

Digital Comparison Tools Market Study

RESPONSE FROM A LARGE HOTEL CHAIN

Non-confidential version

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If you are representing an organisation:

(a) What is the organization's name?*	[A large hotel chain A]
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(b) Please could you briefly explain the role of your organisation, including the sectors in which it operates or has most interest?*

Questions

[Hotel] welcomes the opportunity to comment on the CMA's Update Paper, which it considers draws together many useful insights and ideas. [Hotel] does not have views on all of the questions put forward there, but responds to specific questions below insofar as it believes it can offer meaningful insights from its operations in the hotel sector.

Section 1 (Consumers)

As a preliminary comment, [Hotel] considers that the CMA might usefully draw a distinction, not only amongst the consumer groups identified in its study, but also amongst different types of DCTs.

[Hotel] believes that the kinds of DCTs and competitive structure/dynamics that the CMA has analysed in its case studies bear very little relation to the kind of DCTs that operate in the hotel sector – namely, online travel agents (OTAs) and metasearch engines (MSEs). Accordingly, many of the insights arising from the CMA's current market study, if applied to the hotel sector, could lead to harmful and unintended regulatory outcomes.

The CMA's market study to date focuses largely on products/services (broadband, credit cards, energy, home and motor insurance, and legal services) that are relatively complex, that consumers have difficulty evaluating, and for which consumers are disinclined to shop extensively. Further, these are industries in which consumers may be reluctant to switch suppliers, either because they don't know that switching is possible or because they believe that switching will entail significant costs. Nonetheless, these also are industries in which consumers can make significant gains by switching suppliers, and in which consumer use of DCTs is likely to be particularly beneficial.

The hotel industry is entirely different. Hotel accommodations are easy for consumers to evaluate; rates are not complex (i.e. are typically set and advertised on a per-day basis), and add-on amenities (e.g. breakfast, Wifi, parking) can readily be identified and compared. Consumers can readily switch hotels at little or no cost (i.e. bookings are always for limited stays, with no obligation to return). Leisure travellers in particular (i.e. those travellers who are most likely to use DCTs) typically consider a range of hotels before booking their travel. While DCTs can reduce transaction costs for travellers who are unfamiliar with the

accommodations on offer in a particular location, other resources – including not only hotels’ own websites but also general travel websites, online guides for travel destinations, guidebooks, and brick-and-mortar travel agents – readily do likewise.¹ Indeed, none of the barriers to consumer engagement that the CMA has identified in its Update Paper apply to any appreciable extent in the hotel sector.² Accordingly, the benefits afforded by DCTs in the hotel sector are significantly more limited than the benefits afforded by DCTs operating in the sectors that the CMA has selected as its case studies.³

Further, it appears that DCTs occupy a very different position in the hotel sector than they do in the CMA’s case studies. The CMA has noted that many suppliers, in various sectors, reported that their cost per acquisition on DCTs is “considerably lower” than their cost of direct acquisition.⁴ Exactly the opposite is true in the hotel sector, where OTAs are the hotels’ higher-cost channel.⁵

In sum, the benefits afforded by DCTs in the hotel sector are lower, and the relative costs that their usage entails are higher, than appears to be true in many (if not all) of the CMA’s case studies. These critical differences should be borne front of mind in weighing the costs and benefits of various regulatory interventions.

¹ [§<]]

² [§<]]

³ Aside from the industries noted above, [Hotel] recognises that the CMA also is studying the sale of airline tickets, which is more analogous to the supply of hotel accommodations. However, even here, there are significant differences. As the CMA has observed (Update Paper, sections 4.11 (Table 4.2) and 6.10-6.12), consumers must make relatively complex comparisons when choosing flights. These include assessment not only of add-on pricing and amenities but also, e.g. of different routes (e.g. direct or multi-city flights) that may yield different prices for the same trip, interactive pricing of different parts of a single journey (e.g. the fact that changing the date, time, or class of service for one flight may affect the tariffs charged for other flights on the same itinerary), change/cancellation privileges and charges, and the like. The sale of hotel accommodations is much simpler (e.g. rates are set individually for each day of a stay and are easily assessed by the consumer, and changes/ cancellations typically can be made up to the date of arrival unless the consumer chooses a special, prepaid rate). Accordingly, even comparison shopping for flights is a significantly more complicated endeavour than shopping for hotel accommodations.

