



FINAL REPORT

Study on Consumer Protection against Aviation Bankruptcy

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EXECUTIVE SUMMARY

This study was commissioned to consider the impact on EU consumers in the event of airline bankruptcies. We identify and evaluate the forms of relief that are or might be made available to assist them in distress. Our work updates and builds on an earlier study, the AIRREG study, completed for the Commission in 2005 by an interdisciplinary team led by the Transport Studies Unit of Oxford University.

INTRODUCTION

The European Commission has engaged the Project Team to provide a *high level analysis* of the causes and situations surrounding aviation bankruptcies in the EU since 2000 and to determine their impact on holders of pre-paid transportation by:

- describing how passengers who had commenced travel and were stranded were or were not repatriated and/or reimbursed;
- considering forms of relief provided to passengers who had pre-paid tickets but who had not yet commenced travel on airlines that later suspended operations because of insolvency;
- assessing the feasibility of both existing and possible alternative consumer protection mechanisms to provide consumers with necessary information and reasonable security or relief;
- evaluating concerns expressed by stakeholders interested in the regulation of consumer protection in order to provide the Commission with both information and perspectives to assess what further legislation if any may be needed or should be avoided.

A central question is whether consumers enjoy sufficient and reasonable protection under the rules and enforcement procedures of the current regulatory framework and/or through forms of insurance required or offered in the marketplace - especially with respect to individual travel (that is, when not covered under existing legal requirements for insuring package travellers). Finally, the application of actual or contemplated legislative requirements on foreign carriers selling air transport to travellers originating in the EU will be assessed from the standpoint of its impact on competitiveness and whether considerations of maintaining a level playing field have been adequately addressed.

Context for our analysis is provided both by:

1. the impact of strong competition under difficult conditions on Community airlines (which has led to a high rate of airline bankruptcies in the EU as well as worldwide); and
2. the rule-making reviews and analyses that have been taking place under Commission auspices incident to a systematic restructuring of the market access regulations as now comprehended under EC Regulation 1008/2008.

Our findings in the Final Report cover the following areas:

- *Air Transport Industry Outlook.* We examine the current situation in the air transport market in the context of general economic conditions which, in 2008, have continued to put strong pressure on airlines.

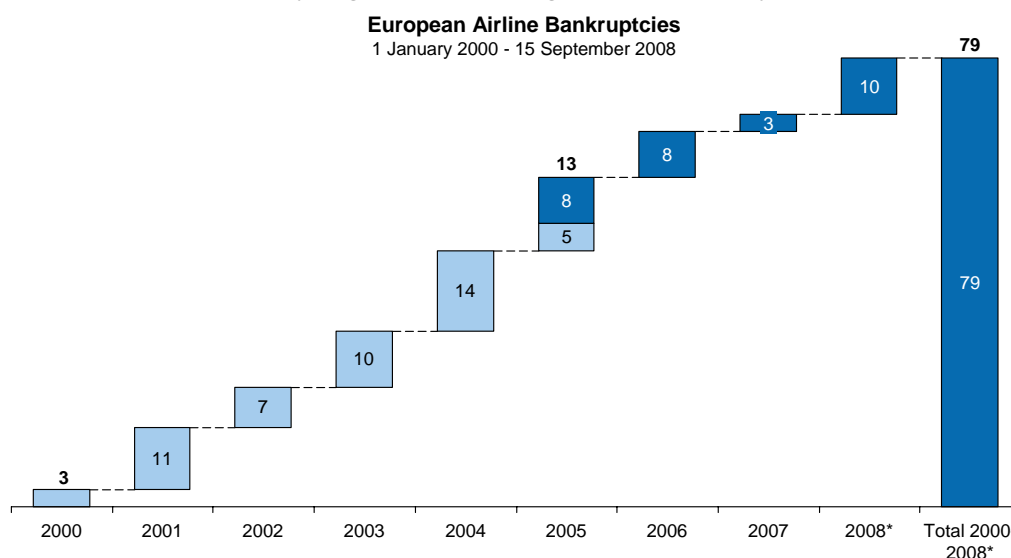
- *Existing Rules and Practices for Consumer Protection.* We examine the existing legislative rules, regulatory procedures and commercial law practices (e.g. contractual arrangements) that provide direct or indirect protection to consumers against the risks to them ensuing from airline bankruptcy.
- *Changes in the Travel Market.* The risks for consumers result not only from airline behaviour but also from their own behaviour. The travel market is experiencing significant restructuring of demand influenced by modern distribution methods (internet sales, for example) that has led to the phenomenon of so-called “self-packaging”, while the use of travel agents has decreased.
- *Case Studies.* Selected bankruptcy cases are examined in depth.
- *Policy and Regulatory Options.* Taking the most recent events as well as stakeholder views into account, we review the possible consumer protection mechanisms.

THE AIR TRANSPORT INDUSTRY: ECONOMICS & OUTLOOK

Liberalisation of the EU air transport sector has been a driver of profound changes in the market through the rise of low cost airlines and privatisation of the legacy carriers. Competition between legacy carriers and new entrant low cost carriers has sharply intensified and multiplied the number of firms exiting the market as well as the number of new entrants, alongside consolidation among existing carriers.

Air transport is a dynamic industry that is subject to periodic shocks. In recent years, the events on 11th September 2001, the SARS outbreak and a sharp increase in oil prices during the first half of 2008, have had a profound impact on profitability. The global economic downturn caused by the banking crisis is expected to have a significant impact on demand. Airline traffic growth is forecast to decrease. These tough economic conditions may force marginally profitable and unprofitable carriers into bankruptcy, with potentially severe effects on consumers.

Our survey shows a considerable number of bankruptcies during the last decade. The graph below gives an overview of bankruptcies over the last eight years. The number of bankruptcies in 2008 is already high despite being an incomplete year.



Source: AIRREG (2000-2005), Booz&Co analysis (2005-2008)
* 2008 incomplete year

Considering the period 2005-08, the majority of bankrupt carriers (41%) were relatively small regional scheduled carriers. The total number of bankruptcies since January 2000 is at least 79, and a higher rate than that reported in the 1990s.

The number of individual bankruptcies alone does not give a clear indication of the scale of impact. The severity of the situation varies depending on the size of the carrier, with larger carriers tending to have a bigger impact, and the type of destinations served, as alternative capacity is in general more difficult to source for long-haul destinations, and passengers stranded would have less options in terms of alternative forms of transport to return home.

EXISTING RULES AND PRACTICES FOR PROTECTING TRAVELLERS AGAINST FINANCIAL RISKS

This study considers the implications for consumer protection of airline bankruptcy specifically. Existing regulation does not make a distinction between transport providers in this regard. That is, under legislation such as the Package Travel Directive (PTD) as described below, financial protection applies equally to all modes and aspects of travel services provided against advance payment, so that travel by rail, bus or cruise ship would equally be included (hypothetically at least). However, it is on aviation that this report focuses, due to its ubiquity, particularly for international travel, and the comparatively high incidence of airline bankruptcy, both of which have implications with respect to consumer protection.

It is worth noting at the outset that not every airline bankruptcy leads to a suspension of services. From a consumer perspective, problems only arise when a flight is not operated as planned. In this study the scope of the term bankruptcy is defined as '*An economic condition when individuals, enterprises or public institutions incur debt they are unable to repay*'. Available legal remedies are grouped as either liquidation or reorganisation. In the former situation the enterprise ceases operations and existence, selling the remaining assets. In the latter situation the creditors become owner of a reorganised company accepting equity in exchange for cancelling debt.

There are a number of legal and contractual remedies available on national, European and international levels that may reduce the impact suspension of air services in case of bankruptcy. The basis of European consumer protection is set out in Article 153 of the EC Treaty, with a wide array of auxiliary legislation available.

Precautionary standards with respect to airline operator licensing, as well as truth-in-marketing requirements, are set out in Regulation 1008/2008, obliging licensing authorities to suspend airline operations in case of financial problems. Authorities can revoke, suspend or grant a temporary operating license in order to maintain proper safety standards.

The most far-reaching passenger protection is currently offered under the Package Travel Directive (Council Directive 90/314/EEC). It provides protection to passengers in case of insolvency of a tour operator and/or travel agents. Liability is placed on operators to perform the package booked by the customer. Member States have all implemented this on the national level: the level of protection is of a similar standard, although different compensation schemes are currently in existence. Airline tickets when sold independently of an agreed package are not within the scope of this Directive.

Rules on basic airline liability are defined in Regulation 2027/97 and were amended by Regulation 889/2002. They mainly cover liability of airlines in case of death or injury sustained in an accident. Requirements for airline operator insurance are based on Regulation 785/2004 which provide for second and third party liability for passengers, baggage, cargo and third parties on the ground. However, insolvency is not mentioned.

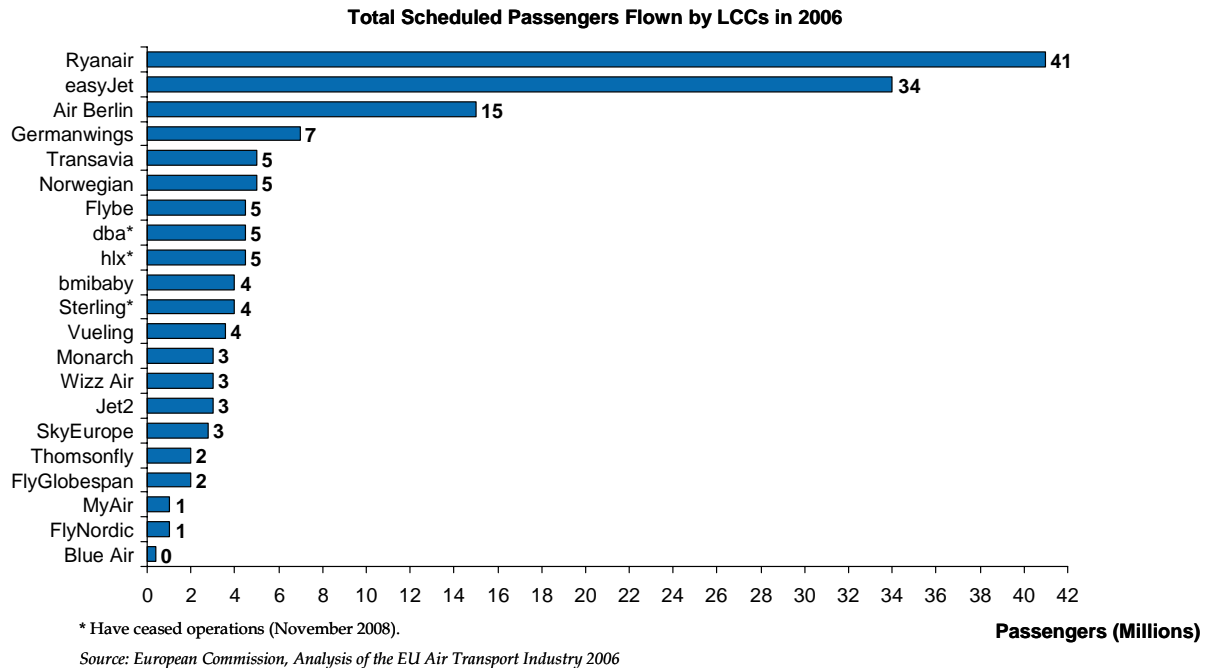
Denied boarding compensation rules (in defined cases) are embodied in Regulation 261/2004, although it excludes compensation in case of 'extra-ordinary circumstances'. This includes financial failures that lead to cessation of operations. Recourses might be available under general rules governing insolvency, based on Regulation 1346/2000. This regulation partly harmonises national provisions on insolvency. Other Community regulations on consumer or creditor protection that may have bearing include Directive 98/27, which affects procedures for making recovery claims, although implementation within Member States differs based on legal systems and national perceptions. However, in some Member States this Directive has been used to enact possibilities for so-called 'class-action' claims.

A range of financial protection practices, such as options for personal insurance and other forms of contractual protection, are also available. Among them are credit card guarantees against non delivery of goods and services and Scheduled Airline Failure Insurance (SAFI). However, the latter are subject to constraints and limitations.

CHANGES IN THE TRAVEL MARKET

The travel market has experienced profound changes across the European Union in recent years. One of the most important changes has been the rise of low-cost carriers (LCCs). The most notable impact on passengers has been the significant change in distribution channels through the rise of online bookings, bypassing the middle man and travel agents, a sales method pioneered by the LCCs which has since become common practice amongst airlines. These developments have led to changes in supply and demand.

In 2006, the total number of passengers of passenger carried by LCCs exceeded 150 million. The dominant carriers were Ryanair and easyJet, with Air Berlin holding the third place, as set out in the figure below:

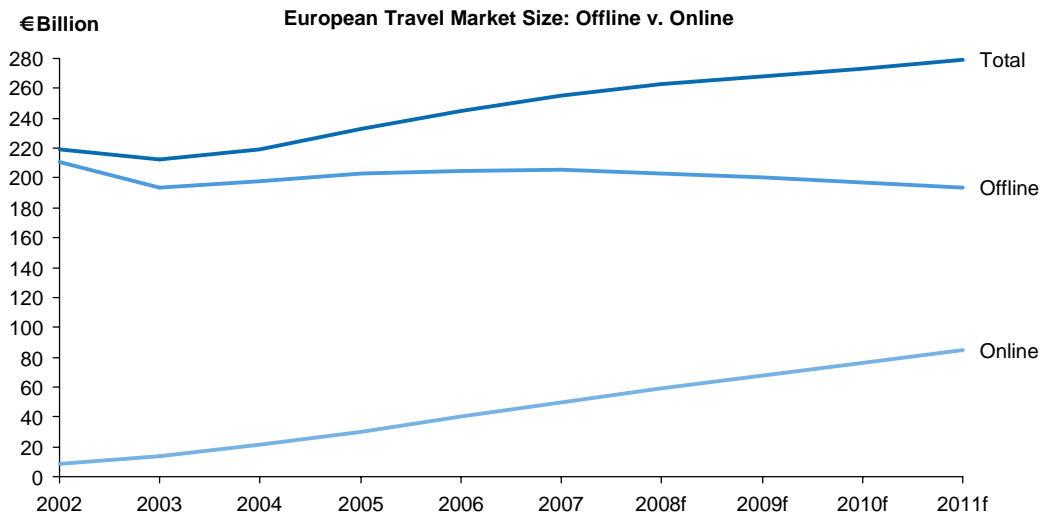


According to comparative data¹, in 2007, Ryanair and easyJet were respectively first and fourth largest airlines in the world by number of scheduled passengers carried in border-crossing traffic, with Lufthansa, Air France and British Airways respectively second, third and fifth.

LCCs have had a major effect on holiday markets, which were previously served by charter airlines and full-service airlines. In the case of the former, the flight was usually within the scope of the Package Travel Directive, leaving the passenger well protected in case of airline failure. The penetration of the holiday market by LCCs has resulted in falling demand for traditional package travel. In the UK, demand for short-haul charter traffic fell by 20% between 2003 and 2006. EU-wide, many charter airlines have either failed, demised or changed their business model. Focus for remaining charter carriers has shifted from short to long haul markets, in which the LCCs are not currently represented.

The purchasing methods of consumers have also experienced changes. Changes in distribution networks enabled by an increase in internet penetration have made direct online sales channels increasingly available to new consumers. Air tickets, like music and books, are very amenable to being sold over the internet since they do not require actual physical inspection. Our data show a strong correlation between rising internet penetration, subsequent e-commerce spending and a strong increase in online travel bookings. LCCs have pioneered online sales which offer customers the ability to 'self-package' holidays, creating tailor-made trips utilising the internet. Other carriers soon followed suit. The graph below illustrates the increase in online travel sales in Europe, with a forecast through to 2011.

¹ Provided by the International Air Transport Association (IATA)



Source: EyeforTravel Research, *European Online Travel Report 2008*

When it comes to consumer protection in case of airline bankruptcy, there is a clear distinction between the flight only services typically sold by scheduled airlines and package travel sold by travel agents/tour operators, whereby the latter is subject to protection requirements based on the implementation of the Package Travel Directive.

Flight-only sales are not covered by this directive. With the rise in online bookings, scheduled carriers have become increasingly dependent on advanced cash flow through early booking passengers, making them more vulnerable to shocks in demand. In case of failure of a scheduled carrier, passengers are unlikely to be able to purchase alternative products at similar costs and may find themselves stranded.

Across the entire air transport sector, there is a trend toward consumers choosing to book their travel independently of an agent or pre-packaged tour. In some instances, self-packaging options may lead customers to believe they have the same protection they would enjoy under the Package Travel Directive. In others, customers may believe, from past awareness of 'package' protection schemes, that they are protected, when in fact they are not. In addition, the distribution methods of the 'full service' sector have also become increasingly direct to the consumer rather than via travel agents.

