For example, if American Airlines provides \$1,000 worth of service and Canadian Airlines provides \$4,000 of air service, American Airlines, as the Issuing Carrier, would receive \$1360, but if it were not the Issuing Carrier it would receive only \$910. Thus, in the foregoing situation, the extra \$450 that American receives constitutes almost 50% more than it would otherwise receive if it were not the Issuing Carrier.

As the foregoing reveals, both American Airlines and Canadian Airlines have significant incentives and motives to be designated the Issuing Carrier. Once a consumer chooses to buy an American-Canadian international ticket, there are two ways that the interline carriers can be designated as the Issuing Carrier. First, if the ticket is issued by one of the carriers directly through its own reservation, ticket offices, or Internet web site, then that carrier automatically designates itself as the Issuing Carrier. Second, if the ticket is issued through a travel agent, then the travel agent has the discretion to designate either of the carriers as the Issuing Carrier. In 1998, approximately 25% of American Airlines' tickets were issued directly by American Airlines and the remaining 75% of its tickets were issued by travel agents.

The foregoing process creates a series of competitive interests by American Airlines and Canadian Airlines. First, since approximately 75% of American Airlines tickets are issued through travel agents, the best way for American to be designated as the Issuing Carrier on American-Canadian international tickets is to essentially pay travel agents to designate American Airlines as the Issuing Carrier. The same is true for Canadian Airlines. Since a travel agent receives his or her commissions for issuing an interline ticket from the "Issuing Carrier", both American Airlines and Canadian Airlines use commissions to bid against each other to convince travel agents to designate each respective carrier as the Issuing Carrier. If, for example, Canadian Airlines pays travel agents a higher commission for issuing American-Canadian international tickets than American Airlines does, travel agents will designate Canadian Airlines as the Issuing Carrier in order to gain the higher commissions.

Canadian has an incentive to out-bid American on travel agent commissions for American-Canadian international tickets, so long as the benefits it receives from being designated as the Issuing Carrier are greater than the costs it must pay to obtain that designation; the cash flow sitting with the Issuing Carrier being the other obvious benefit.

Second, in addition to competing against each other, the two carriers also compete against travel agents. Both of the carriers perform two, distinct economic functions in the airline industry. Each acts as both (a) a supplier of air transportation that competes with other airlines and (b) a ticket issuer that competes with travel agents. As stated above, if one of the interline carriers (such as American Airlines) issues the international ticket itself, then American Airlines acts as the "travel agent" and designates itself as the Issuing Carrier. In such a situation, American Airlines receives a 9% fee for acting as the travel agent that issued the ticket. Since American Airlines did not have to pay a commission to a real travel agent for issuing the ticket, it is able to keep a much greater portion of the 9% fee it receives from Canadian Airlines than if the ticket were issued through a travel agent. Thus, American Airlines has an incentive to attract as many customers as possible to buy tickets directly from it so that it can retain the greatest possible portion of the 9% "travel agent fee" it receives from Canadian Airlines. The same is true with Canadian Airlines. Consequently, both carriers are competing against travel agents for customers and have the greatest interest in seeing travel agent competition reduced, if not eliminated.

On 17 November 1998, American Airlines announced that it would impose caps on international commissions. American Airlines' commission cap had various effects on its competitive interests discussed above regarding American-Canadian, international tickets. To the extent American could continue to be designated as the Issuing Carrier on the American-Canadian, international tickets, the reduced commission would allow it to keep a larger portion of the 9% fees it received from Canadian. Thus, in the past when it was designated the Issuing Carrier on a \$5,000 ticket it would receive a \$450 benefit but it would pay \$400 in commissions to a travel agent, enabling American Airlines to keep \$50.

Under its new commission cap, however, American Airlines would pay a travel agent, at most, only \$100, enabling American Airlines to keep at least \$350 of the \$450 it received as the Issuing Carrier.