⁴ Update Paper, section 4.3 (Table 4.1).

⁵ As a rough indication of the magnitude of difference, it might be noted that the Bundeskartellamt conducted an extensive investigation in which it found, on the basis of submissions by various hotel operators and Booking.com’s economist, that hotel operators are likely to incur average costs on the order of 5-7% when handling bookings through their direct online channels. BKA Decision B 9-121/13 – *Booking.com B.V.* (23 December 2015), para. 21. The costs imposed by the leading OTAs (which typically amount to as much as 15-30% of revenues booked even before added charges for preferred placement and the like are assessed) obviously far exceed this.

Responses to more specific questions, insofar as [Hotel] believes its experience in the hotel sector may meaningfully inform the CMA’s study, are noted below.

3. How has the growing use of DCTs affected suppliers’ offers to consumers who do not use DCTs in our case study sectors and more broadly? What impact have DCTs had on suppliers’ ability to discriminate between active and inactive consumers?

The hotel industry is very fragmented, with large numbers of properties in virtually all local markets.⁶ Moreover, consumers have always had many ways of finding and comparing hotel offers, through brick-and-mortar travel agents, guidebooks and, more recently, travel-related websites. Accordingly, hotel rates long have been set in intensely competitive markets, and the growth of OTAs has not materially changed that.⁷

To the extent that consumers who do not use DCTs may be affected by the growing use of DCTs over time, [Hotel] considers that this is likely to be through price increases, as [✂]. The leading OTAs charge commissions that typically amount to as much as 15-30% of revenues booked⁸ (and some industry observers suggest that those rates may climb to as high as 50%⁹). In the absence of “narrow” MFNs, hotels might be expected to limit recovery of some or all of the costs of DCT usage to those customers who actually use these websites. However, “narrow” MFNs ensure that these costs are spread across all customers (including the many customers who never use DCTs). Accordingly, they may eventually lead to higher room rates for all hotel guests, as hotels must recover these costs (or reduce their own investments in the business). This is discussed further below, in response to Question 16.

[✂]

Section 2 (Inputs to DCTs)

⁶ This is demonstrated, for example, in the fact that the merger last year of Marriott and Starwood to create the world’s largest hotel operator was cleared unconditionally by regulators worldwide. See, e.g. Case M.7902 – *Marriott/Starwood*, para. 204 (noting that the five largest hotel companies in the EEA collectively account for only about 15% of total rooms, and that the largest operator (Accor) has no more than 10%).

⁷ More specifically, whilst the growth of the OTA channel doubtless has enabled many independent hotels to reach a broader group of customers than was formerly the case, [Hotel] believes that the hotel industry was already so fragmented and competitive, prior to the emergence of OTAs, that development of that channel has not generated appreciably greater pressure on hotel rates.

⁸ The ECN’s recent monitoring exercise found that “the basic commission rates of the three major OTAs range from ten percent to above twenty percent” (Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities in 2016, page 18). However, this does not indicate what is normal/typical (it is simply a range, with an unidentified upper limit) and does not include added charges (for, e.g. preferred placement) that substantially boost the cost of OTA listings.

⁹ [✂]

7. Have we captured the range of issues that might prevent DCTs from operating effectively?

[Hotel] considers that the CMA has identified some important inputs that DCTs require for effective operation, but that it has not sufficiently addressed DCTs' most essential input: that is, the substantial numbers of users that an online intermediary must be able to offer on each side of its platform in order to be viable.¹⁰ Smaller DCTs are confronted with the basic problem that you can't get eggs without chickens, and you can't have chickens without eggs: if a DCT lists too few suppliers, consumers will not consult its site, and if the DCT does not attract a sufficient number of consumers, suppliers will not assume the costs of being listed.