Thus more people are travelling without protection against airline failure. This includes not only vacationers but also a growing number of people travelling in order to visit friends and relatives (VFR travel) who usually have no auxiliary accommodation booked. However, there are also a larger number of holiday-makers who more frequently book in such a way that they are not protected, and who, in general, are the most financially exposed. It is this section of the market which has been the most protected in the past which now is left increasingly vulnerable.

The protection mechanisms available to non-package passengers are credit card refunds, a Scheduled Airline Failure Insurance (SAFI) or by voluntary arrangements of other airlines offering help to travellers in need. In most circumstances, these provide partial protection only for any passengers who have 'self packaged' a holiday.

CASE STUDIES

A number of recent bankruptcies can put these findings of this report in perspective:

XL Airways

XL Airways was a charter carrier based in the United Kingdom which went into administration on 12th September 2008. Its bankruptcy left 80,000 to 85,000 passengers stranded, with another 240,000 booked for the coming months. The vast majority of XL's passengers were booked on a package deal, which meant they were covered under the UK's Air Travel Organisers' Licensing (ATOL) Scheme. Some 8,000 to 10,000 passengers were holders of flight-only tickets. The UK Civil Aviation Authority initiated an airlift under the ATOL Scheme to repatriate stranded package passengers; flight-only passengers were able to participate on payment of a fee. A proportion (but not all) chose to do so.

Although the XL bankruptcy primarily affected the package tour sector, a number of lessons were learnt that would apply equally in the event of launching a repatriation effort in respect of a bankruptcy of a carrier primarily selling flight-only transport:

- There will *always* be a delay between collapse and any repatriation mission. Even if the existing fleet & staff of an operator can be utilised, there is a period where every aircraft has to be checked, and agreements made with the Administrator.
- Difficulties may occur with the authorities of some other countries that may not allow repatriation flights to operate, citing bilateral restrictions.
- Problems are created by media frenzy, which can prompt large numbers of passengers showing up for repatriation days ahead of their scheduled return.
- Particularly in the case of flight-only passengers, there can be difficulties in contacting and communicating with affected passengers whose location and contact details may not be known.

Air Madrid

Air Madrid was Europe's only long haul low cost carrier. It suspended its flights in December 2006 after threats by the Spanish authorities to revoke its aircraft operator certificate (AOC) due to continuous maintenance issues and poor service. It left more than 100,000 people stranded, mainly in Spain, Latin America and Romania. The majority were immigrants heading home for the holidays. Spain's transport ministry was able to charter flights to help around 8,000 travellers get home and Air Comet took over some of Air Madrid's assets and routes, but thousands were still left stranded. It also promised to help passengers win compensation for cancelled flights.

After the cessation of the operations, the Spanish authorities and the Spanish Airport administration (AENA) helped frustrated and stranded passengers as a matter of courtesy, *ex gratia*. The Spanish public authorities do not have legal or other remedies at their disposal in order to solve the problems of the passengers.

Legally speaking, frustrated passengers of Air Madrid can:

- 1) Submit their claims before the court mandated with the insolvency proceedings;
- 2) Sue the travel agent if they contracted the air travel through a travel agent.

Option (1) was made available to all passengers. However, the scope of recovery was very limited, as there are many claims, including claims with priority rights made against Air Madrid.

Option (2) is only available to passengers who made their booking on an Air Madrid flight through a travel agent. The travel agent, that is, the seller in the contract in relation to the passenger, must answer that claim as apart to the contract. *Spanish travel agents have created a fund amounting to about €60,000, which should provide some coverage for claims falling under its terms of reference.*

In February 2007, Air Madrid proposed a Plan to the Court, subject to the latter's approval (see below). The Plan proposed giving passengers preferential treatment in comparison with other creditors; that is, passengers should receive the full amount of air fares paid for, whilst other creditors are paid with a reduction of fifty per cent in two instalments.

In May 2008 the bankruptcy administrators for their part submitted an inventory of Air Madrid's assets and their listing of qualified claims. These have not yet been approved by the Court, as some 200 challenges to these findings, including by Air Madrid, were then filed.

As at 9 December 2008, the liabilities and claims have not yet been definitively fixed. Once approved by the Court, the settlement will be binding for all the ordinary and subordinated credit. We understand that the outlook for significant recovery is not good.

EUJet

A similar situation occurred after the demise of Irish low cost carrier, EUJet. Passengers holding tickets could file a claim with the administrator. The bankruptcy left some 5,000 passengers stranded on several European destinations. The industry response in this case was good, with several other airlines offering return flights at low costs. EUJet apparently refunded the tickets booked in advance.

Sabena

The Sabena bankruptcy in November 2001 left surprisingly few people stranded, since many passengers were aware of the financial problems of the Belgian carrier, leading to considerably less bookings in the final stages of the carrier's history. All aircraft were repatriated. Sabena's subsidiary airline DAT quickly resumed part the former destinations under a bridge loan of the Belgian government and eventually evolved into Brussels Airlines. This was in contrast to the demise of Sabena's parent company, Swissair, which left numerous people stranded, although most of these passengers were repatriated on an *ad hoc* basis. The Sabena case might be exemplary in case of the (threat) of failure of other major carriers. Passengers are generally aware of the turmoil and refrain from booking.

Summary on Case Studies

Each of the case studies represents unique challenges but collectively they demonstrate that risks for consumers that used to be perceived as occurring mainly for advance purchasers of package travel now exist to a greatly increased degree for purchasers of scheduled services. However, the risks and consequences of a bankruptcy differ according to circumstances and operating model.

Scheduled service airlines no longer operate in protected markets, and government owners stand less and less frequently behind them. Competition is sharp; operating margins are

under intense pressure; and pricing strategies aimed at getting consumers to pay money long in advance to obtain the lowest possible fares has encouraged a bargain-hunting mentality as well as risk taking by airlines. The new entrant failure rate remains high, but bankruptcies can also claim legacy carriers who cannot cope with low cost competition.

CONSIDERATION OF POLICY OPTIONS

When it comes to contemplating regulatory action, it is important to consider the impact on all agents involved, including the unintended consequences of any intervention. As has been described by a number of stakeholders we have consulted, risks are particularly great when it comes to regulating the activity of potentially insolvent airlines. When regulatory action, media reports, reactions by other parts of the industry (including suppliers) suggest lack of confidence, consumers are likely to react in turn, making recovery and survival even more difficult.

Menu of Options

We have identified a range of actions or rules (many mentioned in the AIRREG Study) as possible measures to provide more protection and developed the following menu of solutions:

- 1) *Raised standards/pro-active monitoring of financial fitness* as well as possibly intensifying technical oversight of airlines on the edge;
- 2) *Strengthened information requirements.* Requiring marketing websites and other sales outlets to advise ticket purchasers of risks, insurance options, terms of credit card protection and/or alerting vacation planners to the protections they could have under the PTD if they book through an accountable organiser;
- 3) *Clarifying the role of sovereign responsibility.* It may be relevant to clarify the responsibilities of Member States to travellers on airlines operating under their Air Operator Certificates. One may, for example, postulate an obligation for Member States to provide or facilitate *ad hoc* protection under special circumstances to stranded travellers and also, through planning and coordination procedures, to create contingency plans and obtain commitments of assistance from industry;
- 4) *Airline self-insurance.* Mandating insurance of all airlines for all classes of travellers against bankruptcy risk. By amending Regulation 785/2004 requiring airlines to extend the same scope of coverage now required under the Package Directive to all purchasers of scheduled airline transport;
- 5) *Consumer self-insurance.* Mandating availability of some form of scheduled airline failure insurance and/or compensation by credit card companies to recover advance payments for services not rendered to be offered to travellers;
- 6) *Creating general reserve funds* on the basis of fixed levels of contribution per traveller (as opposed to risk-based premiums on insurance);
- 7) *Considering standards under the bankruptcy laws* such as steps to: a) ensure fair and efficient treatment of ticket holders as a creditor class in cases of liquidation; and b) encourage the use of reorganisation procedures under which companies with prospects for restructuring can maintain services.

Broadly speaking these measures can be thought of as applying as either:

- I. Precautionary measures designed to prevent the problem in the first place; and/or
- II. Relief measures designed to work *ex post facto*.

The first two measures are precautionary, designed respectively to avert bankruptcies in the first place and to mitigate consumer risk and exposure before the fact should they threaten to occur. The third measure, sovereign responsibility, also emphasises precautionary planning, but its ultimate purpose is to deal effectively with ex post facto consequences, notably the problem of repatriating stranded passengers.

The 4th and 5th measures, insurance of airlines or of consumers, offer financial protection of passengers which provides reimbursement to consumers after the event. However, such instruments also create important market pressures on airlines to remain solvent and maintain financial reserves before the fact. For example, insurance and credit card companies have a vital interest to monitor the financial performance of the services they would be voluntarily insuring and therefore can and do deploy contractual controls to preserve liquidity.

The establishment of a general reserve fund (6th measure) is fundamentally an instrument of ex post assistance.² Focus on ex post facto compensation or relief to creditors is also a basic function of the 7th measure, amendment of bankruptcy laws.

Evaluation Parameters

The study team has evaluated the options against a set of seven evaluation standards or parameters, namely:

- *Relevance.* Does the proposed solution address a clearly defined and agreed problem?
- *Acceptance.* Is there a consensus among the stakeholders, including airlines, travel agents, financial institutions, courts and bankruptcy administrators, aeronautical authorities as well as consumers, that the measure is practical, reasonable and justified?
- *Clarity & simplicity.* Is the solution clear in its content and scope? Will consumers as well as the travel industry understand its terms and the procedures it may introduce? Could it have indirect and negative effects – unintended consequences – that would undermine or even cancel-out achievement of objectives?
- *Legal soundness.* Are the terms of any proposed legislation entirely consistent with the treaties, EC Law and national laws (as harmonised through the EU) and do they comply with sound and established precedents?
- *Efficient/fair enforceability.* Does the reform pose enforcement problems? Can it be applied in a transparent, non-discriminatory, uniform and cost-effective way to all firms in the market including third country airlines marketing international air services to EU consumers?
- *Market impact.* What impact will the reform have on current marketing and sales practices? Can all or most companies adapt to its requirements easily and quickly; could it affect certain business models disproportionately? Will it increase direct or indirect costs significantly?
- *Cost-benefit proportionality.* Considering the full range of its possible impacts in the preceding six (or any other) areas of evaluation, does the reform seem likely to produce worthwhile benefits overall in light of the known or probable costs?

² *Theoretically, administrators of the fund might also monitor financial performance a priori, but they would lack the tools of insurance and credit card companies to encourage financial discipline.*

Note: While we believe that the above parameters should be taken into consideration, they should not be considered complete. The objective here is to suggest that a standard set of questions or tests should be applied when comparing the benefits and costs of various courses of action.

Individual Evaluations

The Study Team has made estimates, based on a composite of its individual views, of the strengths and weaknesses of the first six options.³ Each option was given scores in a range of +5 (most positive) to -5 (most negative) for the seven parameters. For the first six parameters, the graphic presentations below show an average of the individual views. In the case of the last parameter, "Cost Benefit Proportionality" (which constituted an overall judgement) we show the range of views. We should state at the outset that in some cases there was a considerable range of views within the Team. This outcome thus may reflect what the AIRREG Study also found – namely that: There is no general agreement on a single or best solution.

For this reason, it should be emphasised, the evaluations that follow are not recommendations but rather examples of how the measures can be evaluated individually as well as considered collectively. In addition, if several of these options were to be applied in concert, then the overall effect may be greater than the sum of the parts.

The results of our analysis are presented and discussed below:

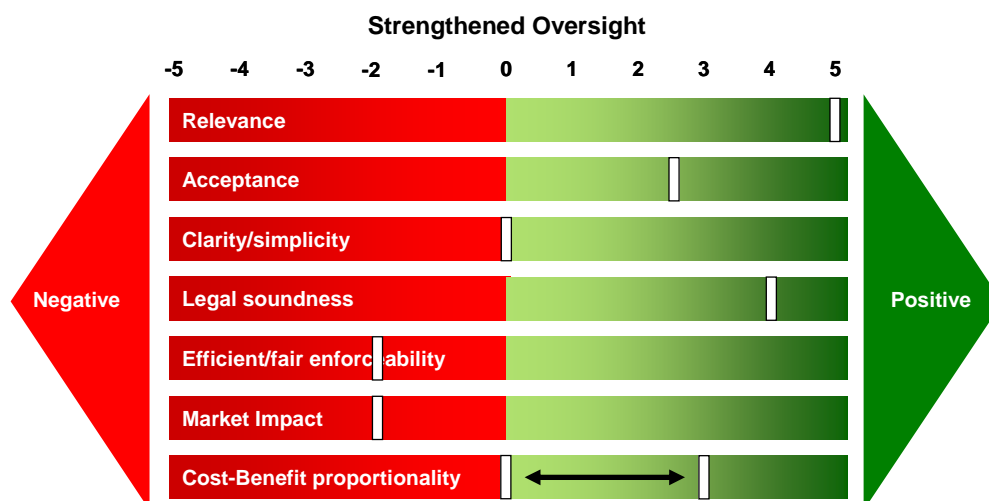
1. *Strengthened Oversight: Raised standards/ pro-active monitoring of financial fitness, as well as possibly intensifying technical oversight of airlines on the edge*

Content and Scope: Present Community regulations (Regulation 1008/2008) establish the principle that financial fitness is a condition of receiving an Air Operator Certificate (AOC) to operate and hold out flying services to the travelling public. The regulation also sets forth minimum standards of enterprise liquidity. One course of action might be to make such standards or at least their enforcement more rigorous.⁴ A judicious but clear step in this direction has been taken in Regulation 1008/2008, which encourage if not require national regulators to control the financial fitness of their AOC holders in a more active and systematic way than previously.

Following consideration of various advantages and disadvantages to this option, the study team summarises its evaluation of "Strengthened Oversight" pursuant to the seven parameters (scale +5 to - 5) as follows:

³ As will be explained below, in the case of the last option, reform of bankruptcy procedures, the ideas are indicative rather than firmly formulated. Further research would appear necessary before attempting a comparative evaluation.

⁴ We note that the AIRREG/Booz bankruptcy data show that a number of airlines who obtained AOC's were not capable of even starting operations. Whether this suggests current financial fitness standards are too weak or whether it rather implies they have not been adequately monitored and enforced is a question beyond the scope of this study.



Discussion. The new licensing and market access rules embodied in Regulation 1008/2008 establish a clear context and a mandate for the implementation of this measure. Stakeholders will not seriously object to, and for the most part will welcome, stronger financial standards applied uniformly to the industry.

The goal of the measure is clear, but oversight always demands judgement as well as expertise. Financial regulation is far from simple. Comparing treatments of individual cases might also produce variances across the Member States and indicate the need for monitoring at Community level as well.

Application and enforcement of this measure will add conditions to market entry and work to constrain it. Greater stability of performance will of course benefit consumers; however, fewer very low prices are likely to result. Costs of doing business will rise at the margin and for individual operators could be significant.

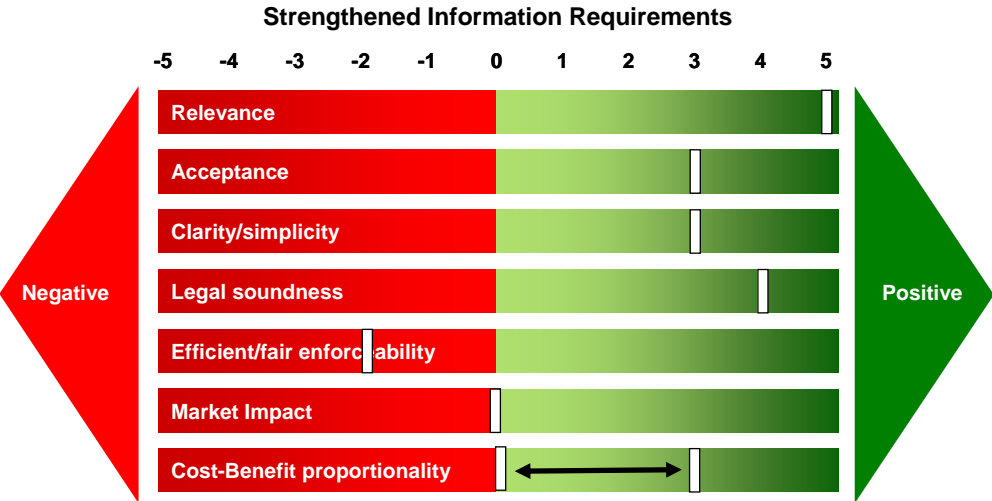
An overall estimate of cost/benefit from a Community perspective is extremely difficult. This measure depends significantly on the work of individual regulators in Member States in difficult individual cases.

