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From the Editor: Just in time for the 65th Antitrust Law Spring Meeting, we have an exciting new edition of the Pricing Conduct Committee's newsletter, The Price Point. After a welcome message from committee chair Dale Grimes, you will find two articles about the intersection of antitrust law and technology. The first article "Do Android Merchants Dream of Electronic Cartels" addresses a form of dynamic pricing used by Uber to calculate surge fares during periods of high demand and a Southern District of New York case alleging a conspiracy between Uber and its drivers managed by Uber's pricing algorithm. The next article explores the operation of online travel agents as compared to booking directly with hotel brands and the impact on consumers and competition. A summary of the November 18, 2016 program presented by the Pricing Conduct and Health Care and Pharmaceuticals committees on various topics related to generic drug pricing and consolidations is also included in this edition. The newsletter also includes summaries of several recent decisions and a case filed last month alleging Section 1 and Section 2 claims against two companies providing access to vehicle and customer data to third-party electronic vehicle registration and titling services. The newsletter concludes with a welcome to new committee members and information about how you can get involved. Hint: we are looking for authors for our Summer 2017 edition!

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Pricing Challenges for Hotels in a Price Parity World

Steve Schwartz

Internet commerce has expanded shopping options and altered the way in which competition takes place in markets where internet commerce is prevalent, such as travel sites that offer airline and hotel bookings. However the long-term competitive effects of the internet commerce explosion in the travel sector is not so obvious.

Consider the case of online travel agents (OTAs), recognized by consumers as expedia.com (Expedia), booking.com (Booking), priceline.com (Priceline), and the like. It is unclear, on its face, whether these OTAs have enhanced competition or merely changed it. Have OTAs reduced the economic rents earned in travel by enhancing competition among airlines and/or hotels or succeeded in shifting some (much) of competitive rivalry away from airlines and hotels and on to themselves? The answer is unclear, based on public evidence. Nonetheless, a look at the hotel side of the OTA business is informative about the impact that OTAs have had on pricing and on the current nature of competition.

Pricing parity: an example from the UK

In 2010, the UK's Office of Fair Trading (OFT) began an investigation of agreements between Intercontinental Hotel Group (IHG) and Expedia and Booking.¹ The agreements under investigation established, among other things, requirements for pricing parity, in effect, a most-favored nation (MFN) clause. The OFT focused its investigation on provisions under which OTAs agreed not to discount prices on hotel rooms sold through their sites below the prices set by the hotels. The hotels agreed not to offer rooms on any site at prices lower than the prices offered to other OTAs.² The OFT's concern was that these contractual provisions limited opportunities for

other OTAs to compete by, for example, offering discounts from the prices quoted by the hotels (by using their commissions, for example, to pay for the discount or by negotiating discounts with hotel groups like IHG). In other words, the OFT feared that the agreements limited opportunities for price competition from other OTAs that sought to compete with Expedia and Booking.

Expedia and Booking entered into consent agreements with the OFT (later succeeded by the Competition and Markets Authority (CMA)). The consent agreements were subsequently challenged by a competing OTA (Skoosh International Ltd.) as insufficient in respect of avoiding potential injuries to competition and were overturned by the Competition Appeal Tribunal. The matter was referred back to CMA for further consideration. Among the reasons the CMA cited for closing the investigation in September 2015 was a set of other agreements reached by the parties in various European jurisdictions to eliminate restrictions that precluded hotels from offering rates lower than those available on the OTA sites and uncertainty about whether those agreements would address any competitive concerns in the UK.

OTA v. branded hotel websites

What is interesting about this case, and its ultimate resolution, is that the same behaviors exist in the United States but have gone largely unchallenged competitively, until recently. In the United States, OTAs typically require hotel companies to maintain parity between the prices posted on the branded hotel websites (brand sites) and those presented on the OTA sites. This most-favored nation (MFN) practice carries over to the hotel companies that typically preclude their (franchised) hotels from offering rooms on the OTA sites at lower rates than are available on the branded websites.