The CMA has identified in its Update Paper the basic factors that create this "chicken-and-egg" problem. On one hand, it has observed that "DCTs compete for consumers with one another" and that barriers to entry/expansion include "[h]aving a sufficiently comprehensive panel of suppliers to be attractive to consumers"¹¹ In this regard, the CMA has found that 61% of consumers surveyed expect hotel DCTs to cover "all" or "most" of the accommodations on offer.¹² If this 61% of consumers were to defect from a hotel DCT that did not offer such coverage, the remaining consumer base might well be so small that even more suppliers decided not to list their inventories on that site, setting off the "death spiral" that can cause a multi-sided platform to fail.¹³

The CMA likewise has recognised that suppliers incur systems integration and other transaction costs in dealing with DCTs, and that they may forego listing with a DCT that does not offer sufficient consumer prospects.¹⁴ This is clearly true. For example, [Hotel] operates a centralized reservations system (CRS) in which the room availabilities and rates at all of its hotels are automatically updated on a real-time basis, integrated/displayed as single-image inventory, and enable OTAs to handle bookings through an electronic connection with the [hotel system]. However, establishing connectivity with [Hotel's] systems requires integration of each DCT's technology/systems capability and testing of the reliability of those

¹⁰ As noted in an academic study of multi-sided platforms, "the fundamental product they are selling is providing one group of customers convenient access to one or more other groups of customers. There is no product for one group if the others don't show up." Evans & Schmalensee, *Matchmakers*, page 71.

¹¹ Update Paper, section 7.8 and Appendix 5, section 2(a)).

¹² *Id.*, section 5.49 (Figure 5.13).

¹³ For a general discussion of multi-sided platforms, and the "death spiral" that results for platforms that do not have sufficient sets of users on each side, see David S. Evans & Richard Schmalensee, *Matchmakers: The New Economics of Multisided Platforms* (Harvard Business Review 2016).

¹⁴ Update Paper, section 7.6, note 153.

connections (e.g. through bookings at pilot hotels). The costs of such integration naturally limit the number of DCTs/OTAs with which [Hotel] lists its inventories.¹⁵

While the CMA has recognised these basic dynamics, what goes essentially unremarked in its paper, but [Hotel] considers to be vitally important in its industry, is that the leading DCTs in a sector may effectively marginalize their rivals by virtue of the fact that both consumers and suppliers tend to migrate to the most heavily used platforms (i.e. the platforms where the market is most “thick”). This enables the operators of the leading platforms to capture massive income streams, because the ongoing costs of operating an established platform are generally low (particularly in the hotel sector, where most of the website content is provided free of charge by platform users) and the leaders, given their extensive coverage, can impose high platform access/usage charges. The revenues so generated enable the leading operators to further entrench their position, through extensive advertising/promotional strategies that overwhelm competing voices (of rival DCTs and suppliers) in search engine optimisation (SEO), search diversion, and the like. As a result of this self-reinforcing cycle (where network effects facilitate an exclusionary level of promotions that lead to even greater use of the dominant platforms), the leading DCTs may capture substantial market power, enabling them to impose terms of service that may increase industry costs and ultimately harm consumers.

[Hotel] recognises that the problem noted above is not amenable to easy solutions. However, the company believes that, at a minimum, any sectoral rules, review of mergers and acquisitions, application of general antitrust concepts to company behaviour, and the like should be fully informed by the critical importance of such platform and network effects. Although there may be many DCTs in an industry (as there are in the travel sector, despite the fact that [X]), many of them lack the large and well-balanced sets of users that enable them to compete effectively outside a limited space ([X]). In such circumstances, without appropriate regulatory intervention, leading DCTs’ ability to use exclusionary marketing strategies, unduly restrictive or abusive terms of service, and various means of affiliating with (or acquiring) actual or potential rivals can frustrate the consumer benefits that DCTs might otherwise provide.