2. *Strengthened Information Requirements*

Content and Scope. The Commission and Member States have become increasingly watchful with respect to the rapidly rising level of business being done on the internet which is heavily dependent on the presentation of information. Regulators would require marketing websites and other sales outlets to advise ticket purchasers of risks, insurance options, terms of credit card protection and/or alert vacation planners to the protections they could have under the PTD if they book through an accountable organiser.

In the specific case of airline transportation, standards for information display have been a concern of regulators for some years (for example with respect to information management rules on computer reservations systems). The high rate of airline bankruptcies as related to advance sales techniques described in this study make the issue of minimum standards with respect to the scope and content of consumer information highly relevant.

Following consideration of various advantages and disadvantages to this option, the study team summarises its evaluation of “Strengthened Information Standards” pursuant to the 7 parameters (scale +5 to - 5) as follows:



Discussion. Current problems relate directly to marketing trends and the increase of sales via the internet. Regulatory standards and ongoing oversight in this area are highly relevant. The new marketing rules (also embodied in Regulation 1008/2008) provide fresh context for air transport sales regulation as do regulations with respect to information display and truth-in-advertising more generally. Stakeholders should welcome steps that add to transparency, completeness and timeliness of information. However, an informed, prudent and coordinated approach to the formulation and implementation of requirements will also be critical to assure acceptance of industry as well as consumers.

Clarity and simplicity are fundamental objectives of the measure itself (as is the development of uniform standards to assist consumers across the Community). Thus a positive impact may be reasonably expected.

The ingenuity and dynamism of the market will, however, provide an ongoing challenge, and the implementation of standards must be adaptable to changing and perhaps complex situations. As a dynamic, rapidly evolving medium, the internet is very difficult to regulate in an efficient, fair and timely manner. Moreover, while regulation can ensure that the information is displayed, it may be more difficult to persuade time-conscious consumers to read it, particularly if it is not presented in an enticing fashion. Ongoing monitoring is indispensable and also a major challenge.

Overall we believe that a strengthening of information standards is likely to provide some benefits, but only addresses one side of the problem in a limited fashion.

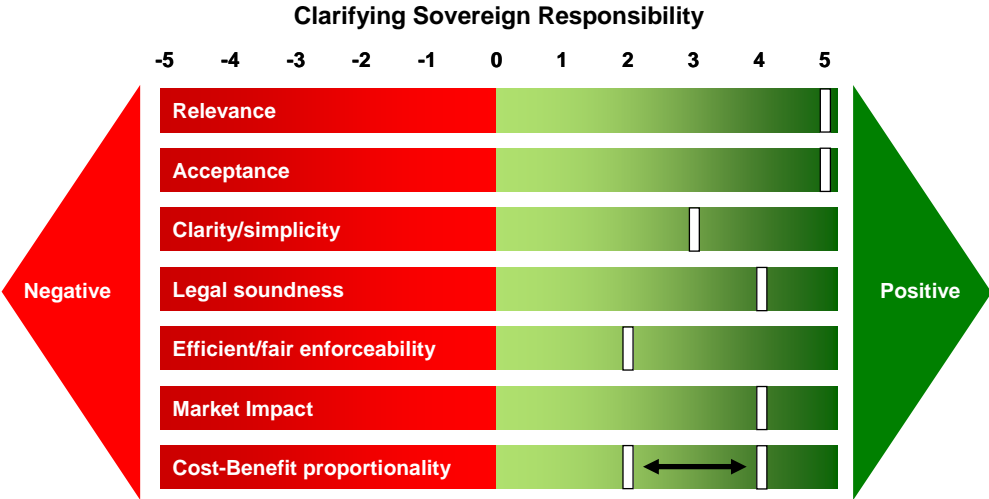
3. *Clarifying the Role of Sovereign Responsibility: It may be relevant to clarify the responsibilities of Member States to travellers on airlines operating under their aircraft operator certificates*

Content and Scope. Agreed contingency procedures are a familiar tool to deal with problems created by suspension of flights. Arguably they should be part of the planning of all Aeronautical Authorities. A common basis for such planning is the need to generate airlift capacity which will have to be provided from civil or military resources – preferably and

most probably from the former. Considerable precedents both within and outside Europe for such planning exist.

The key in such airlift planning is the willingness and perhaps even preference of the airline industry to use voluntary self help measures to solve *ad hoc* problems such as repatriation of stranded passengers rather than creating formal instruments involving continuing and possibly universal obligations. Such “bottom-up” willingness to assist ticket holders on bankrupt airlines, however, requires government approval and coordination, and especially in a major case during the peak travel season, the government may need to organise supplementary airlift. It would be difficult for a government to just ignore 10,000 citizens stranded far away, on the basis that those consumers should have been aware of the risk and made private contingency plans.

Following consideration of various advantages and disadvantages to this option, the study team summarises its evaluation of “Contingency Planning” pursuant to the seven parameters (scale +5 to - 5) as follows:



Discussion. The Team believes that appropriate planning and the identification of needed resources to act in a timely manner to ensure effective repatriation of larger numbers of stranded travellers is indispensable. The benefits of such planning far outweigh their costs, since insecurity and even short term chaos can result if the event strikes and the system is unprepared.

Not only the stakeholders but the general public accepts the need of public authority to act professionally and decisively in the face of emergency situations. Both airlines and airports will wish to cooperate in a solution of the problem. There is considerable tradition in the development and execution of airlift operations, though in the individual case of course political issues can arise.

From a social and economic perspective, the ability and willingness of the state to act in the case of a public emergency will also provide a measure of underlying assurance to markets, giving confidence to buyers and sellers.

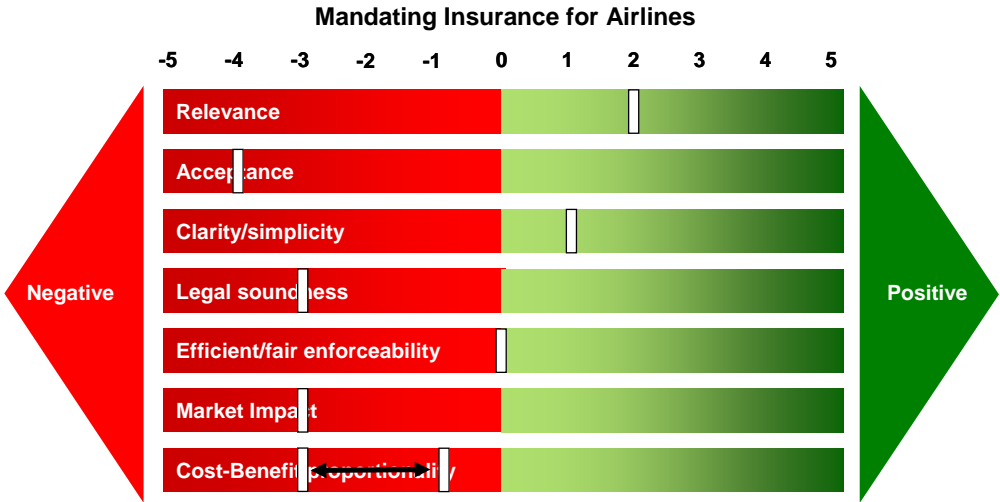
What contingency planning does not do is create a relevant tool for averting the problem in the first place. At the level of the market as a whole it can inadvertently play the role of a

safety valve encouraging airlines and consumers in the belief that help will come. Thus it may facilitate continuation of current marketing practices, whether for good or for ill.

4. *Mandatory airline insurance. Mandating insurance by airlines for all classes of travellers against bankruptcy risk*

Content and Scope. This measure requires the airline itself to carry insurance to protect its passengers so that they would be provided alternate transportation and/or compensation for out of pocket expenses if the airline is unable to operate a scheduled service because of bankruptcy or for other reasons such as cancellation of its operating authority. Such a provision could be accomplished at Community level by amending the airline insurance Regulation 785/2004.

Following consideration of various advantages and disadvantages to this option, the study team summarises its own evaluation of “Airline Self-Insurance Requirements” pursuant to the seven parameters (scale +5 to – 5) as follows:



Discussion. This measure would eliminate lack of coverage against the risk of airline bankruptcy. However, it would impose a requirement that is arguably not relevant for many Community airlines carrying the bulk of EU traffic.

The recent public comment review conducted by the Commission with respect to airline insurance requirements (Regulation 785/2004) showed stakeholder opposition, particularly from airlines, for adding such a general requirement, with the exception of tour operators and travel agents who already face this obligation and feel discriminated against as a result.

As a single explicit requirement this measure is relatively simple to formulate. Execution in the marketplace could be another matter. Insurance companies set and adjust premiums based on perception of risk and a problem could arise if individual airlines are deemed uninsurable.

Legal and policy issues would be significant. Airline insurance requirements in relation to airline liability for damage caused to passengers and shippers of cargo during air carriage have been extensively addressed at the international and multilateral level (e.g. the Montreal Convention of 1999). A unilateral decision to impose new forms of insurance requirements

on all carriers operating to the EU could result in international protests. A decision to impose the requirement only on Community carriers could lead to distortion of competition.

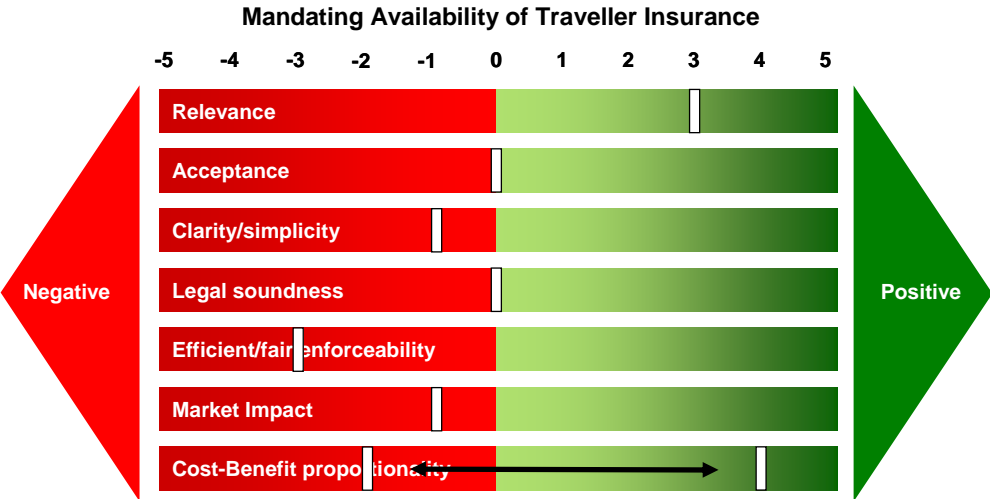
All airlines would have to pay a new set of costs. While the insurance premiums could be negligible or low, they will also vary in accordance with risk perception. Overall, we believe there is a strong probability that the economic costs and the political complications would outweigh the potential benefits.

5. *Optional Consumer Insurance: Mandating availability of some form of scheduled airline failure insurance and/or compensation by credit card companies to recover advance payments for services not rendered to be offered to travellers*

Content and Scope. The concept of individual traveller insurance is considered here broadly; that is, we focus on the common effects as well as the following general characteristics of the protective structure:

- *Ticket holder responsibility.* While the airline’s obligation is to provide options and all relevant information about them, the ticket holder decides which if any options he or she will choose and pay for.
- *Acceptance of dynamic commercial risk factors.* Unlike trust fund-type arrangements (below) this requirement accepts (perhaps even welcomes) the fact that commercial risk factors can play a dynamic role; that is, that premiums will be higher for airlines whose financial position is shaky and lower for those with strong cash positions. Credit card companies, who insure consumers against non-delivery of goods and services purchased, may require escrowing of funds being billed until flights have actually taken place. Insurance companies may also stop offering coverage if they consider the level of risk of a weakening company unacceptable.
- *Regulatory focus on information requirements (with certain forceful elements).* In this measure, the central task of both rule making and oversight is to define, publish, monitor and enforce information requirements and perhaps certain procedural aspects of the booking process (recording awareness and acceptance/decline of protection options).

Following consideration of various advantages and disadvantages to this option, the study team summarises its own evaluation of “Providing self-insurance choice options to ticket holders” pursuant to the seven parameters (scale +5 to - 5) as follows:



Discussion. This measure creates a procedure that could go far to reduce consumer risks while at the same time placing the costs of coverage on the consumer who would benefit from it. Acceptance by stakeholders, however, appears to be mixed. Airlines, while they might prefer this measure to the ones that precede and follow it, will resist new regulation that applies mandates not only to their marketing and sales procedures but which also sets forth new conditions for their financial relationships. Tour operators, for their part would prefer a stronger regulation to govern insurance of non-packaged travel services. Consumer groups may also find this proposal as not going far enough in the right direction.

While its core idea is relatively simple, this measure creates room for dispute over what constitutes protection. Would the guaranteed availability of credit card refund guarantees suffice, at least with respect to non-commenced travel? What exact scope should insurance policies provide; that is, would they also need to offer compensation for losses such as pre-paid hotel services that could not be used after flights fell through?

This measure could require comprehensive monitoring of websites and other selling procedures (to ensure that each airline or travel agency provided acceptable access to voluntary coverage options) as well as periodic examination of the scope and terms of the insurance coverage itself to ensure that standards (as might be formulated in the regulation) were being met.

While the direct costs for coverage would shift to consumers, airline revenues and costs would be affected indirectly as they would be made subject to stronger monitoring procedures by insurance and credit card companies if the latter find their financial risk exposure increasing.

The wide range in cost benefit analysis reflects, on the one hand, a scepticism about the ability of this measure to produce significant benefits (while entailing definite costs); on the other hand, there is an appreciation of the fact that it could provide a cost-effective tool to direct consumer attention to relevant products – thus allowing them to protect themselves or to choose to assume known risks.

6. *Creating General Reserve Funds*

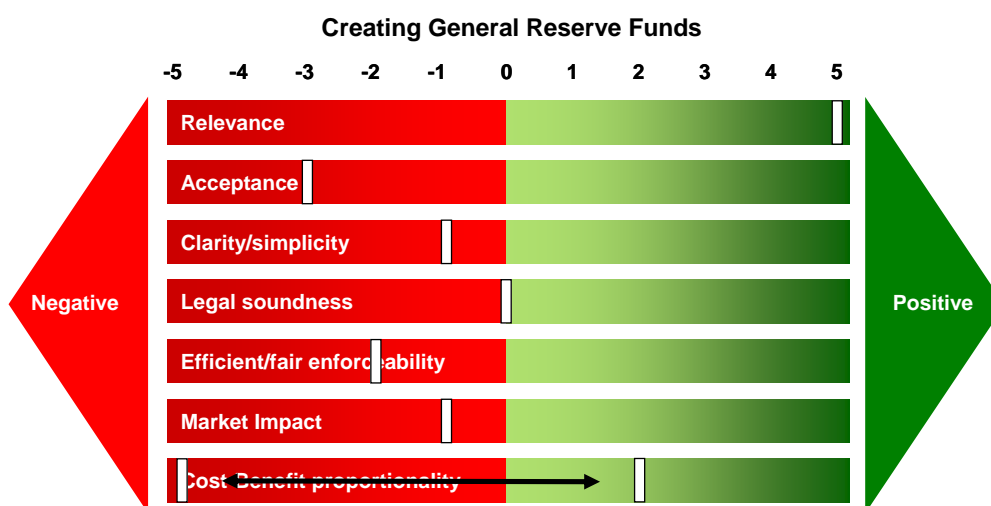
Content and Scope. The concept of a general public insurance fund established by a standard charging formula such as a flat fee per ticket, which would cover all scheduled services flights, has been proposed by various industry stakeholders and government bodies. Such a system would, by regulation, close the coverage gap between individual travel purchase and package sales covered by bonding arrangements as required by the PTD.

Such funds might most logically be established at national level with oversight by aeronautical authorities who issue AOCs. On the other hand, Community airlines increasingly operate in multiple markets and this would raise issues as to whether fees should not go to funds maintained in the country of travel origin? In any event, given the level of air travel in the EU, even a fee of 1 Euro (or 1 GBP) per ticket would build up considerable funds rapidly.

While simple and clear in basic outline and seemingly equitable in structure, a general contingency fund will throw up complex issues such as:

- Whether a single flat fee is really fair and whether claims for compensation are then limited to set amounts, or whether there should not be some variability in premiums (e.g. percentage relationship to the prices paid) or based on the amount of coverage being needed or desired in the individual case?
- Whether the scope of coverage of such a general fund should be limited to cases of service stoppage for financial reasons or whether it should not broadly cover dealing with emergency situations?
- What to do with funds if (as would be hoped) few or no bankruptcies occur and fund balances swell? Should ongoing contributions then be suspended or past contributions paid back, and if so to whom, the airlines or the travellers?
- Should the funds simply be administered by financial institutions or should they acquire an own institutional form and perhaps competences to go with that?
- Would the goal be to displace the role of private insurers entirely?