The logic of these agreements is obvious (and is at the heart of the competitive *raison d'être* for the OTAs). Any given OTA needs consumers to know they can find the "best" available rates on that OTA site. OTAs use that promise as a tool to drive customers to their sites. If consumers could not count on that commitment, their incentives to

¹ For a complete summary of the procedural history of the investigation, see *In the Competition Appeal tribunal, Case No.: 1226/2/12/14 Between Skyscanner (Appellant), supported by Skoosh International Ltd. (Intervener) v. Competition and Markets Authority (Respondent), supported by Booking.Com B.V., Expedia, Inc. and International Hotels Group PLC (Interveners)*.

² In other words, the agreements provided that the prices at which rooms were offered on Expedia would be the same as the prices offered for the same rooms on Booking (and all other OTA sites).

search other OTA sites and, more likely, the brand sites would be greatly enhanced. For their part, the hotel groups want to ensure that the consumers they are able to drive to the brand sites are similarly assured that there is no price advantage to booking on OTA sites.

Hotel room rates can be set however low (or high) a hotel operator chooses. However, the rates must be identical across all platforms. There is no *necessary* adverse effect on interbrand competition from arrangements such as this. No explicit limitation exists on discounting, and there is no constraint on the ability of OTAs to compete on other bases (e.g., site functionality) or for hotel brands to compete aggressively on an interbrand basis. OTAs simply assure that there is no cross-site discounting.

A pricing relationship

The agreements between the hotel brands and the OTAs exist in the context of a market in which the nature of the buyer/seller relationship is changing.³ Consumers reserving rooms on an OTA site establish a customer relationship with the OTA site and not the hotel where they will stay. Sites such as Expedia offer loyalty programs, present search results according to proprietary algorithms and have the ability to favor certain brands and hotels. These practices have threatened the brand loyalty that hotel companies work assiduously to develop. As a consequence, hotel brands are increasingly trying to solidify *their* relationships with customers and maintain (if not enhance) the brand loyalty that helps the hotels be effective interbrand competitors. Recent trade press indicated that hotel chains increasingly are providing specific discounts only to customers who participate in the hotel group's loyalty program; these discounts are *unavailable* on OTA sites.⁴ These discounts are small, but they provide an incentive for direct booking. While there is no evidence of any systematic discounting to non-brand loyal customers, it is unclear whether the MFN clauses will remain effective.

³ See Liz Weiss, "5 Myths About Online Travel Agencies," *U.S. News & World Report*, July 22, 2016, <http://travel.usnews.com/features/5-myths-about-online-travel-agencies/>, accessed February 22, 2017.

⁴ *Ibid.* Deanna Ting, *Choice Hotels Joins the Direct Booking Pack with New Loyalty Rates*, July 20, 2016, on Skift.com, <https://skift.com/2016/07/20/choice-hotels-joins-the-direct-booking-pack-with-new-loyalty-rates/>, accessed February 22, 2017 and "This is How Hotels Could Win the Direct Booking Wars", <https://skift.com/2016/08/02/this-is-how-hotels-could-win-the-direct-booking-wars/>, accessed February 22, 2017.

Hotel groups and OTAs compete for visitors to their sites. Any visit is a potential booking. Aside from avoiding the commission payments to the OTAs, direct booking has demonstrable advantages for hotels to create and/or reinforce brand affinities and to build/grow brand loyalty. Hence, the (halting) steps towards setting prices beyond the scope of the MFN clauses.⁵

How have the OTAs responded? Interestingly, there is no evidence of systematic price matching. Seemingly, the OTAs prefer to stay within the price-parity world they have created. There is some suggestion that the OTAs have responded to the hotels' pricing by changing search result placement (a process called *dimming*).⁶

In the long-run, the net effect of this dimming is unclear. If dropping the offending hotel brands so low in the search results leads consumers to choose other hotels in sufficient numbers to hurt the brands, the brands may be compelled to relent