Section 3 (Competition)

10-11. What do DCTs do to grow their business in sectors where they appear to be relatively small compared to the leading DCT of the sector? What are the barriers, if any, for DCTs to enter or expand in sectors where they currently do not provide comparison services or where they are currently relatively small?

¹⁵ Indeed, the [X] connection alone is a custom solution that consumes a large proportion of the resources that [Hotel] has available to maintain its connectivity with all OTAs.

[Hotel] considers that increased DCT competition in the hotel sector is most likely to come (if at all) from smaller OTAs and MSEs. However, each of these groups faces very significant barriers to entry/expansion, as discussed below.

Smaller OTAs

Probably the largest hurdle to the growth of smaller OTAs [X]. These undertakings benefit from strong network effects, as described in response to Question 7, and their organic growth has been reinforced by a series of consolidating acquisitions of competing OTAs¹⁶ and operators in adjacent markets.¹⁷ [X] account for the great majority (almost 90%) of [Hotel's] OTA bookings in the UK, and [Hotel] believes that this is reflective of the general market position in Europe.

Given the leaders' outsized share and the related network effects, [Hotel] considers that smaller OTAs cannot realistically hope to compete head-to-head with them – indeed, the third-largest OTA in Europe (HRS)¹⁸ has effectively conceded this, refocusing its business to become a corporate booking tool rather than competing as an OTA outside its core geographic markets (Germany, Austria, and Switzerland). Similarly, other OTAs typically cater to specialised user groups (i.e. hotels and travellers in a particular country/region), trying to make up for their lack of scale with a more “local” flavour/focus.¹⁹

A further barrier facing smaller OTAs, as indicated in response to Question 7, is the fact that [X] spend a substantial part of their revenues on extensive marketing efforts that erect high reputational barriers and essentially drown out aspiring rivals (and, often, hotel operators).²⁰ Publicly available information indicates that [X],²¹ and in 2017 increased its first-quarter advertising spend [X].^{22 23} Smaller DCTs simply cannot afford to compete with that kind of advertising expenditure.

16 [X]

17 [X]

18 [Hotel] estimates that HRS accounts for approx. [1-5]% of total OTA bookings in Europe, and approx. [1-5]% of OTA bookings in the UK.

19 Leading researchers have noted that intermediaries' need for a critical mass of users on each side of their platform presents a “huge hurdle” for new/small operators, and “often requires focusing efforts narrowly” (Evans & Schmalensee, *Matchmakers*, page 81).

20 “High levels of advertising tend to increase the ‘sunk costs’ of entry . . . and thus increase the risk that entry will be unprofitable and unsuccessful, or not even attempted at all.” Bellamy & Child, *European Union Law of Competition* (Oxford Univ. 2013 (7th ed.)), section 10.039.

21 [X]

22 [X]

23 [X]

[X] make particularly heavy investments in SEO, where they buttress their advantage over smaller DCTs (and hotel operators) by bidding aggressively for top-line exposure in online search results. [X] Indeed, a more specific search for “London [brand] hotel” still yielded [X] (not [the Hotel’s brand website]) as the top-line result. Smaller OTAs (other than a few who might attempt geographically-targeted SEO) have little or no hope of appearing at all. Thus, advertising on the scale undertaken by the leading OTAs does not truly inform consumers, but effectively excludes rivals.

[Hotel] considers that a third barrier to potential entry/expansion by smaller OTAs may exist in the leading OTAs’ imposition of “narrow” MFNs.

As discussed further in response to Question 16, [Hotel] (and, [Hotel] believes, other hotel operators) have strong economic incentives to ensure that they make their lowest rates available in their own, direct channels (where costs of distribution are relatively low and they can try to build a connection between consumers and their [X] brands). Rates that are tied to the general public rates in a hotel’s direct channels therefore are highly likely to be the lowest general public rates on offer. However, without the “narrow” MFNs, hotels might decide to offer different rates through their direct channels than they offer through various intermediaries, more precisely allocating their costs of distribution to the bookings on which those costs are incurred. In such a case, smaller OTAs that were equally (or more) competitive than the leading DCTs might be able to enter/expand by negotiating with hotel operators for lower room rates (in exchange for lower rates of commission) that enable them to offer consumers better deals than the leading DCTs do.²⁴ Given the importance that hotel operators generally put on offering their lowest rates through their direct channels, the leading OTAs’ “narrow” MFNs effectively deprive smaller OTAs of the ability to differentiate themselves through such growth strategies.²⁵