Following consideration of various advantages and disadvantages to this option, the study team summarises its own evaluation of “Requiring General Contingency Funds or Trust Fund Arrangements” pursuant to the seven parameters (scale +5 to - 5) as follows:



Discussion. This measure focuses in a very direct way on the problem. It provides universal coverage to the consumer at an affordable price that is likely to be much lower than private insurance. However, airlines strongly object to this measure. Other groups may also have difficulties with various aspects of this measure.

While its core idea is simple, this measure will create new administrative and institutional machinery whose remit over time is not clear. The test of such a fund is not just how it collects money but how it manages and disburses it. Will it need to establish a permanent staff for claims administration that can act rapidly in emergencies that are only very occasional events for most Member States?

This measure would extend some of the protections of the PTD to individual travellers in exchange for paying a small mandatory fee. Such regulation, however, would work to displace private sector enterprises. If mandated by Community Directive the measure would have to address the issue of scope of responsibility of which national fund is to assist which travellers? Since most EU air travel is on carriers that offer network or point to point

services in multiple markets, the traveller may have paid his or her fee into the Fund of one country but embarked on a carrier whose services were suspended in another.

As relief measure the test of enforceability is how well such a Fund will actually work after the fact of a service suspension (not how easily it collects modest fees).

Though the fees would be small for individual travellers they are still part of the final price paid and as such constitute potentially foregone revenues for airlines, or a negative consumer surplus which may, at the margin, dampen demand for travel.

While this measure could produce net benefits for consumers originating travel in certain Member States at least, the risk of producing unintended consequences, such as either piling up money, creating high and redundant administrative overheads or otherwise not being cost-effective in their operational use were deemed to be significant.

Most fundamentally, policy makers need to ask how general the problem has become and whether the creation of large general funds to relieve problem cases are essential and whether they will support and compensate or interfere with the natural disciplines of the market.

7. *Considering Standards under the Bankruptcy Laws: such as steps to: a) ensure fair and efficient treatment of ticket holders as a creditor class in cases of liquidation; and b) encourage the use of reorganisation procedures under which companies with prospects for restructuring can maintain services*

Content and Scope. While the application of bankruptcy law is obviously relevant, defined proposals for reform of general bankruptcy law are not under discussion in the current debate. Changes cannot be proposed realistically on an individual economic sector basis. It seems unlikely that the discrete problems of the airline industry can *per se* influence formal changes in this very sensitive legal and economic policy area.

However, it may be relevant to consider the role of two particular general policy issues whose handling could be quite important in managing future cases of airline industry bankruptcies, since consideration of these points also connects to the management and use of the more specific industry measures described and analysed above. These issues are:

A. *A consideration of the procedural issues involved in managing the interests of ticket holders as a creditor class in an insolvency proceeding*

Concretely, ticket holders are creditors if they have not received the transport they paid for or refund of the monies paid. Should they recover their money by a reversal of credit card charges when the airline fails to deliver service, then they effectively subrogate their creditor claim to the credit card company. As a general matter, credit card companies and insurance companies are in far better position than individual claimants of smaller sums to bundle claims and to seek partial recovery in the bankruptcy proceeding from the available asset mass based on the legal standing of such claims under the applicable national law.

It could also be helpful to airline travellers if states take note of and reflect on the procedures in the Air Madrid case to deal with the ticket holders as a creditor class and implications that might be drawn.

B. To reflect on the benefits of using reorganisation (as opposed to liquidation) procedures whenever realistically feasible, especially when larger operators are involved.

Bankruptcy proceedings can essentially follow two courses of action: liquidation in which remaining assets are simply divided up among the creditors; and reorganisation in which efforts are made to save at least parts of the company.

From an operational standpoint, and in the interest of travellers as well as employees, a reorganisation strategy is far more attractive than liquidation. Without getting into a debate on the change of laws, it may be useful to explore the scope of policy to encourage greater pursuit of reorganisation strategies. These are obviously most important in the case of larger airline failures where meaningful service demand has existed and perhaps can be revitalised than with very recent and small start ups which have less market to work with.

SUMMARY & GENERAL CONCLUSIONS

This study has considered the adequacy of protection of consumers in the European Union against financial and personal risks that may arise when airlines go bankrupt against the backdrop of a rapidly changing marketing and sales environment which has increased risk taking and risk exposure.

Risks broadly take two forms: first, the consumer is almost certain to suffer inconvenience and some level of financial loss if planned arrangements are abruptly cancelled (even with insurance or other refund guarantees); second, if the trip has already commenced, he or she may be stranded at the outbound destination and exposed to personal and family hardship in the absence of prompt assistance with repatriation. As is elaborated in the study, the relative impact of such a stranding will vary according to numerous factors, including the distance of travel, availability of alternative transport (including other modes) and the extent to which the consumer has other holiday elements dependent upon availability of air travel.

A key question is whether the risks to consumers are so general as to require a systematic, mandatory safety net to cover all of them or whether public authority and the general public interest would be adequately if not better served by focussing on strengthening the consumer as an intelligent buyer who is better positioned to be aware of areas of risk and make choices as to whether to accept them?

In dealing with instant problems of consumer protection against airline failure, a central finding of this study is that the aeronautical authorities who grant and oversee aircraft operator certificates (AOCs) to commercial operators can play a crucial role from a precautionary standpoint as well as operationally in cases where travellers are stranded.

The new, consolidated Community market access regulation 1008/2008 has both confirmed the ability of national authorities to condition the term validity of AOCs and placed greater weight on the control of financial fitness. The new regulation also establishes standards for the disclosure of prices. How the law will be implemented in practice will depend on the skill and judgement of the regulators who implement it. Over time it seems reasonable to expect, especially in the currently developing financial environment, that it will lead to more conservative financial policies on the part of operators.

States apply their general laws on bankruptcy when airlines become insolvent, declare bankruptcy and seek protection from their creditors. Two forms of general outcome can result:

1. The enterprise can be *reorganised*; that is, under supervision of a court and/or an appointed administrator, the company can re-emerge, usually under new ownership and resume services in a similar or modified form. During this period, the company may also be able to maintain at least a certain level of business activity while enjoying a moratorium on at least some of its debt obligations.
2. The enterprise will be *liquidated*; that is, it will cease operations entirely, and its remaining assets will be allocated to its creditors.

For the passenger, it is clear that the reorganisation scenario is the preferred situation, as the airline may continue to fly. An element in emergency planning response could include a more pro-active monitoring by competent authorities of deteriorating situations under which enterprises caught in dangerous, and especially vicious circle, situations are given latitude if not encouragement to seek protection earlier rather than later - when there still may be constructive prospects to reorganise successfully.

Public authorities are challenged to rethink the traditional tools of consumer protection. This need not and probably should not include protecting bargain hunters against risks they are prepared to accept; however, reasonable and cost-effective rules that ensure they have been made aware of such risks may not only help individual travellers, they may also reduce the need for public efforts to assist them in distress.

Although this study shows clearly that an increasing number of passengers are purchasing flight-only options or self-packaging their holidays, this fact alone does not entail the need for increased protection. Many consumers are travelling to relatively near destinations, for example in the EU or its immediate neighbourhood, where the consequences of being stranded are unlikely to be as severe as if stranded at an intercontinental destination. Furthermore, many more are travelling for purposes of visiting friends and relatives (VFR) and are thus more likely to be well-supported in the case of disruption to travel. In the case of nearby markets, alternative transport options (including other modes) exist for repatriation at reasonable cost. Even these travellers can, of course, suffer significant material cost, not to mention considerable stress, when their vacations are disrupted; however, repatriation and returning home or to the workplace will be a lesser problem.

Thus, rather than looking for a single solution, we believe, consistent with AIRREG's earlier findings, that experience shows that it may be more valuable to think of a combination of measures in the framework of a general responsibility of governments, industry and the courts to create and provide rapid *ad hoc* responses if and when emergency conditions arise as well as ensuring fairness in the treatment of all damaged persons and bodies. This situation implies a key role for individuals such as bankruptcy administrators but also for governments in their oversight and response-coordination capacities.

1 INTRODUCTION

1.1 GENERAL REPORT

This document forms the final report that considers the impact on EU consumers of airline bankruptcies. We identify and evaluate the forms of relief that are or might be made available to assist them in distress. Our work updates and builds on an earlier study done for the Commission in 2005 by an interdisciplinary team led by the Transport Studies Unit of Oxford University (see below).

Booz & Company Ltd of London and its subcontractors, Mr Erwin von den Steinen, Dr Ingomar Joerss and Dr Pablo Mendes de Leon have prepared the study.

1.2 OBJECTIVES OF THE STUDY

The European Commission has engaged the Project Team to provide a *high level analysis* of the causes and situations surrounding aviation bankruptcies in the EU since 2000 and to determine their impact on holders of pre-paid transportation by:

- describing how passengers who had commenced travel and were stranded were or were not repatriated and/or reimbursed;
- considering forms of relief provided to passengers who had pre-paid tickets but who had not yet commenced travel on airlines that later suspended operations because of insolvency;
- assessing the feasibility of both existing and possible alternative consumer protection mechanisms to provide consumers with necessary information and reasonable security or relief;
- evaluating concerns expressed by stakeholders interested in the regulation of consumer protection in order to provide the Commission with both information and perspectives to assess what further legislation if any may be needed or should be avoided.

A central question is whether consumers enjoy sufficient and reasonable protection under the rules and enforcement procedures of the current regulatory framework and/or through forms of insurance required or offered in the marketplace -- especially with respect to individual travel (that is, when not covered under the package travel directive). Finally, the application of actual or contemplated legislative requirements on foreign carriers selling air transportation to travellers originating in the EU will be assessed from the standpoint of its impact on competitiveness and whether considerations of maintaining a level playing field have been adequately addressed.

Context for our analysis is provided both by: 1) the impact of strong competition under difficult conditions on Community airlines (which has led to a high rate of airline bankruptcies in the EU as well as worldwide); and 2) the rule-making reviews and analyses that have been taking place under Commission auspices incident to a systematic restructuring of the market access regulations as now comprehended under EC Regulation 1008/2008 (as will be discussed below).

An early element of this policy review was the study *Functioning of the Internal Market for Air Transport – AIRREG (AIR transport REGulations)* completed in 2005 by a team led by Oxford University, henceforth cited as AIRREG. In addition to its general consideration of integrating the market access regulations, AIRREG also examined the scope and extent consumer protection issues raised the abrupt suspension of services by Community airlines going bankrupt.

1.3 THE AIRREG STUDY AS BACKGROUND

AIRREG provides both solid and extensive information on and analysis of the impact of airline bankruptcies on travellers. Empirical research established an historical listing of bankruptcies of Community operators to 2005 and examined selective cases. The need for and feasibility of passenger protection measures were then examined by way of comparative analysis. AIRREG concluded that, due to the specific characteristics of air transport passengers, arguments can be made to improve their protection, especially so when they are stranded in a faraway destination.

AIRREG, however, also found that there was no consensus establishing preference for particular protection measures. The study examined a range of procedures and policies finding objections or concerns as well as selective supports or endorsements for all of them. Noting that any new regulation in the area would have at least some secondary (and perhaps unanticipated) impacts on competition, it broadly concluded that a mix of policy instruments might best be considered, and it outlined three general options for augmenting current procedures:

- *Minimal intervention* with emphasis on *ex ante* measures such as tighter economic licensing conditions and oversight – that is, precautionary measures to ensure adequate enterprise liquidity and to avert bankruptcies in the first place but flanked also by encouragements to the market players to promote or adopt voluntary procedures to minimise the brunt of any suspension of service (insurances, mutual support arrangements among airlines, etc.).
- *Medium intervention*, which would involve direct emphasis on the need for airlines to provide consumers with options to protect themselves or otherwise to create trust funds or other industry mechanisms on a voluntary basis to provide financial resources for repatriation and/or reimbursement.
- *Maximum intervention*, which would involve mandating specific programmes for guaranteeing full coverage of risk, such as placing a general surcharge (like a user fee) on all ticket sales or otherwise finding a way to close the protection gap that now exists under the regulations between travellers purchasing tour operator packages (for whom financial protection is mandated under Community law) and purchasers of individual travel.

1.4 ORGANISATION AND METHODOLOGY OF THE BOOZ&CO STUDY

1.4.1 Scope of the Study

The scope of this study includes both updating and expanding upon the empirical findings of AIRREG – that is, determining the facts of the situation and the extent of the problems to 2008 -- and considering the implications for law and policy. We present our findings in the following order:

- *Air Transport Industry Outlook.* First, we examine the current situation in the air transport market in the context of general economic conditions which, in 2008, have continued to put strong pressure on airlines. This examination includes description and analysis of structural trends in demand as well as supply; that is, a general review of evolving consumer preference as well as reviewing the shifting profiles of airline service offer such as the growth of low cost carrier service and trends in new entry into the market. We conclude this chapter by updating as well as reviewing the AIRREG bankruptcy list to include cases up until the autumn of 2008.
- *Existing Rules and Practices for Consumer Protection.* In this chapter, we set forth and examine the existing legislative rules, regulatory procedures and commercial law practices (e.g. contractual arrangements) that provide direct or indirect protection to consumers against the risks to them ensuing from airline bankruptcy. While our focus in this study is on air transport, it should be noted that the existing rules do not single out air services *per se*. Legislation such as the Package Travel Directive provides protection for payments made in connection with travel generally; that is, payments to other providers such as train companies, cruise lines, bus companies or hotels are equally covered. Air transport is, for the moment at least, however, the part of the travel industry producing the most policy concern. The chapter addresses both Community law and practice as well as examining examples in other countries.
- *Changes in the Travel Market.* The risks for consumers result not only from airline behaviour but also from their own behaviour. That is, the travel market is experiencing significant restructuring of demand influenced by modern marketing (internet sales, for example) that has led to the phenomenon of so-called “dynamic packaging” and thereby to the retreat of travel agency use as consumers purchase through individual selection often with the goal of minimising costs (and thereby accepting greater risks).
- *Case Studies.* In this chapter we examine selected, mostly recent, bankruptcy cases in greater depth in order to understand both the evolving scope of the problem and to assess the methods used in addressing it under specific circumstances.
- *Policy and Regulatory Options.* Taking the most recent events as well as stakeholder views into account, we review all of the instruments presented in the AIRREG Study in order to identify costs and benefits of each course of action, individually or in combination. We suggest a framework for comparative analysis of the individual measures.
- *Overall Conclusions.* In this final chapter, we recapitulate findings and offer a strategic approach.

1.4.2 Methodological Approach & Definition of Bankruptcy

The diagnosis of the problem begins by recognising that there are both supply and demand sides that must be critically analysed. On the supply side, the point of departure is the liberalised open competitive environment enabled by the Third Package, which has stimulated both dramatic levels of new entry and the creation of new products and business concepts of which the Low Cost Carrier (LCC) business model may be the most striking phenomenon. On the demand side, new forms of information technology (the Internet) have permitted and encouraged consumers to enter into more direct relationships with airlines, averting the mediation of travel agents and tour operators, but by doing so taking on an increased level of direct risk when seeking bargains from bargain sellers who may be skating toward the financial edge.

As explored further in Chapter 3, bankruptcy or “insolvency” (these terms are used almost interchangeably) can be defined as an economic condition when individuals, enterprises or even public institutions incur debt which they are unable to repay.⁵ This simple fact, however, can lead to a wide range of legal and policy responses. Setting aside possible actions under the criminal law (when the bankruptcy has been caused by fraud), the responses under civil law can typically be grouped under two broad forms:

- *Liquidation* – under which the enterprise ceases to operate and exist and its remaining assets are sold off and apportioned among its creditors; or
- *Reorganisation* – under which the creditors agree to become owners of a reorganised company accepting equity in exchange for forgiving debt.⁶

In cases of reorganisation (e.g. so-called Chapter 11 proceedings in the United States), the company will not only resume some form of normal operation but may in fact continue providing services during the period it is being reorganised. Flight cancellations if they occur in such cases will be selective and not general, and thus it may be feasible to apply Community rules that define consumer protection obligations for operating companies -- such as provisions for denied boarding compensation (see discussion of Directive 261/2004 below) to provide for relief in such cases.

This study will, therefore, focus on those cases where the company (airline operator) suspends its scheduled operations or ceases service altogether. This means the ticket purchasers have been stranded at the outbound destination or were never able to commence travel in the first place.

⁵ See also Subsection 3.3.7 below for more detailed discussion of the meanings of insolvency in Community and Member State law.

⁶ The term “creditor” as used for purposes of refloating a reorganised company must be broadly understood here as the final holder(s) of the company’s obligations which may have been traded and consolidated and then perhaps assumed by an outside acquirer.

2 THE AIR TRANSPORT INDUSTRY: ECONOMICS & OUTLOOK

2.1 TRANSPORT INDUSTRY BACKGROUND

Air transport is a dynamic industry, and one that is, by its nature, subject to periodic shocks. In order to determine which factors have influenced the market over the last decade, we conduct a sector analysis of the present aviation market and then consider the consequences for consumer rights. The first section is devoted to background information on the sector as a whole. We examine the impact of strong competition and external factors on passenger air transport within the EU. The second part looks into several economic aspects, as well as a general overview on the recent number of airline bankruptcies and its implications.