⁵ "After renegotiating lower booking fees late last year, most of the major hotel brands have launched campaigns aimed at getting their loyalty members to book on their brand sites. In February, one of the largest operators unveiled its largest marketing campaign in history, called 'Stop Clicking Around,' promoting a 10% discount and free Wi-Fi for loyalty members who book direct." See "Pillow Fight: Hotels and Online Travel Agencies Battle for Bookings," June 23, 2016, Morgan Stanley, <http://www.morganstanley.com/ideas/hotels-vs-online-travel-agencies>, accessed February 22, 2017. See, also, Deanna Ting, *Choice Hotels Joins the Direct Booking Pack with New Loyalty Rates*, July 20, 2016, on Skift.com, <https://skift.com/2016/07/20/choice-hotels-joins-the-direct-booking-pack-with-new-loyalty-rates/>, accessed February 22, 2017. See, also, Carly Okyle, "Marriott Offers Lowest Rates to Loyalty Program Members," March 21, 2016, <http://www.entrepreneur.com/article/272812>, accessed March 7, 2017 ("We're rewarding our loyal members by providing a rate exclusively designed to show them how valuable they are to us," said Karin Timpone, global marketing officer of Marriott International, in a statement. "We also want to help dispel the myth that other travel websites offer better rates for our hotels. The simple fact is that you will find the lowest rates across our portfolio when you join Marriott Rewards and book direct.").

⁶ "The dimming problem flickered to life this spring, after hotels won a series of court victories in Europe that effectively allowed them to offer lower rates on their own websites... (t)he practice quickly spread to affect properties in the United States...Expedia acknowledged it is lowering the rankings of some hotels, but said it was for the benefit of the customer." See Christopher Elliott, "How Online Travel Agencies Manipulate Your Search Results," *Huffington Post*, July 31, 2016, http://www.huffingtonpost.com/entry/how-online-travel-agencies-manipulate-your-search-results_us_579e0279e4b00e7e269fa568, accessed February 22, 2017. For example, If a customer did a search on February 22, 2017 looking for the prices charged by Marriott hotels for rooms in Marriott-branded hotels from March 8–10, the customer could scroll through the first four screens and still not find a Marriott-branded hotel. Marriott is one of the hotel groups offering loyalty discounts to its Rewards members.

on their brand building-discounting. This would benefit the OTAs, but in the short-run it could hurt consumers who are willing to be brand loyal for small price differences, though the impact on the competitiveness of the market is uncertain, absent additional economic evidence.

Choice, commodities, consumers

Is there a solution to this that serves the interests of the OTAs and the hotel groups (without injuring consumers or reducing competition)? OTAs have a vested interest in driving consumers to their sites and persuading them to purchase on their sites. The OTAs have *no* interest in promoting any one brand or, for that matter, promoting—or discouraging—price competition across hotels (or brands). OTAs appear to be content to let the hotel companies adjust prices as the hotels deem necessary, so long as the OTAs are able to remain viable competitors. Regardless of the extent or vigor of price competition that exists, the OTAs are interested in making sure that competition plays out on equal terms with every other booking site. The OTAs are brand-agnostic, except to the extent that their commission agreements with the different brands create incentives at the margin to prefer one hotel (group) over another. Put differently, OTAs do not care where you book, as long as you book with them.

There is an imperfect alignment of incentives between the OTAs and the hotel groups. For the OTAs, rooms are fungible. They want to offer rooms across price points, but, rooms are mere commodities to the OTAs. Hotel groups/brands need and want consumers to see differences among their hotel choices. They need to be differentiated, and their success is at risk from the OTAs.

Conclusion

Over the long-term, if the hotel brands are able to draw (potential) brand loyal customers away from the OTAs with small discounts, it opens up to the possibility that the hotel brands, especially a powerful brand like Marriott (including the Starwood properties), could choose to totally discard the parity agreements. It is not difficult to imagine a regime in which a hotel company such as Marriott offers all consumers discounts of some form when booking directly with Marriott, such discounts not being available on the OTA sites. How the OTAs will respond is difficult to predict, but it is clear that if a Marriott (or other large hotel

group) succeeds in weakening (or even eliminating) the MFN clauses in its agreement, it will be difficult for the OTAs to sustain those requirements in other agreements. That could lead to more (and varied) discounting.

Some might argue that the OTAs have led to lower prices. By reducing consumer search costs, the OTAs have made it easier for consumers to identify price differences and to make rational price comparisons. To whatever extent that is true, it does appear that the MFN clauses in the OTA arrangements may have discouraged at least some discounting. The competitive battle in the industry is being fought on several fields. The outcome of the fight between the OTAs and the hotel groups will go a long way towards determining how hotel interbrand competition, especially price competition, looks in the future.

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About the Author



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