MSEs

As the CMA is doubtless aware, although MSEs traditionally have provided only price comparison data on their websites, some have begun to offer instant booking functionality as well. Such initiatives arguably might turn these platforms into the same kind of “one-stop shops” as are operated by the OTAs, and a few MSEs operate at a scale that might effectively rival the network effects of [X].

²⁴ Alternatively, some hotel operators (or, indeed, all) might decide that the maintenance of system-wide rates most effectively addresses the available demand in different channels, and that channel-specific pricing would simply complicate their rate structures and confuse consumers. [Hotel] cannot comment meaningfully on the likelihood that hotel operators would choose one particular approach over another, as in-depth consideration of the question has long been foreclosed under the leading OTAs’ terms of service.

²⁵ It might be noted that, even if smaller OTAs were able to pursue such price-differentiating strategies, they might find hotels reluctant to engage them because of fears that the larger OTAs (who account for substantially greater volumes of business) could retaliate, e.g. by dimming or de-ranking their properties. Such practices are discussed further in response to Question 17.

Despite the foregoing, [Hotel] considers that such recent expansions are unlikely to go very far, for several reasons.

First, it appears likely that the leading MSEs will develop as allies of the OTAs, rather than as viable alternatives to them. [REDACTED]²⁶

Second, leading OTAs traditionally have imposed on hotel operators terms of service entailing the same kind of MFN obligations toward MSEs that have applied with respect to other OTAs. To the extent that such provisions might make new entry/expansion more difficult, these could readily become barriers to MSE entry/expansion as well.

16. In what sectors, if any, are (i) wide or narrow MFNs; (ii) non-branding or negative matching; or (iii) non-resolicitation agreements in place? What impacts do these have in these sectors?

(i) MFNs

As the CMA is aware, the leading OTAs impose “narrow” MFNs on hotel operators whose properties are listed on their sites. These MFNs, and related confidentiality provisions, prevent consumers from considering the (undisclosed) cost of the OTAs’ services, almost certainly leading to over-consumption of those services.²⁷ They also are likely to lead to an eventual inflation of consumer prices for hotel rooms because all consumers (including those making direct purchases) effectively share that cost.²⁸ The best information available to [Hotel] at present (from a preliminary study by [REDACTED] in 2016) indicates that working with OTAs cost hotels in Europe at least €[REDACTED] billion in 2015 – approximately [REDACTED]% of the hotels’ total revenues (from bookings through all channels). Given the very competitive structure and dynamics of the hotel industry, and the corresponding rates of return for hotel operators, these costs sooner or later must be recovered in rising hotel room rates (or lead to a reduction in hotel operators’ investments in the business).

As the CMA has noted, a DCT potentially makes a trade-off between higher commissions and lower consumer prices (which might make its platform more attractive), and its focus in doing so will depend on the extent to which consumers compare the DCT with other DCTs and other

²⁶ [REDACTED]

²⁷ As the CMA has found in its study, consumers rarely think about how DCTs make money, believe that DCT commissions must be much lower (in the range of 1-5%) than they actually are, and do not understand that these costs are being passed on to them in suppliers’ prices (Update Paper, sections 5.33-5.34).

²⁸ For a cogent discussion of the economic distortions that can arise when MFNs are imposed by intermediary platforms [REDACTED], see Benjamin Edelman & Julian Wright, *Price Coherence and Excessive Intermediation*, HARVARD BUS. SCHOOL QUARTERLY J. OF ECONOMICS (August 2015) (available online at <http://www.benedelman.org/publications/pricecoherence-2015-03-12.pdf>).

sales channels.²⁹ [Hotel] considers that, in the hotel sector, the leading OTAs are likely to focus on raising their rates of commission and imposing other charges (like payment for preferred placement in their search results) – not on enabling consumers to find lower prices – because their “narrow” MFNs insulate them from potential price competition in the direct channels where hotels have strong economic incentives to offer their lowest rates.