In recent years the 11th September 2001 terrorist attacks in the US, and the 2003 SARS outbreak have had profound effects on industry profitability. Loss-making as a whole in the period 2000-2006, the industry returned to profit in 2007 with a reported overall profit of \$5.6bn.

The figure below indicates the amount of capacity, in available seat kilometres (ASKs), offered by profitable and unprofitable European airlines over the period 1996-2007. It shows the increasing number of carriers in the European market and, despite oil prices notably higher than a decade ago, the profitability with which these carriers have increased capacity.

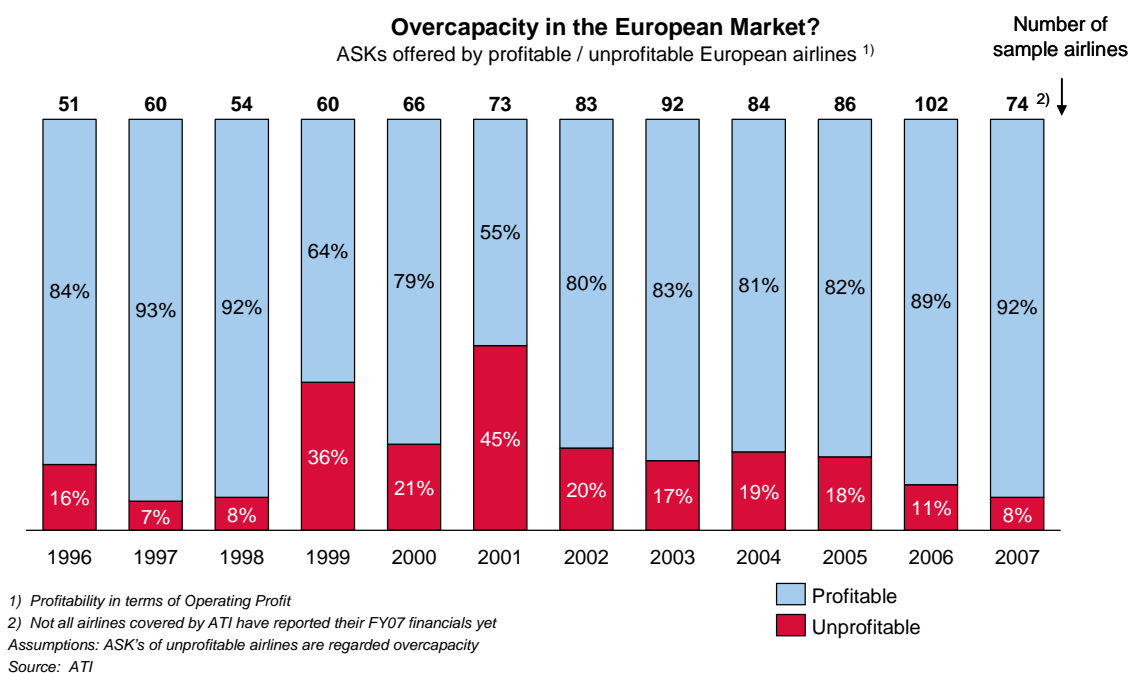
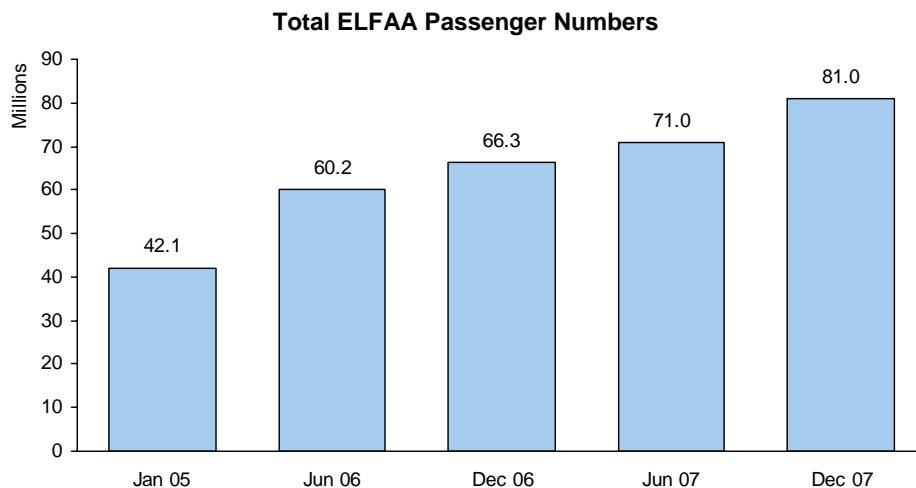


Figure 1: Capacity in the European Market by Profitability of Carrier, 1996 - 2007

Liberalisation of the EU air transport industry has been a catalyst for significant industry change: from the privatisation of many so-called “legacy” carriers, to the entry and development of the low cost carrier model which has rapidly expanded its presence in the European marketplace. The figure below indicates the increasing number of passengers flying on European Low Fares Airline Association (ELFAA) member airlines.



Source: ELFAA Website

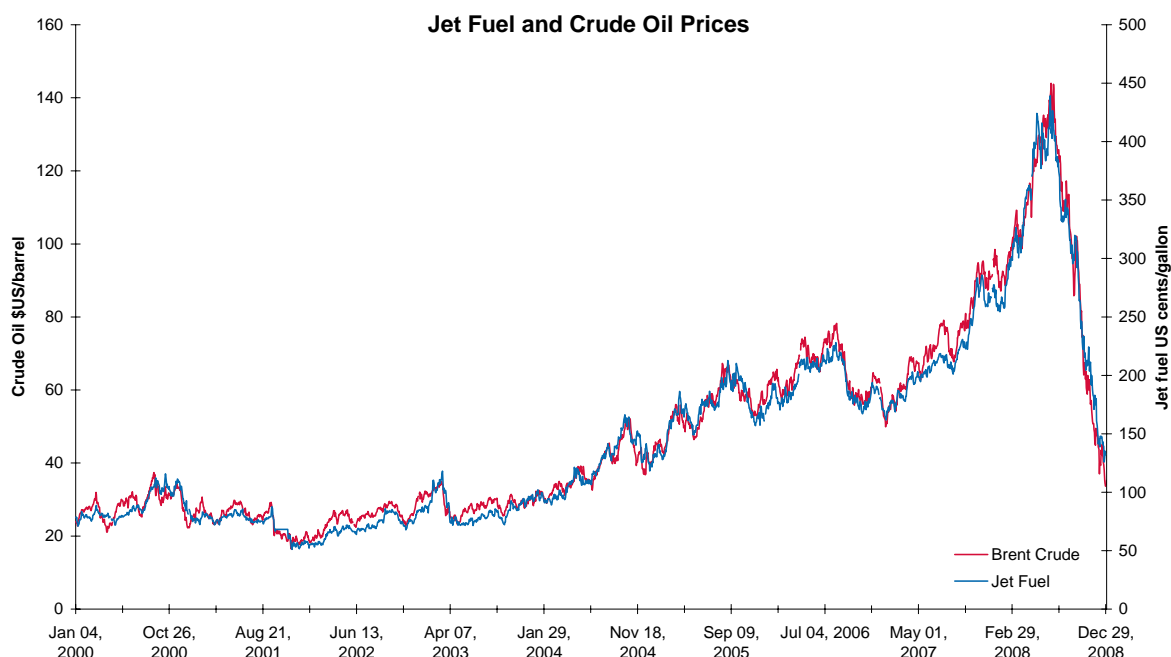
Figure 2: Growth in Low Cost Airline Passengers (ELFAA Members Only)

Alongside market exits and some consolidation, have been many new entries, including as attempts by carriers such as Zoom and Oasis to apply the low cost model to long-haul services to North America and East Asia. Most recently another group has challenged the industry's norms, with the emergence of business-class only airlines (e.g. EOS, Silverjet, Maxjet). However, all those listed have failed, filing for bankruptcy within a few years of their high-profile launches.

Current economic conditions driven by escalating fuel prices, economic slowdown and weakening consumer confidence, seem set to reverse positive 2007 results. Among numerous profit warnings issued by airlines during 2008, British Airways' chief executive was quoted as saying "we are in the worst trading environment the industry has ever faced. We have already seen 30 or so airlines go bust this year and it would be fair to expect a similar number of casualties worldwide over the next three to four months"⁷.

Oil prices reached a peak of \$145 per barrel in mid-2008, before regressing in July-September. In May 2008 BA announced that its profits would be hit by £18m for every \$1 the oil price rose - but, in August 2008, claimed to have lowered this figure to £8m via hedges. Virgin Atlantic reports that its fuel bill has doubled over the past three years, and is now approaching £1bn for 2008 alone. Low cost airlines face the same unit fuel prices - though larger low costs typically operate relatively young and fuel-efficient fleets. Michael Leary, Ryanair's CEO, stated in July 2008 that its profits could drop by 50 percent if fuel prices continue to rise and a recession were to occur. Looking at the industry collectively, IATA's Director General, Giovanni Bisignani claimed in May 2008 that the world's airlines would lose £3bn a year should oil remain above \$130 per barrel. The figure below indicates the increasing cost of oil and jet fuel since 2003.

⁷ Quoted in *the Independent*, 13/9/2008



Source: EIA

Figure 3: World Average Indexed Jet Fuel and Crude Oil Prices

This has had a strong impact on airline operating expenditure. The table below shows how the cost of fuel has formed an increasingly large percentage of operating costs, for full service and low cost carriers alike. Reaching extreme levels in mid-2008, fuel prices have eased more recently, but remain significantly above the level of earlier years. Low cost carriers, by virtue of their efforts in other areas, have, in proportional terms, been particularly affected by the volatility of fuel prices. The table below illustrates the increasing burden of fuel costs as a proportion of each airline's total costs in recent years.

	2004	2005	2006	2007	2008 (Q1b)
BA	15.3%	20.5%	24.5%	26.1%	31.7%
Lufthansa	10.8%	14.2%	16.5%	17.1%	18.0%
Air France	14.3%	17.5%	19.5%	20.1%	22.4%
Ryanair	27.1%	35.1%	39.3%	36.4%	48.8%

Sources: Company annual reports, Booz & Co Analysis

Table 1: Cost of Fuel as Percentage of Operating Cost for Major Carriers

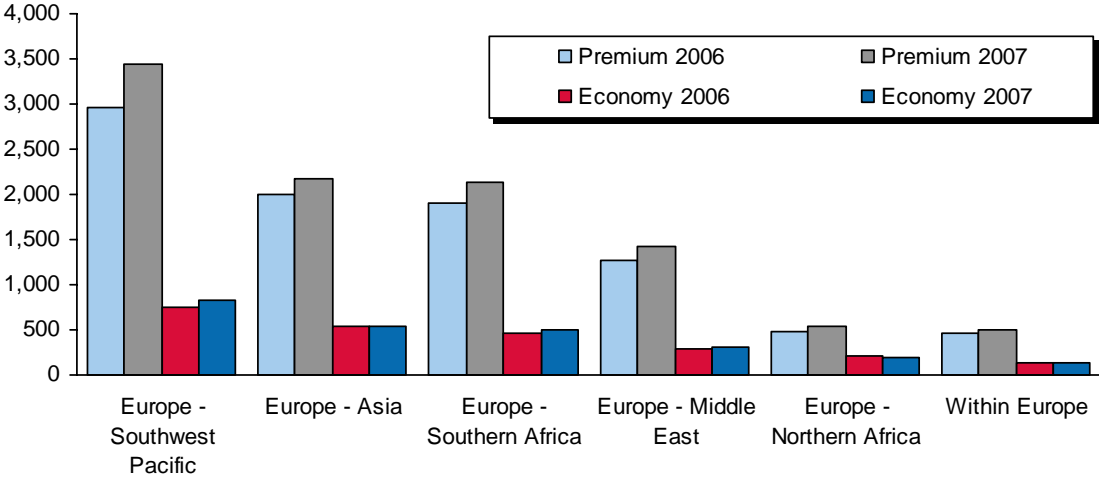
In 2004, fuel made up only 15% of British Airways' costs, but this more than doubled to nearly a third of its total operating costs in the first quarter of the 2008 financial year. Similarly, the percentage of operational costs spent on fuel by Air France increased from 14.3% to 22.4%. Fuel already took up over a quarter of Ryanair's costs in 2004, but this jumped to almost 50% by mid-2008. Lufthansa's fuel bill remained the smallest in proportion to its overall operating costs of the carriers shown, but, even so, the amount spent on fuel, as a proportion of total costs, increased by around 40% since 2004, to 18% in this period.

As shown in Figure 3, oil prices have dropped dramatically since the peak in Summer 2008. Although this has led to a general ease of the fuel burden, paradoxically, many airlines are

now making considerable losses on hedging schemes based on mounting oil prices. In general, airlines are also being affected by the fallout of the global economic crisis.

While costs for airlines have risen, economy airfares to/from and within Europe have remained relatively static, with only modest increases in premium airfares. The figure below indicates airfare development 2006-2007, by region.

Fare Development 2006-07 (\$US)



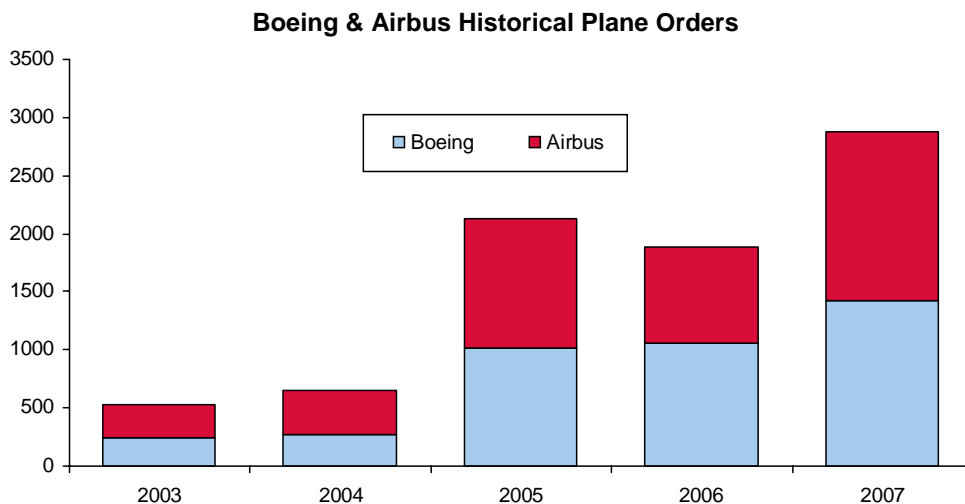
Source: IATA (WATS 52nd Edition, 2007)

Figure 4: European Fare Development in Major Route Areas (\$US)

Some airlines are seeking alliances or merger with complementary players, to access cost savings in terms of procurement-scale, maintenance services, and the rationalisation of unprofitable routes, as well as potential strategic opportunities. But some commentators claim the greatest savings have already been taken: “there is no fat left, so even more massive changes will be needed [to survive]”, said Giovanni Bisignani of IATA in May 2008. According to IATA, the global airline industry has already reduced non-fuel unit costs by an average of 18%, whilst improving fuel efficiency an average 19% over the past six years⁸. Likewise many of the more lucrative operational cost-saving changes have already been made - airlines no longer face the regular expense of paying commission to travel agents, and investment in online booking and simplified electronic ticketing systems has also delivered savings.

Fleet management is potentially a means to manage costs. Yet the world’s major aircraft manufacturers, Boeing (US) and Airbus (Europe), have seen record orders, despite the crisis facing the industry.

⁸ ATW World Airline Report, July 2008



Source: Airbus website, Boeing website

Figure 5: Major Aircraft Manufacturers' Order History

Approximately 20% of new orders are for Europe, making it the third most important region after Asia and North America. It is forecast, by Boeing and Airbus respectively, that Europe will account for 23-24% of new orders over the next twenty years.

Initial results for the first half of 2008 indicate a continued strong sales performance for both Airbus and Boeing, with just under a thousand orders and the delivery of 8% more aircraft than in the same period last year. The backlog of orders is high, currently standing at a new record of 7,324 aircraft - some 1,600 aircraft more than this time last year, and an increase of 7% from the end of 2007. Despite increasing economic uncertainty, there are no signs yet of large-scale cancellations, with the 39 cancellations so far in 2008 being significantly lower than the 67 in the first half of 2007⁹.