Significantly, however, American Airlines could not receive the increased revenue discussed above, unless it was actually designated as the Issuing Carrier. This was unlikely to happen, however, if Canadian Airlines, American Airlines' code-share and marketing partner, did not also cap its commissions. As long as Canadian continued to pay an uncapped 8% commission, American Airlines was effectively under-bidding Canadian Airlines in their competition to curry favor with travel agents. Consequently, any travel agents which had previously been designating American Airlines as the Issuing Carrier on American-Canadian international tickets would be motivated to switch their designation to Canadian Airlines. Thus, American's cap undermined its position in its competition with Canadian Airlines as buyers of travel agent services.

As stated above: (a) the vast bulk of tickets are sold through the travel agents and (b) the fees American Airlines received from being designated as the Issuing Carrier could constitute 50% (or more) of additional revenue on its international, interline tickets. Thus, if Canadian Airlines did not cap its commissions, American stood to lose significant amounts of existing and/or potential revenues.

A joint cap between American Airlines and Canadian Airlines on international commissions would serve many purposes including hampering competition between travel agents and the airlines in various ways. For example, many travel agents attract customers by offering to rebate a portion of the commissions that the travel agent receives. As stated below, such rebates benefit consumers because it reduces the effective price that consumers have to pay for the air service they purchase. If both American Airlines and Canadian Airlines reduced travel agents' international commissions, it would reduce the amount that travel agents could use as rebates on American-Canadian international tickets to attract customers. This would essentially remove a competitive tool that travel agents have and make it easier for American Airlines to attract customers.

The foregoing is one example of how travel agents would be competitively harmed if American Airlines and Canadian Airlines jointly capped commissions.

Significantly, however, American Airlines commission cap would only hamper travel agents in the sale of American-Canadian international tickets if Canadian Airlines also capped its commissions. If travel agents could still receive an uncapped 8% commission on American-Canadian international from Canadian Airlines, travel agents could continue offering rebates to attract customers and competing with American Airlines in the sale of American-Canadian international tickets.

As stated above, as long as Canadian Airlines continued to pay an uncapped commission: (a) American would lose significant amounts of revenues that it could otherwise receive from being designated the Issuing Carrier, (b) American's commission cap would not significantly improve its competitive position against travel agents in the sale of American-Canadian International tickets.

On information and belief, sometime between 17 November 1998 and 20 November 1998, American Airlines and Canadian Airlines agreed that Canadian Airlines would also cap the commissions that it paid to travel agents in the United States for issuing international tickets. As alleged further below, the agreement between American and Canadian had various competitive effects. First, it artificially restrained competition between American Airlines and Canadian Airlines in their respective efforts to win the Issuing Carrier designation.

Second, Canadian Airlines' agreement to cap its commissions seriously harmed travel agents who could have used the higher commissions to compete against American Airlines by, amongst other things, offering rebates to consumers. By convincing Canadian Airlines to cap its commissions, American Airlines convinced Canadian Airlines to continue paying American a 9% "travel agent fee" each time American Airlines sold a Canadian-American international ticket, while paying travel agents significantly less.

Thus, American Airlines, acting in its role as a travel agent, agreed with a buyer of travel agent services (Canadian Airlines) to discriminatorily harm American's travel agent competitors.

The Canadian Airlines-American Airlines joint agreement, in the minds of many an alleged conspiracy, is evidenced by various facts. First, a 21 November 1998 article in the Canadian newspaper, *The Financial Post* expressly stated that Canadian had acknowledged that it had "coordinated" its decision to cap commissions with American. As that article stated:

*"Canadian Airlines International Ltd. has joined other carriers in limiting travel agent commissions, but only for U.S. agents. United Airlines capped commissions paid on international tickets to agents at \$50 (US) on one way and \$100 (US) on two way tickets. Delta Airlines and American Airlines followed suit this week. **Canadian said it acted in coordination with its alliance partner, American Airlines, but isn't planning to cut fees to Canadian travel agents at present.**"* (emphasis added).