The CMA has noted that “While a single narrow MFN may replicate a wide MFN, the likelihood of harm increases with the number of narrow MFNs in a given sector”.³⁰ [Hotel] considers that this is likely true, with a slight modification – that the likelihood of harm increases with the share of sales that is subject to narrow MFNs (not the number of MFNs itself). Given the developing duopoly that now accounts for approx. [redacted]% of all OTA bookings in Europe, the leading OTAs’ imposition of “narrow” MFNs gives clear cause for concern.

A number of considerations are listed in the Update Paper that suggest when “narrow” MFNs might result in competitive harm.³¹ Significantly, all of them exist in the hotel sector. In particular:

- Hotel operators’ direct channels are likely to exert a significant competitive constraint on DCTs, to the extent that hotel operators choose to make lower rates available through the former. The CMA’s consumer survey has shown that over half (56%) of DCT users compare the rates available through DCTs with the rates available elsewhere³², and [Hotel] believes that most or all of these consumers refer to hotels’ direct channels. Strong indications of this exist in the fact that approx. [redacted]% of [Hotel’s] UK bookings are made through its direct channels.
- Hotels that are not subject to “narrow” MFNs exert no greater competitive constraint on other hotels than those that are subject to “narrow” MFNs. [Hotel] believes this to be true because [redacted].³³
- Smaller DCTs exert a weak competitive constraint, if any, on the leading DCTs ([redacted]). As discussed in response to Questions 10-11 above, hotel operators have strong economic incentives to ensure that their lowest rates are available in their direct channels, and are highly unlikely to offer smaller OTAs lower prices than they make available through those channels (and, given the “narrow” MFNs, through the two leading OTAs).

²⁹ Update Paper, section 7.11.

³⁰ *Id.*, section 7.54 note 191.

³¹ *Id.*, Appendix 5, sections 26-30.

³² *Id.*, section 5.24 (Figure 5.8).

³³ [redacted]

- Finally, hotels that wish to make their rooms as widely available to consumers as possible cannot effectively resist the “narrow” MFNs in the leading OTAs’ terms of service. Considerations that the CMA has identified as most probative in this regard³⁴ clearly support this, given the leading OTAs’ ability to impose charges that are relatively high (both in absolute terms, as discussed above, and relative to hotels’ own costs of direct distribution); extensive dimming, de-listing, and de-ranking of hotels that have begun to advertise lower rates for their [redacted] (discussed further in response to Question 17 below), and the existence of the MFNs themselves.

[Hotel] considers that the leading OTAs’ “narrow” MFNs do not provide any genuine benefit either in preserving the credibility of their business model or in preventing free-riding.

[redacted] hotel chains [redacted] have undertaken significant promotional campaigns for their loyalty programmes, [redacted]. Given such sustained efforts across the hotel industry, the leading OTAs have introduced their own loyalty programmes as a means of retaining customers.³⁵ This alone provides compelling evidence that maintenance of “narrow” MFNs is not essential to OTA credibility, and that the OTAs have a variety of means by which they can preserve and enhance their business model.

Nor is the prevention of “free-riding” a genuine concern. The ECN’s recent monitoring exercise in the OTA sector found “no evidence” that hotels free-ride on publicity afforded by the leading DCTs.³⁶ More importantly, free-riding presents a legitimate justification for potential competitive restraints only when there are real risks that, without such provisions, businesses will invest less than is economically desirable/efficient because the benefits of those investments (increased sales) might be mis-appropriated by others. This should be of little (if any) concern with respect to internet operations like the OTAs; any marginal costs such platforms incur for free-riding users are essentially zero, because website design and maintenance entail largely fixed costs and much of the information appearing on-site is actually provided by platform users (i.e. hotel operators in their property descriptions/ images, and consumers in their ratings/reviews) – not by the OTAs.³⁷ In such circumstances,

³⁴ Update Paper, section 7.38 (Figure 7.9) and Appendix 5, sections 26-27.