Older fleets are less fuel efficient. Efficiency has become a significant profitability lever in the light of diminishing margins in the industry. This effect is being compounded by social and political pressures to reduce carbon emissions, and the decision to include aviation in emissions-trading systems within the next few years. Approaches to fleet economics vary among airlines: future cost savings via fuel efficiency, as well as other regulatory compliance issues, must be weighed against the capital expenditure or loan commitments required. Some smaller airlines' fleet strategies are particularly based on leasing, trading flexibility for relatively thin capitalisation or leverage for further credit¹⁰.

Current global financial conditions, particularly since August 2007's sub-prime mortgage lending crisis, are expected to have a significant effect on demand for airline travel. As the major developed economies slow, airline traffic growth is reported to have followed, particularly among high yield customers¹¹.

As the economics of the industry get tougher, some industry experts fear that marginally profitable (or unprofitable) players may be forced into bankruptcy, with more stable

⁹ Air Transport Intelligence, July/August 2008

¹⁰ Jurgen Ringbeck, Partner, Booz & Company, 2008

¹¹ ATW World Airline Report, July 2008

operators capitalising through consolidation of customer bases, landing slots, fleet utilisation.

2.2 EUROPEAN AIRLINE BANKRUPTCIES 2005-2008

The authors of this report have been asked to update and expand the bankruptcy database of AIRREG, which examined European aviation bankruptcies in the January 2000 – October 2005 period. To the extent possible, we have used the same structure, methodology and terminology to maintain consistency with the previous report, enabling the European Commission to have a detailed picture of airline bankruptcies across the full 2000-2008 period.

Definitions of terms

For consistency with previous studies, we have adopted the following terms in use throughout this report:

- *Full scheduled airline* refers to the scheduled airline sub-sector that has traditionally primarily (though not exclusively) been made up of traditional “flag carrier” airlines. These airlines typically operate scheduled flights to a range of destinations beyond their home country, usually on busy routes. Their service will often include a range of products and benefits such as in-flight meals, frequent flyer programmes, premium cabins and airport lounges. It should be noted that these benefits are under threat from cost-cutting considerations as these airlines face the competitive pressure in the scheduled air transport market.
- *Regional airlines* typically provide scheduled services within a sub-region of Europe. They usually serve less busy routes with smaller aircraft and often operate under public service contracts, by which public authorities to a certain extent take over the responsibility for the profitability of the routes served.
- *Holiday charter airlines* fly leisure passengers on package holidays, usually to leisure destinations in Southern Europe or outside Europe.
- *Low cost airlines* offer simple no-frills scheduled flights. They are able to offer low fares to the consumer by avoiding congested, expensive airports and minimising business complexity.
- *Bankrupt airline* - an airline declared insolvent by the relevant national authority. It does not include airlines that were taken over by or merged with other airlines, or those that ceased trading without a bankruptcy declaration.
- *Date of bankruptcy*: the date the aircraft of the carrier were grounded (or date of declaration of bankruptcy, if aircraft were not grounded).
- *Stranded passenger*: a person travelling abroad without access to an air transport service to reach the final destination and/or return to place of residence due to the airline going bankrupt or being grounded.
- *Affected passenger*: a person who has bought a ticket with an airline that is subsequently declared bankrupt and/or has its planes grounded.
- *Fleet size* is the unweighted sum of the aircraft, both owned and leased, available to an airline.
- *Weekly seats*: passenger seat capacity over the period of a week taking into account fleet size and route frequency.

2.2.1 Scope of Survey

As noted above, this report extends the analysis of AIRREG, which covered the 1 January 2000 – 31 October 2005 period. The focus of this survey is thus on airline bankruptcies occurring from 1st November 2005 until 15 September 2008, and as requested in the study Terms of Reference, covers all EU-27 Member States.

Ensuring consistency with the previous study, airlines included are those companies providing scheduled flights (incl. national flag carriers and low cost airlines). In addition, it would cover those charter airlines that are also providing (some) scheduled services. As such the survey excludes cargo-only carriers. We will distinguish between the following types of airlines: (1) full -service scheduled, (2) low cost, (3) regional and (4) charter. Each airline is included in the Bankruptcies Database according to the date (year) for which its planes were grounded. This date will determine the length of operation calculated for each airline.

2.2.1.1 Data Collection Approach

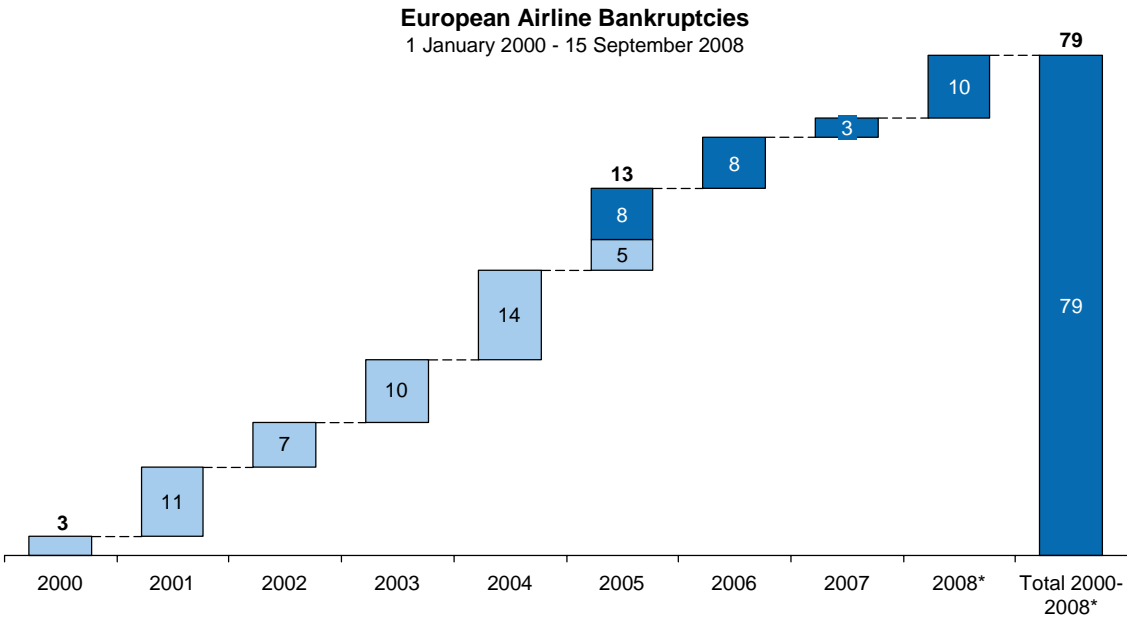
As in the previous study, a wide variety of sources has been consulted in collecting data to update the Bankruptcy Survey, in particular to find the numbers of passengers stranded away from home when airlines go bankrupt and the number of passengers who had already booked and paid for tickets for travel at some future date. There is no centralised collection of this data in any country. Following similar methodology, the following steps were undertaken to establish the data for the present survey database:

- a list of airlines that ceased services during 2005-2008 was established through research via the Official Airline Guide (OAG) and www.rati.com. A total of 354 European airlines were identified as having ceased trading, which were then investigated for timeframe and reasons for cessation to identify those of interest to this report. Evidence of bankruptcy (as opposed to service cessation without a bankruptcy declaration) was established via aviation internet sites such as www.rati.com, www.justplanes.com, www.ruudeeuw.com, as well as general news media.
- background information about the identified airlines were collected from three main sources: (1) OAG (weekly seats), (2) Aviation websites (mainly general company information, fleet size, length of operations, type of operations), (3) Amadeus Pan-European Company Database (financial data).
- information about the implications of bankruptcies in terms of stranded and affected passengers have been collected through: (1) contacts with Civil Aviation Authorities, (2) searches through general news media archives, (3) searches through aviation internet sites, (4) airline user groups; and (5) contacting the bankruptcy administrators for individual airlines directly.

2.3 BANKRUPT AIRLINES 2005 – 2008

Extending the previous report on European airline bankruptcies, our analysis in the following section focuses on the 1 January 2005 – mid-September 2008 period. However, it is useful at the outset to indicate the total number of airline bankruptcies that have taken place

over the full period of *both reports* (i.e. 2000-2008). As indicated by Figure 6 below, there have been nearly 80 European airline bankruptcies¹² across this 8 year period.



Source: AIRREG (2000-2005), Booz&Co analysis (2005-2008)
 * 2008 incomplete year

Figure 6: European Airline Bankruptcies since 1 January 2000

There have been a relatively high number of bankruptcies in the current decade, compared to a much lower rate of bankruptcies of scheduled airlines in the 1990s reported by AIRREG. The number of bankruptcies in 2008 may increase further as the year goes on and oil prices remain high. 29 airline bankruptcies have occurred in the period 1 November 2005 - 15 September 2008, which will be the focus of the remainder of this report.

Table 2 below is a list of the 29 European airlines that went bankrupt between November 2005 and mid-September 2008, arranged by year of bankruptcy. The table includes: (1) the company name, (2) start of operations, (3) end of operations, (4) country of registration, (5) type of operation, (6) size in terms of weekly seats.

¹² Includes all airlines listed as bankrupt but **not those which ceased operations without a bankruptcy**. All parts of ExelAviation Group (HollandExel, BelgiumExel, AlsaceExel, LoirExel, Dutchbird, etc) counted as one bankruptcy. All parts of Futura (Futura, Futura Gael, Flyant), and of Alitalia each counted as one bankruptcy.

European Airline Bankruptcies 1 November 2005 - 15 September 2008							
Airline	Country	Founded	Ceased	Operations	Regional	Low Cost	Weekly Seats ¹³
Air Horizons	France	1962	2005	C	NO	NO	24,000 (Jun 05)
Air Lithuania	Lithuania	1991	2005	RS	R	NO	4,700 (May 2005)
Fischer Air	Czech Rep.	1996	2005	C	R	NO	280 (June 05)
European Executive Express	Sweden	1997	2005	RS	R	NO	3,000 (June 05)
Champagne Airlines	France	1998	2005	RS	R	NO	n/a
Aero Flight	Germany	2004	2005	OS	NO	NO	n/a
Flywest	France	2004	2005	LC	R	LC	n/a
MagicBlue Airlines	Netherlands	2004	2005	NCS	NCS	NCS	n/a
Swedline Express	Sweden	1993	2006	RS	R	NO	3,000 (June 05)
Styrian Spirit	Austria	2002	2006	RS	R	NO	8,300 (June 05)
Air Madrid	Spain	2003	2006	OS	NO	NO	n/a
Eirjet	Ireland	2004	2006	C	R	NO	n/a
Air Turquoise	France	2005	2006	RS	R	NO	n/a
Dauair	Germany	2005	2006	LC	R	LC	1,900 (June 05)
FaroeJet	Denmark	2005	2006	RS	R	NO	1,152 (Dec 06)
EclipsAir	France	2006	2006	NCS	NCS	NCS	n/a
Slovak Airlines	Slovakia	1995	2007	RS	R	NO	420 (Oct 06)
FlyMe	Sweden	2003	2007	LC	NO	LC	3,672 (Oct 06)
Whoosh	UK	2006	2007	LC	R	LC	16,00 (June 05)
Coast Air	Norway	1986	2008	RS	R	NO	702 (Oct 06)
Alpi Eagles	Italy	1996	2008	RS	R	NO	12,266 (Oct 06)
Euromanx	Austria	2002	2008	RS	R	NO	898 (Oct 06)
City Star Airlines	UK	2004	2008	RS	R	NO	141
Silverjet	UK	2006	2008	OS	NO	NO	1,600 (Feb 08)
Zoom Airlines Limited	UK	2006	2008	LC	NO	LC	n/a
UK International Airlines Ltd	UK	2007	2008	OS	NO	NO	n/a
Alitalia	Italy	1946	2008 ¹⁴	S	NO	NO	545,000 (Sept 08)
Futura	Spain	1989	2008	C	NO	NO	n/a
XL Airways	UK	1994	2008	C	NO	NO	n/a
Abbreviations used				LC = low cost carrier			
C = charter				OS = other scheduled			
S = scheduled service				NCS = never commenced services			
R = regional service (often limited to domestic services)				n/a = not available			

Source: Booz & Company Airline Bankruptcy Database (2008).

Note: For 2005, only November and December are included. 2008 data is 1 January to 15 September.

Table 2: Bankrupt European Air Carriers since 1 November 2005

¹³ Source: OAG

¹⁴ In the case of Alitalia, operations have not ceased and efforts to reorganise the airline into a new entity seem to be progressing. The date given is thus the year of declaration of bankruptcy rather than cessation of service.

The following table disaggregates the bankruptcies by year of occurrence. As indicated, 2008 data is for 1 January - 15 September only, and additional bankruptcies may occur in the remainder of the year.

Year	No of Bankruptcies	% of total
2005	8	28%
2006	8	28%
2007	3	10%
2008*	10	34%
Total	29	

Source: Booz & Company Airline Bankruptcy Database (2008).

Table 3: Percentage Distribution of Airline Bankruptcies since 1 November 2005 by Year

As shown above, 28% of airline failures between 2005 and 2008 took place in each of 2005 and 2006. Already bankruptcies in 2008 exceed this, even though the data does not cover the full year. Only in 2007, the first year in which the world-wide airline industry as a whole has been profitable since 2000, did a smaller number of bankruptcies occur.

	Number	% of total
Low Cost Scheduled	5	17%
Regional Scheduled	12	41%
Other Scheduled	5	17%
Charter	5	17%
NCS	2	7%
All	29	

Source: Booz & Company Airline Bankruptcy Database (2008)

Table 4: Types of Operations of Bankrupt Carriers

Table 4 above shows that the majority of airlines to have gone bankrupt since 2005 have been Regional Scheduled carriers. One reason for such a high number is that some of these regional airlines were relatively small in scale and therefore exposed to changes in market conditions, such as a sharp increase in the cost of fuel.

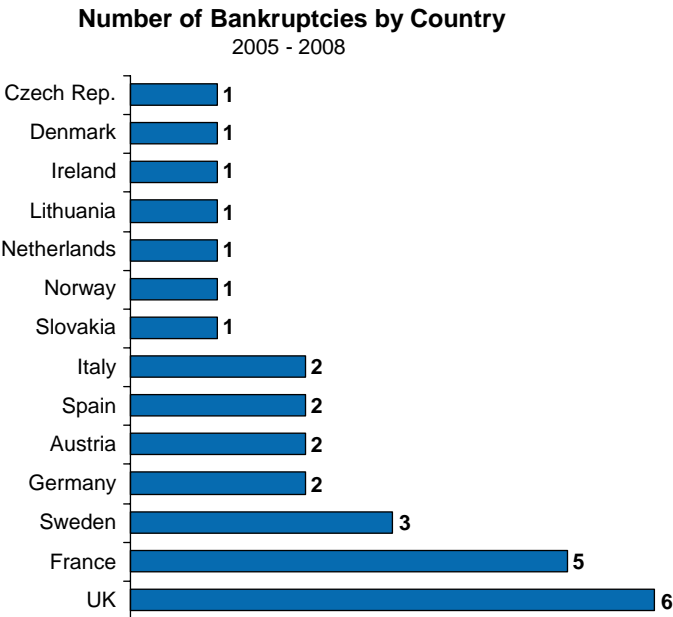
	Number	% of total
Inter EU	13	45%
Inter EU and EEA	4	14%
Inter EU and rest of Europe (non EEA)	1	3%
Inter EU and other long distance	6	21%
Other long distance	3	10%
NCS	2	7%
All	29	

Source: Booz & Company Airline Bankruptcy Database (2008).

Table 5: Sphere of Operations, Bankrupt Carriers

Many of the airlines that have gone bankrupt since 2005 operated only within the EU (45%). If other European destinations are included (EEA and rest of Europe), this figures increases

to 62%. This leaves a significant minority (about 31%) of the bankrupt airlines, including SilverJet, Air Madrid, Zoom and XL Airways, operating long distance where the impacts on any stranded passengers may be greater.



Source: Booz&Company database (2005-2008)

Figure 7: Air Carrier Bankruptcies by Country of Registration, 2005- mid-September 2008
Note: Excludes air carriers which have ceased services, but for which no bankruptcy declaration can be found.

Here we can note that the highest number of individual airline bankruptcies occurred in the UK (6) and in France (5), followed by Sweden (3). In total, 15 of the 28 countries in this study (EU-27 + Switzerland) have suffered at least one airline failure in recent years. One of the airlines registered in Austria, EuroManx, in fact operated most of its flights from the Isle of Man before it went bankrupt in 2008.

The number of individual bankruptcies does not necessarily give an accurate indication of the scale of impact, however. For example, the loss of a large capacity carrier, offering hundreds of thousands of weekly seats is likely to be a far greater impact than the loss of several small capacity carriers.

A further relevant factor may be alternative options for affected passengers – both in number of alternative carriers, and indeed, in alternative transport modes. A passenger who has travelled from Marseille to Frankfurt, for example, and finds himself stranded by an airline bankruptcy is far less likely to be severely impacted than one who has travelled from Marseille to some remote long distance destination, separated from Europe by sea. In the former case, repatriation may be achieved via any of a number of alternative air carriers operating on the route, or indeed, via a relatively inexpensive and convenient road or rail journey. In the latter case, the only time-efficient means of repatriation may be by air, few alternative carriers may be operating, and the relative cost high.