Furthermore, Canadian Airlines' decision was contrary to its own economic interests since its decision sacrificed various financial benefits that it could have received had it not capped its commissions. For example, had it not capped its commissions, Canadian Airlines would have received a 9% fee each time it was designated as the Issuing Carrier, but it only would have had to pay an 8% commission to travel agents that issued the tickets. Thus, on each international, interline ticket Canadian Airlines could have received additional revenue equal to 1% of the entire ticket price. For example, on a \$5000 international, interline ticket Canadian Airlines would have paid the issuing travel agent \$400 but Canadian Airlines would receive \$450 from American Airlines under the IATA Service Charge Agreement. Thus, Canadian Airlines would have received an additional \$50 on the foregoing \$5,000 ticket. Had Canadian Airlines not capped its international commissions, virtually all travel agents would have designated Canadian Airlines as the Issuing Carrier so that travel agents could obtain the higher commission.

This would have resulted in Canadian Airlines receiving additional revenue equal to 1% of the entire ticket price for many, if not all, of the international, interline tickets sold on the American-Canadian inter-line routes.

Furthermore, Canadian could have used the higher commissions in an effort to win market share on various routes. For the last several years, Canadian Airlines has been attempting to increase its competitive position on routes to and from the United States. There are various routes on which both Canadian Airlines and other carriers offer competing service. For example, Canadian Airlines offers international air service from New York to Hong Kong through its Vancouver hub, while United Airlines offers international air service from New York to Hong Kong through Chicago. United Airlines had already decided to cap its international commissions approximately two weeks prior to Canadian Airlines cap. Thus, because of the higher commission that Canadian Airlines was offering, travel agents would have been motivated to influence consumers who did not care which carrier they flew to fly with Canadian Airlines rather than United Airlines. Moreover, to the extent consumers preferred United Airlines, travel agents could have used the higher commission amounts from Canadian Airlines to offer consumers substantial rebates if they switched to Canadian Airlines.

Thus, Canadian Airlines could have used the higher commissions to influence travel agents to shift market share to it. In capping its commissions, Canadian Airlines sacrificed the significant financial and competitive benefits it would have received from retaining its 8% uncapped commissions.

American Airlines and Canadian Airlines anticompetitive behavior has adversely impacted competition between travel agents and American Airlines in the sale of tickets for international, interline air service offered jointly by American Airlines and Canadian Airlines.

American Airlines and Canadian Airlines adverse effect on travel agent competition has, and will, adversely affected consumer welfare in various ways.

First, as stated above, many travel agents have historically used commission dollars from airlines as rebates that they offer to attract customers. These commission rebates are, in effect, discounts that are offered to consumers which enable them to reduce the total price they pay for air service. By agreeing to reduce the amount of commissions that Canadian Airlines paid travel agents, American Airlines and Canadian Airlines improperly interfered with: (a) travel agents' ability to offer rebates and (b) the existence and/or size of the discounts that consumers received by the rebates. Thus, the carriers interfered with and prevented consumers from saving money on international air service.

Second, travel agents offer numerous benefits to consumers, including, most notably, information and options which provide consumers with the greatest number of purchase choices. By providing the increased information and choices, travel agents help consumers obtain the desired air service at the lowest possible price. Absent travel agents, consumers are unlikely to receive the same amount of information and options from airlines. Thus, absent travel agents it will likely be increasingly difficult for consumers to obtain the options and savings they do now. American Airlines and Canadian Airlines commission caps has had the purpose and effect of reducing travel agent competition and reducing the number of travel agents in the market. In so doing, the carriers' conduct threatens to reduce, if not eliminate, the number of sources for information and lower prices. Thus, the carriers' conduct threatens to seriously reduce, if not eliminate, the benefits that consumers obtain from travel agents' existence and competition with airlines.

11. Conclusion and Request for Expedited Consideration of its original complaint

USTAR stands on the merits and content of its original complaint and this rebuttal and asks the Department to order the carriers to restore their pre-international commission cap levels forthwith.

Since the original complaint, many international airlines have also capped international travel agent commissions, harming consumers in ways identical to the respondent carriers in this proceeding.

USTAR urges the Department to consider the merits and issues under this complete with expedited treatment, and to afford USTAR with any additional enforcement or remedy which the Department is able to provide.

USTAR thanks the Department for consideration of its request in the present complaint and rebuttal.

Respectfully submitted,

A handwritten signature in black ink that reads "Bruce Bishins". The signature is written in a cursive, flowing style.

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12 February 1999

CERTIFICATE OF SERVICE

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12 February 1999