³⁵ While [Hotel] recognises that patterns of OTA engagement may be different in Europe than in the UK, it might be noted that recent market research with over 1000 US consumers shows that [35-40]% of those booking online believe they can get better deals on hotel websites than they do on OTA websites, and that [55-65]% believe they can get better deals if they compare the prices on hotel and OTA websites. [redacted]

³⁶ Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities in 2016, pages 19-20. Indeed, one wonders how such an argument can seriously be made, when the balance of investments clearly demonstrates that, if anything, OTAs free-ride on the substantial investments made by the hotel operators in building and running their properties.

³⁷ See, e.g. Gregory T. Gundlach, Joseph P. Cannon, & Kenneth C. Manning, *Free riding and resale price maintenance: Insights from marketing research and practice*, ANTITRUST BULLETIN (Summer 2010) 55:2 (available at <http://www.antitrustinstitute.org/sites/default/files/gundlach%20papers.pdf>).

the OTAs cannot be expected to make any appreciable investments that might be foregone without the “narrow” MFNs.³⁸

Crucially, as the CMA and other regulators appear to recognise, elimination of all MFNs in hotel DCTs’ terms of service would subject OTA charges to competitive pressure from the availability of lower rates elsewhere. In such a case, one might reasonably hypothesize that OTAs would be incentivised to reduce their commissions and other charges to a level that reflects the true (fully absorbed) costs of their service plus an appropriate return on investment.³⁹ [Hotel] is not in a position to estimate what DCT prices/subsidies would emerge, given the commercial judgment that the DCTs would exercise in developing their marketing strategies, setting their compensation schemes (by selecting amongst, e.g. access and usage fees, commissions on bookings, cost-per-click metering, and a range of other options) and adopting a corresponding price structure (i.e. determining how much of the cost of their services should be borne on each side of the platform). However, the resulting prices assumedly would reflect the true economic value of the services that OTAs perform for the hotels and consumers that use them.

Without such competitive pressure, under the “narrow” MFNs, OTA commissions assumedly will reflect whatever economic rents the leading OTAs believe they can extract given the network effects operating on their platforms. As noted above, the result (given the very fragmented and competitive nature of the hotel industry) must eventually be a reduction in consumer welfare, as hotel operators either raise room rates to recover their rising distribution costs, or reduce their investments in the business.

(ii) Non-brand bidding terms

[✂]

The leading OTAs, equipped with massive advertising funds (as described above) regularly outbid their suppliers in the use of hotel trademarks, appearing at the top of search engine results even when consumers have searched for hotels by name. Such search diversions represent nothing more than attempts to capture income from consumers who, in fact, already know that they want to book with a particular chain and are not looking for the type of comparison-shopping services that DCTs provide. However, consumers clicking on these OTA links often book accommodations without realising that they are not, in fact, dealing directly with the hotel. [✂]

Quite apart from the foregoing, it bears note that the OTAs who engage in unauthorised trademark use are in fact “free riding” on the investments that hotels have made in

³⁸ [✂]

³⁹ For a general discussion suggesting how such pricing might evolve, on both the subsidy and money sides of the platform, see Evans & Schmalensee, *Matchmakers*, at pages 91-100.

developing and promoting their brands. [✂], understanding that does provide an interesting context for the assessment of OTA conduct.

17. Are there any other agreements in place that may affect the effectiveness of DCTs and/or the effectiveness of competition between DCTs (and competition between DCTs and other sales channels)?

Aside from the “narrow” MFNs and related confidentiality provisions discussed above, [Hotel’s] contracts with leading OTAs contain several other provisions that have at least the potential to insulate those OTAs from effective competition.

Under their terms of service, the leading OTAs have essentially unfettered discretion to determine where a hotel appears in their rankings of consumer search results, and with how much of the detail that consumers may consider important in selecting accommodations. ([X])

The essentially unfettered discretion that OTAs exercise in this regard creates several problems.