As indicated by the preceding tables, the majority of bankrupt airlines were of relatively small scale (in terms of seat capacity), and operating primarily over short-medium haul distance. However, the wider impact, as indicated below, is also a factor of alternative capacity on specific routes.

2.3.1 Impact of bankruptcies on capacity

In the table that follows, we have used data from the *Official Airline Guide* (OAG) to indicate the number of seats per week lost on routes where some of the bankrupt airlines have operated, and the number of alternative seats offered by competing airlines.

Impact of Airline Failure on Seat Capacity						
Airline	Route	Seats lost	Other seats available	Route	Seats lost	Other seats available
Air Lithuania (Lithuania)						
	KUN-BLL	460	0	KUN-OSL	460	0
	PLQ-BLL	460	0	KUN-PLQ	1,564	0
	KUN-HAM	644	320	PLQ-OSL	460	0
	PLQ-HAM	644	320			
Dauair (Germany)						
	DTM-POZ	330	0	DTM-THF	1056	576
	DTM-ZRH	660	0	THF-WAW	396	1,340
	HAI-POZ	330	0			
European Executive Express (Sweden)						
	ARN-EVG	380	0	KLR-VXO	n/a	
	ARN-HFS	380	0	LLA-PJA	380	0
	ARN-MHQ	760	0	MHQ-TKU	1,140	0
	ARN-TYF	380	0	MIK-HEL	380	0
	CPH-KLR	n/a		PJA-LLA	380	0
	CPH-VXO	n/a				
	HFS-TYF	380	0			
Swedline Express (Sweden)						
	ARN-GEV	700	1300	ARN-OSK	660	0
	ARN-HLF	660	0	OSK-HLF	660	0
Styrian Spirit (Austria/Slovenia)						
	MBX-CDG	700	0	KLU-SZG	700	0
	SZG-CDG	1,100	0	SZG-MBX	600	0
	GRZ-STR	1,100	0	KLU-ZRH	700	0
	GRZ-TXL	600	0	SZG-ZRH	1,200	0
	GRZ-ZRH	2,140				

Impact of Airline Failure on Seat Capacity						
Airline	Route	Seats lost	Other seats available	Route	Seats lost	Other seats available
Alpi Eagles (Italy)						
	VCE-ATH	1,176	0	NAP-PMO	2,744	5,424
	VCE-BCN	588	2,040	NAP-VCE	1,176	6,212
	NAP-BLQ	2,352	3,240	NAP-VRN	2,352	4,430
	BRI-Milan	980	20,964 ¹⁵	VCE-OTP	980	0
	VCE-BRI	980	1,708	VCE-PMO	2,744	5,828
	VRN-BRI	1,372	1,904	VCE-REG	588	0
	VCE-CAG	784	1,024	VCE-SUF	392	0
	NAP-CTA	1,372	5,424	VCE-TIA	588	0
	VCE-CAT	2,744	5,880	VCE-TSR	980	600
	NAP-BCN	1,372	1,800	VCE-BDS	588	0
	NAP-NCE	392	0	VRN-SUF	392	150
Silverjet (UK)						
	London-DXB	1,400	51,814	London-EWR	2,600	97,024
Zoom (UK)						
	London-JFK	1,596	97,024	London-FLL	1,064	2,772

Table 6: Impact of Some bankruptcies on Weekly Capacity

It becomes clear that failure of small domestic airlines (e.g. Air Lithuania and Styrian Spirit) can have a severe impact on capacity on the designated routes; in most cases they were the only airline operating them. However, in these cases, the distances operated were generally very short, and other modes of transportation - e.g. trains, car or other airlines - were readily available as replacement alternatives. Where airline bankruptcies have occurred affecting longer distance domestic routes (where aviation is a viable alternative to other means of transport), for example, Alpi Eagles (Italy), existing alternative airline capacity has generally exceeded that 'lost' with the bankrupt carrier. Lastly, when we look at bankruptcies on routes with extensive capacity and fierce competition, such as London-Dubai or London New-York, the effects on overall route capacity are close to nil.

It should be noted that the above analysis is intended to indicate the wider impact that airline bankruptcies have had on the markets in which they operated. It cannot and does not provide a measure of the hardship that individual affected passengers may have experienced as a result of those bankruptcies, nor even the overall number of affected passengers (which, as indicated by the discussion of voluntary industry response in Chapter 4), can be substantially higher than weekly scheduled seat offer) – but does offer an indication of the relative ease or difficulty repatriation of any stranded passengers may have presented. Note also that the number of seats offered by carriers that were primarily tour operators (such as XL) are not quantified here as the airline did not offer scheduled service – even though we understand that the practice of selling some seats 'unpacked' on charter services is quite widespread. There were a number of flight-only passengers affected by its bankruptcy (see discussion in Chapter 5).

¹⁵ Figure includes departures from all Milan airports.

3 EXISTING RULES AND PRACTICES FOR PROTECTING AIRLINE TRAVELLERS AGAINST FINANCIAL RISK

3.1 GENERAL SETTING

This chapter reviews the forms of legal protection (regulatory and contractual) that presently exist to protect travellers when airlines have to suspend operations without orderly notice. The most typical cause of suspended operations, and a central theme of this study, is bankruptcy. However, as we shall elaborate below, all bankruptcies do not result in suspension of services; nor do all suspensions of service result from bankruptcies.

From the standpoint of consumer protection the problem arises when flights do not operate as planned. Thus the problem consumers confront is the same or similar if operations were to be stopped abruptly for other causes – for example, if regulators suspend the airline’s operating license because of non-financial reasons.

In all such cases of abruptly suspended operations, consumers who have commenced travel may be stranded, and those who have prepaid tickets will lose money unless they can get timely reimbursement and are able to rebook at comparable rates.

Historically regulators in Europe and other geographic areas of the world have provided certain levels of protection or assistance to consumers, concentrating for the most part on relief for travellers on tight budgets, such as families on holiday, by establishing insurance requirements on the sale of package tours.

A fundamental policy question is to what extent public authorities (the State) should intervene to protect buyers in the marketplace? As long as the market provides consumers with adequate information and competition exists among sellers, the ancient Latin standard, namely *caveat emptor* (buyer beware), is arguably the best standard to facilitate the efficient working of a free market in a democratic society. The effective demand of informed and critical buyers creates incentives for competing producers to offer the most attractive combination of quality and price to consumers.

Practical experience, however, also suggests that public standards uniformly enforced are needed to establish and maintain consumer confidence especially in high technology goods and services. Such standards provide the market with critical and essential underpinning in the form of controls on safety, security, health and access to information.

Standards embodied in law and implemented through administrative or judicial processes also play a critical role in resolving cases of economic failure. Thus, as will be outlined in this chapter, there is a long history of economic regulation in cases of bankruptcy.

3.1.1 A Definition of Bankruptcy

Bankruptcy or “insolvency” (these terms are used almost interchangeably) can be simply defined as an economic condition when individuals, enterprises or even public institutions incur debt which they are unable to repay.¹⁶ This simple fact, however, can lead to a wide

¹⁶ See also Subsection 3.3.7 below for more detailed discussion of the meanings of insolvency in Community and Member State law.

range of legal and policy responses. Setting aside possible actions under the criminal law (when the bankruptcy has been caused by fraud), the responses under civil law can typically be grouped under two broad forms:

- *Liquidation* – under which the enterprise ceases to operate and exist and its remaining assets are sold off and apportioned among its creditors; or
- *Reorganisation* – under which the creditors agree to become owners of a reorganised company accepting equity in exchange for forgiving debt.¹⁷

In cases of reorganisation (e.g. so-called Chapter 11 proceedings in the United States), the company will not only resume some form of normal operation but may in fact continue providing services during the period it is being reorganised. Flight cancellations if they occur in such cases will be selective and not general, and thus it may be feasible to apply Community rules that define consumer protection obligations for operating companies -- such as provisions for denied boarding compensation (see discussion of Directive 261/2004 below) to provide for relief in such cases.

This study will, therefore, focus on those cases where the company (airline operator) suspends its scheduled operations or ceases service altogether. This means the ticket purchasers have been stranded at the outbound destination or were never able to commence travel in the first place. Customers cannot get the transportation they paid for and their *ex post facto* claim for relief or compensation will depend on:

- their status as creditors, or
- on claims they can make through bonding requirements, insurance or on trust funds,
- other forms of contractual protection (to be discussed and evaluated below), or
- acts of public assistance (such as governmental repatriation of stranded travellers).

3.2 ANALYTICAL APPROACH OF THIS CHAPTER

As we examine sources and methods of protection of passengers who are denied transportation because an airline has suspended operations, a distinction will be made, where relevant, between:

- Passengers who have made an agreement and paid for the agreed service but who have not yet embarked on travel, and:
- Passengers who have already started their journey but have not yet returned, also referred to as “*stranded passengers*”.

The protection presently afforded to the passengers who find themselves in one of the above situations will be analysed in the light of Community, national and international regulations as well as protections provided by contracts.

Unfortunately, not only the number of bankruptcies in the European airline industry but also the number of travellers affected has been increasing (as to which see Section 2.3 and Chapter 4). That is why a number of European airline bankruptcy cases will be examined in

¹⁷ The term “creditor” as used for purposes of refloating a reorganised company must be broadly understood here as the final holder(s) of the company’s obligations which may have been traded and consolidated and then perhaps assumed by an outside acquirer.

the Chapter 5 in order to assess how well the remedies discussed below were of help to passengers. Experiences in other jurisdictions will also be investigated in order to find out whether lessons can be learned from such experiences.

As discussed in the AIRREG study and as further developed and set forth below, there are a number of types of legal and contractual tools that exist in the EU or internationally to forestall or remedy the risk of suspension of air services. These, *inter alia*, include:

- Precautionary standards with respect to airline operator licensing as well as truth-in-marketing requirements (Regulation 1008/2008)
- Protection offered under the Package Travel Directive (Council Directive 90/314/EEC)
- Rules on basic airline liability (Regulation 2027/97 as amended by Regulation 889/2002)
- Requirements for airline operator insurance (Regulation 785/2004)
- The possible application of denied boarding compensation regulations (in defined cases) – as embodied in Regulation 261/2004
- Recourses that might be available under general rules governing insolvency (Regulation 1346/2000)
- Other Community regulations on consumer or creditor protection that may have bearing including Directive 98/27 affecting procedures for making recovery claims
- A range of financial protection practices such as options for personal insurance and other forms of contractual protection (such as credit card guarantees against non delivery of goods and services)

In the context of our analysis of the Community framework, this chapter also considers certain examples under national laws and procedures of Member States designed to mitigate if not prevent risks for travellers primarily from the standpoint of illustrating the application of Community standards. In separate sections, we also examine remedies available in certain third countries: The USA and Canada and under international aviation law as well as considering the impact of Community standards when applied to international transportation, particularly with respect to competitiveness. The chapter ends with summary conclusions designed to establish the basis for discussing alternatives for future policy as set forth in Chapter 6.

3.3 COMMUNITY REGULATIONS

3.3.1 On Consumer Protection Generally

The basic provision can be found in Article 153 of the EC treaty, aimed at promoting, amongst other things, the protection of consumers, with special reference to their economic interests. This objective is related to the completion of the internal market. Member States are also entitled to maintain or establish more stringent measures than those made at the Community level.¹⁸

¹⁸ Article 153 (as far as relevant) 1. In order to promote the interests of consumers and to ensure a high level of consumer protection, the Community shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organize themselves in order to safeguard their interests.

3.3.2 Precautionary Regulation: On Financial as well as General Fitness of Airlines: Regulation 1008/2008

This sub section discusses a number of inter-related policy and legal considerations. Financial fitness of undertakings is a topical subject matter. For instance, banks are currently under tighter scrutiny of public authorities, and so will increasingly be airlines.

Chapters 3.3 and 4.3 of the AIRREG study of 2005 discussed this subject in the light of the then relevant provisions of Regulation 2407/92, in particular Article 5, and Articles 5 and 9(2) of the consolidated version of the three internal market regulations 2407/92, 2408/92 and 2409/92 as now laid down in the Regulation 1008/2008 (as to which see also below), which otherwise also addresses areas of consumer protection such as marketing standards (see Subsection 3.3.7).

The legal basis for such financial examination is drawn up in the above regulations.¹⁹ A comparative analysis between the current regulation of public intervention in case of the existence of clear indications of financial problems (Article 5(5) of Regulation 2407/92) and the new regulation of such situations (Article 9(5) of Regulation 1008/2008 as adopted and published in the Official Journal L293 of 31.10.2008) can be summarised as follows:

- Whereas under Article 5(5) of Regulation 2407/92 the licensing authorities “*may*” suspend the operating licence under Article 5(5) of Regulation 2407/92 in case of indications of financial problems of the Community air carrier, under the provisions of Regulation 1008/2008 they *must* (“*shall*”) suspend the operating licences when there are such indications of financial problems;
- the licensing authority under Regulation 1008/2008 must now make an in-depth assessment of the financial situation of the Community air carrier “*without delay,*” if

2....

3. *The Community shall contribute to the attainment of the objectives referred to in paragraph 1 through:*

(a) *measures adopted pursuant to Article 95 in the context of the completion of the internal market;*

(b) *measures which support, supplement and monitor the policy pursued by the Member States.*

4.

5. *Measures adopted pursuant to paragraph 4 shall not prevent any Member State from maintaining or introducing more stringent protective measures. Such measures must be compatible with this Treaty. The Commission shall be notified of them. (italics added)*

See also, The Ten Basic Principles of Consumer Protection in the EU; Principle number 9 refers to Protection “while you are on holiday” and to for instance, the Package Travel Directive as explained in the next sub section. See: ec.europa.eu/consumers/cons_info/10principles/en.pdf. The Principles are not formulated as principles and do not appear to have legal force.

¹⁹ See in particular Article 5(5) of Regulation 2407/92 which reads as follows:

“Licensing authorities may, at any time and in any event whenever there are clear indications that financial problems exist with an air carrier licensed by them, assess its financial performance and may suspend or revoke the licence if they are no longer satisfied that the air carrier can meet its actual and potential obligations for a 12-month period. Licensing authorities may also grant a temporary licence pending financial reorganization of the air carrier provided safety is not at risk.”, whereas Article 9(2) of Regulation 1008/2008 on the adoption of common rules for the operation of air services in the Community is formulated as follows: “Whenever there are clear indications that financial problems exist or when insolvency or similar proceedings are opened against a Community air carrier licensed by it the competent licensing authority shall without delay make an in dept assessment of the financial situation and on the basis of its findings review the status of the operating licence in compliance with this Article within a three period months of time.”

there are indications of financial problems, and review the status of the license based upon such an examination. The condition of “without delay” was not provided for under Regulation 2407/92;

- Temporary licenses may only be given under the provisions of Regulation 1008/2008 if there is a realistic prospect of a satisfactory financial reconstruction within a 12-month period – a condition which does not exist under Article 5(5) of Regulation 2407/92.

In short it would seem that the obligations of licensing authorities in case of indications of financial problems of Community air carriers have become somewhat tightened. They have more immediate powers and duties for intervention, that is, suspension or revocation of the operating license, or the grant of a temporary license.

The implicit rather than explicit underlying reasons for such supervision of licensing authorities are consumer protection and safety. There may be a causal link between financial health and safety.

3.3.2.1 Relationship between Financial and Operational Fitness (Safety)

The AIRREG Study found that correlating increased safety risks for passengers flying on airlines going through financial hardship is “a debatable question” as all airlines are subject to tight safety control of national, European and international safety authorities.²⁰ The AIRREG Study also concluded that “substantial differences exist regarding the financial assessment that takes place.”²¹

At the same time, as we shall discuss in Chapter 5 (see the Air Madrid case), it is clear that regulatory enforcement of safety standards must take the financial situation of the operator into some account and establish particularly active oversight in cases where there are indications that maintenance is being deferred or short-changed because of financial pressures on the operator.

Regulation of financial conditions may help the public authorities to be in a better position to check airlines. Public authorities may be able to prevent disruption of air services caused by under-funded start ups, for the benefit of consumer protection in the longer term. See further discussion in Chapter 4.

Finally we may note that in cases of continuing or partial government ownership of Community air carriers, governments can also exercise financial control through their shareholding to ensure responsible performance to the public. As a shareholder the government can make inquiries into the finances of the undertaking and, depending on its rights as a shareholder, influence expenses and investments. Obviously such interventions should not, however, amount to state aid to the airline. Rules against state aid constrained the Belgian government, for example, from intervening financially in the affairs of Sabena.

The Belgian government has taken a reserved stance as a supervisor of its carrier, as the bankruptcy was entirely directed by the commercial court in Brussels.