First, hotels have strong incentives not to offer lower rates or other terms, in their direct channels or through other intermediaries, if doing so might jeopardize their ranking or display on either of the leading OTAs’ websites. [X]^{40 41}

[X]^{42 43}

In addition to the foregoing, the leading OTAs regularly insist on contract terms that enable them to enhance and exploit their market power. For example, [X] have asserted, in recent negotiations over renewal of their contracts with [Hotel], that the terms [Hotel] has agreed with [X] must apply to all [X] affiliates. Similarly, [X] requires that [Hotel] either make its inventory of bookable rooms available to all of its affiliates or turn off the [X] channel altogether. Such leveraging of the leading OTAs’ commercial clout, as a group, enables smaller affiliates to seek preferential terms that are unavailable to their similarly sized rivals. The result can only be a further biasing of the hotel DCT business in favour of a few companies that appear to be placing their own economic interests over the advancement of consumer welfare.

Section 4 (Regulation)

40 [X]

41 [X]

42 [X]

43 [X]

21. What are your views on the issues we list in Table 8.1 and at paragraphs 8.13 to 8.42 of Chapter 8 and how could they be addressed?

[Hotel] shares the concerns expressed by other stakeholders, that there is a lack of timely and effective enforcement of rules that should make hotel DCTs more fair and reliable sources of information.⁴⁴ The introduction of civil fining powers, for infringements of appropriate standards, would be a good step forward. Regulatory agencies also should move the enforcement of these standards higher in their priorities, and provide appropriate staff resources, for so that infringements are actually detected and remedied in a consistent and timely manner.

To cite one example of the need for such steps, requirements for transparency in the business models of price comparison sites, laid down in the Unfair Commercial Practices Directive, appear to be honoured more in the breach than in observance; hotel DCTs rarely (if ever) disclose to users the methodologies they employ in assembling search results, and the economic incentives that often bias what consumers expect to be reasonably comprehensive and objective listings.

[Hotel] also is concerned about a variety of misleading practices that appear to be all too common with leading hotel DCTs, including –

- Artificial rate comparisons: Systematic promotion of “discounts” and “deals” that are based, e.g. on spurious comparisons of [i] a hotel rate on the date being booked with [ii] the highest rate charged for that room in the preceding 30 days;
- Illusory comparisons/choice: Listing of rates from various websites that are all affiliated with each other, or under common ownership, as distinct entries in price comparisons; and
- Marketing hyperbole: Factually insupportable claims giving consumers a false impression that they are getting the “best deal” by using a particular site.

Rules preventing such practices are simply common sense, requiring little in the way of burdensome rulemaking but serving fundamental consumer interests. [Hotel] considers that there is nothing in travel DCTs’ operations that would make the application of such basic rules difficult, and much that would commend it. Indeed, the European Commission recently noted that “a growing number of problems with online travel services . . . are now the among the most frequent consumer complaints” according to the European Consumer Centres, and that a regulatory review found 235 of 352 websites (67%) to be non-compliant with existing requirements of accuracy and transparency.⁴⁵

⁴⁴ Update Paper, sections 8.14 (Table 8.1) and 8.31-8.32.

⁴⁵ EC Fact Sheet, *Questions & answers - Screening of comparison websites in the travel sector* (7 April 2017) ([http://europa.eu/rapid/press-release MEMO-17-845_en.htm](http://europa.eu/rapid/press-release_MEMO-17-845_en.htm)).

22. What is the balance between potential benefits and risks in introducing a cross-sector approach? What would be the most effective approach(es), and why?

While [Hotel] recognises that there may be various hurdles in implementing a number of the reforms suggested in the Update Paper, where industries already operate under complex regulatory regimes, the kind of cross-sector reforms noted in response to Question 21 (i.e. effective enforcement of basic standards for platform accuracy and fairness) should be very straightforward and entail few (if any) risks. Indeed, [Hotel] considers that effective enforcement of such regulation is essential if DCTs are to genuinely promote and serve the consumer welfare.