²⁰ See page 124

²¹ At page 29

3.3.2.2 Possible Liability of Public Authorities

The above sub-section discusses responsibility of EC states with respect to oversight of airlines licensed by them. An interesting question is whether this responsibility or, more accurately, a possible lack of exercise of responsibility by the public authorities, could result in liability of these authorities in relation to passengers -- because of failure to adequately supervise the licensed EC air carrier.

Under certain conditions governmental bodies have been held liable for inadequate monitoring of the public interest, for instance, in the supervision of safety procedures. Courts have held that governmental agencies have a *duty of care* based on tort law. That duty of care must be based on criteria pertaining to fairness and reasonableness, following which courts may decide that governmental agencies have been actually negligent. Moreover, plaintiffs must be able to establish a causal link between the behaviour of the public body and the accident giving rise to the liability claim, in which case courts may decide that such agencies are liable for the damage that followed.

The above considerations have been taken into account by common law jurisdictions in other countries.²² Case law in the EC is scarce, though the UK offers several examples.²³ Absent international or European Standards for liability of governmental agencies for the performance of public tasks such as supervision of financial viability of airlines, each jurisdiction must apply its own rules. It goes without saying that this is a tricky question which has yet to be answered by courts in other Member States.

3.3.3 Package Travel Directive

The most pertinent EC regulation directly aimed at providing financial protection to travellers is the Council Directive 90/314/EEC on package travel, package holidays and package tours, henceforth also referred to as: the Package Travel Directive. It provides for passenger protection in case of insolvency of package organisers and retailers, such as travel agents and tour operators. The Package Travel Directive places a liability on tour operators for the performance of the package as defined under the Directive and as explained in legal proceedings.

The link between travel organisers or retailers on the one hand, and other service providers such as airlines in relation to consumer and passenger protection on the other, can be found in the Package Travel Directive itself. Member States have the obligation to ensure that the tour operator remains liable, even in case of failure of other service providers such as insolvency of the airline.²⁴ Only in very limited cases can the tour operator be relieved from such liability – such cases not including, as we see it, insolvency of the airline.

²² See, *Swanson and Peever v. Canada*, (1990) 2 F.C. 619, 32 F.T.R. 129 as decided by the Federal Court of Appeal of Canada, and *Aharony v. Omni Horizon Ltd. and others*, Case number 1430/96, of the Jerusalem District Court

²³ Three UK cases, namely, *Philcox v. the Civil Aviation Authority*, Decision of 25 May 1995; *unreported*; *Anthony Perret v. Collins (1)*, *Usherwood (2)* and *the Popular Flying Association (3)*, published in 2 Lloyd's Reports 225 (1998), and *Friend v. Civil Aviation Authority* (2005)

²⁴ See, Article 5 paragraph 1

"1. Member States shall take the necessary steps to ensure that the organizer and/or retailer party to the contract is liable to the consumer for the proper performance of the obligations arising from the contract, irrespective of whether such obligations are to be performed by that organizer and/or retailer or by other suppliers of services without prejudice to the right of the organizer and/or retailer to pursue those other suppliers of services."

In cases of insolvency of the airline there remains an obligation for the tour operator to “give prompt assistance to a consumer in difficulty”. This clause would cover a consumer who is for instance stranded abroad as a consequence of the insolvency of a subcontracted airline.²⁵ The tour operator shall provide sufficient evidence of security for the refund of money paid over and for the repatriation of the consumer in the event of insolvency.²⁶

In a judgement made in the UK in 2006, the England and Wales Court of Appeal further defined the terms of the definition of a Package. This court decided that this question is determined by the question whether the travel services are sold or offered for sale as components of a pre-arranged combination or whether they are sold or offered for sale as separate travel services²⁷.

As a corollary, the term “pre-arranged” does, in the words of a European Court of Justice decision²⁸, not only apply to packages put together in advance, for instance, in a brochure, by the seller of the package but also to other combinations of services as required by the customer and as provided by the vendor. “Pre” then refer to the period before the moment on which the seller (travel organiser) or purchaser reach agreement on the combination of services as composed by either party.

Thus the term “Package” has given rise to misunderstandings. The term “Package” is often employed even though the terms and conditions may suggest that the concerned services were not intended to be sold as a Package. Also services that may be sold as ‘flight plus hotel’ might seem to suggest that they do not constitute a package, whereas in reality they could be deemed to fall under the terms of the Directive (see below).

The mentioned judgment of the England and Wales Court of Appeals sheds further light on the interpretation of the term “Package”. For instance, if the components are sold at a price different from the individual elements, the combination of elements/services can be termed

²⁵ See, Article 5 paragraph 2:

“2. With regard to the damage resulting for the consumer from the failure to perform or the improper performance of the contract, Member States shall take the necessary steps to ensure that the organizer and/or retailer is/are liable unless such failure to perform or improper performance is attributable neither to any fault of theirs nor to that of another supplier of services, because:

- the failures which occur in the performance of the contract are attributable to the consumer,*
- such failures are attributable to a third party unconnected with the provision of the services contracted for, and are unforeseeable or unavoidable,*
- such failures are due to a case of force majeure such as that defined in Article 4 (6), second subparagraph (ii), or to an event which the organizer and/or retailer or the supplier of services, even with all due care, could not foresee or forestall.*

In the cases referred to in the second and third indents, the organizer and/or retailer party to the contract shall be required to give prompt assistance to a consumer in difficulty.

In the matter of damages arising from the non-performance or improper performance of the services involved in the package, the Member States may allow compensation to be limited in accordance with the international conventions governing such services.

In the matter of damage other than personal injury resulting from the non-performance or improper performance of the services involved in the package, the Member States may allow compensation to be limited under the contract. Such limitation shall not be unreasonable.

3. Without prejudice to the fourth subparagraph of paragraph 2, there may be no exclusion by means of a contractual clause from the provisions of paragraphs 1 and 2. “

²⁶ See Art. 7.

²⁷ See: *the Association of British Travel Agents Ltd v. Civil Aviation Authority*, decision of 18 October 2006; [2006] EWCA Civ 1356

²⁸ See: *Club-Tour, Viagens e Turismo SA v. Alberto Carlos Lobo Gonsalves Garrido*, Case C-400/00; [2002] ECR I-4015

a “Package”. In another instance, if the customer is not informed of the prices of the individual travel services, the combination is also deemed to be a “Package”.

The tour operator cannot escape its liability by attributing it to their sub-contractors such as airlines. However, the liability to protect only applies to consumers who have contracted the sale of a pre-arranged combination of:

- transport, and or
- accommodation, and or
- other tourist services not ancillary to transport or accommodation and accounting for a significant proportion of the package.

Consumers will only be covered where at least two of the above three elements are sold or offered for sale at an inclusive price and the service covers a period of more than twenty-four hours or includes over-night accommodation. Hence, passengers buying air tickets for a scheduled or non scheduled service without the “extra’s” mentioned under (2) and or (3) above from an airline or from a tour operator are not covered by the protection afforded by the above Directive.

In the event of the insolvency of the travel organiser or retailer, the purchaser of the package is entitled to repayment of the price and repatriation.

The above Directive has been implemented in Member States in their national acts on: consumer protection, trade practices, and acts or laws on tourism. Compensation schemes are set up in different fashions, as explained in the AIRREG study of 2005²⁹.

3.3.3.1 Implementation of the Travel Package Directive: the ATOL Scheme of the UK as a Case Study

A well known system is the UK Air Travel Organisers’ Licensing (ATOL) scheme³⁰, which has been used a number of times for covering expenses and adopting measures for the benefit of consumers coming under the terms of the above Directive. ATOL has established a precautionary procedure through bonding or by requiring sellers of packaged travel to contribute to a Fund from which passengers can be reimbursed. In the period following the AIRREG Study, UK authorities have continued to review the workings of the ATOL programme and its application in one of the Community’s largest leisure travel markets.

The ATOL scheme has been modified per 1 April 2008 – at which date the following changes were introduced³¹:

- The five categories of ATOL license holders have been reduced to two, to wit Public Sales and ATOL to ATOL Sales.
- Airline Deeds of Undertaking have been cancelled.

²⁹ See in particular Chapter 6.2 and Appendices G and F

³⁰ See: www.caa.co.uk/atol

³¹ See UK Civil Aviation Authority, Consumer Protection Group: *Guide to ATOL Reform, One April One passenger One Pound (2008)*, available at: www.caa.co.uk/docs/33/Guide_to_ATOL_Reform.pdf

- The financial protection applying to those bookings under airline Deed of Undertaking will be subsumed under the new TOL Protection Contribution (APC) arrangements (as to which see below).
- So called Small Business Licence Holders, handling a maximum of 500 passengers per year, will no longer need to vary their license. Different license conditions may be drawn up in case the number of handled passengers exceeds 500.
- Under the new ATOL rules, the CAA will apply new monitoring and risk analysis methods to reduce the risk for appeal to the Air Travel Trust Fund (ATTF). The purpose is to make licensing conditions proportionate to risks, with a focus on new applicants having to earn their autonomy.
- As a general rule, ATOL license holders will not be required to provide a bond after 1 April 2008 if their license has been in existence and under the same ownership and/or control for at least four years prior to 1 April 2008. License holders not falling under this category will be required to providing a bond renewed annually for up to four years, in addition to paying APC.
- The APC is set at 1 £ per passenger per booking payable by an ATOL license holder to the ATTF. The amount of the APC must be approved by the UK Secretary of State. If the booking is subsequently cancelled, the APC remains payable because the passenger/customer would have had ATOL protection prior to cancellation.

It would seem that the ATOL scheme is under stricter legal and administrative scrutiny, while its terms and provisions have been clarified and fine tuned. Important features of the changes concern the increased risk analysis which the UK CAA intends to conduct and the security which ATOL license holders are required to provide in order to create financial sources for passengers whose travel packages have been cancelled as a consequence of the insolvency of the travel agent or tour operator.

The next sub section will look at the position of the airline and examine whether the liability regime to which it is subject may provide recourse.

3.3.4 Air Carrier Liability in General

The basic regulation on airline liability concerns Regulation 889/2002, amending Regulation 2027/97. The objectives of Regulation 889/2002 are to:

- improve protection of passengers involved in air accidents, and
- establish a uniform regime applying within the internal market, so as to provide a uniform regulation for passenger protection under the liability regime set forth by the Montreal Convention, 1999, both for carriage of international and intra-EC traffic (pursuant to the provisions of Article 1(2) of the Montreal Convention) and for carriage of domestic traffic within EC Member States.

Under this regulation, Community air carriers are liable for damages sustained in the event of death or bodily injury sustained in the event of an accident. Since suspension of air services is not an accident and the damages do not qualify as “death or bodily injury”, this regulation cannot be made applicable to the present situation.

3.3.5 Airline-Related Insurance Measures: Regulation 785/2004

This section starts with a brief overview of insurance requirements. Next it will explain that in certain instances their contractual conditions may include terms on passenger protection

in case of insolvency. We also allude to the (aborted) proposal for the establishment of a mandatory Passenger Protection Plan. Again, reference is made to the AIRREG study which at various instances touched upon insurance questions.³² Insurance requirements could be applied at various levels:

- Airlines (as discussed in the present sub section);
- Tour operators/travel agents, as to which see their liabilities as briefly explained in the preceding sub section;
- Passengers (as to which see the following sub-section).

This sub section reviews insurance requirements for airlines. The current regulation on that matter is Regulation 785/2004. The Regulation applies to all air carriers “flying within, into, out of or over the territory of a Member State to which the [EC] Treaty applies.”³³

The insured risks concern second and third party liability of airlines in relation to passengers, their baggage, cargo and third parties, basically on the ground, respectively. Other risks include – but are not necessarily limited to – acts of war, terrorism, acts of sabotage, unlawful seizure of aircraft and civil commotion.³⁴

Insolvency is *not mentioned* as a risk against which insurance must be taken.

However, in its Discussion paper on the possible need to consider changes to Regulation 785/2004 of 2007,³⁵ the European Commission asked *inter alia* for public comments, in Questions 12 and 13 of that paper,³⁶ on whether the scope of the Regulation should be expanded to cover consumer protection in cases of insolvency and suspension of operations.

A number of stakeholders filed comments. Many were reluctant to have the scope of the present Insurance Regulation expanded.

However, representatives of the travel industry noted that under current rules (e.g. the Package Travel Directive) that tour operators were required to meet more stringent requirements than airline sellers of transportation who increasingly, *de facto*, organise their websites to encourage the consumer to buy accommodations and other services -- to in effect construct their own packages (absent insurance requirement).³⁷ ECTAA/GEBTA believed that amendment of the regulation to make insolvency insurance mandatory for airlines selling scheduled services transportation could cure discrimination against tour operators as well as assisting consumers.³⁸

³² See for instance pages 12 and 127 and following

³³ See, Article 2(1)

³⁴ See Article 4(1) of Regulation 785/2004

³⁵ COM (2008) 216 final of 24.4.2008

³⁶ “Question 12: Would the insurance market be able to provide insurance coverage to air carriers in order to refund passengers for the sums paid and to cover the costs of reparation passenger if the carrier is not able to operate the flight because of insolvency or revocation of its operating license?

Question 13: Would additional insurance requirements be an appropriate instrument to protect passengers in such cases or are there other more effective and efficient means?”

³⁷ See also discussion of internet marketing issues in Chapter 3.

³⁸ See ECTAA/GEBTA letter of 22 November 2007 to the Commission.

Following the comment period, in a Communication from the Commission to the European Parliament and the Council on Insurance Requirements for Aircraft Operators in the EU – a report on the Operation of Regulation 785/2004,³⁹ the Commission concluded the following:

“There is no clear cut case for additional insurance requirements to protect passengers against the eventuality of insolvency of an airline. While insurance for such cases is available on the market, at least in some Member States, this is a specialised insurance for financial failure which would not be offered in the context of aviation liability insurance. Many stakeholders and national authorities consider close monitoring of the financial fitness of the licensed carriers – as improved in the revision of the third package – to be the most appropriate tool. The Commission is aware of the potential difficulties for passengers and is further evaluating all aspects linked to this issue, including possible options.”⁴⁰

For the time being, there is no broad support for amending insurance requirements applying to Community air carriers so that passengers are protected from damages in case of suspension of flights as a consequence of insolvency. Hence, other options are being explored for this purpose. We shall return to the question of airline insurance requirements in Chapter 6.

3.3.5.1 How Mandatory Insurance Might Work: the Passenger Protection Plan

Incident to proposals to reform of the insurance regulation IATA, UFTAA and ECTAA suggested the possibility of a “Passenger Protection Plan” designed to provide a facility that would improve arrangements for airlines and agents and offer the passenger full protection in the event of an airline and/or travel agency default.

Here are some details:

- the scheme should apply to all scheduled airline ticket sales;
- if introduced into a state the customer/passenger would be protected against airline default – it is not mentioned whether or not ‘insolvency’ can be termed as a ‘default’;
- In the event of an airline default, the passenger would be entitled to the amount paid, travel on an alternative airline and/or repatriation;
- Passengers would pay a fee of US\$ 0.45 per ticket, to be converted into local currency, on all tickets issued;
- The fee would be transferred to a “Trust Company” established as a ‘non-profit’ company.

In 2002, IATA decided to withdraw this plan due to financial constraints facing the airline industry. This initiative, however, may still warrant attention as it parallels in concept both ideas in the UK (to make ATOL type coverage general by extending it to the sale of all flights) and at Community level initiatives to strengthen consumer protections generally.⁴¹

³⁹ COM(2008) 216 final of 24 April 2008

⁴⁰ See point 6, at page 9

⁴¹ “Since the final completion of the internal market in 1997, the EC Commission has increasingly paid attention to enhancing air passenger rights, as evidenced by the establishment of policy documents and legislative proposals for unlimited liability of carriers in relation to passengers (see Regulation 2027/97 as revised by Regulation 889/2002), the protection of passengers in case of overbooking, delay and cancellation of flights (as to which see Regulation 261/2004, and our discussion thereof and the provision of assistance to disabled persons (laid down in Regulation 1107/2006). See also: http://ec.europa.eu/transport/air_portal/passenger_rights/information_en.htm”

3.3.6 Regulation on Denied Boarding, Delay and Cancellation of Flights

Regulation 261/2004 applies to those passengers who are denied boarding against their will on flights, or to those whose flights are delayed or cancelled on a one-off basis. In these cases, the flights are or will be operated – which is not the case if the air carriers have to suspend operations generally after the booking has been made.

Under the terms of the regulation, cancellation is defined as “non-operation of a flight which was previously planned and on which at least one place was reserved.” In cases of cancellation – as defined in the regulation – the passengers are entitled to assistance and compensation unless they are informed in a timely manner of the cancellation before the scheduled time of departure.

Compensation depends on the length of the period between the announcement of the cancellation and the scheduled time of departure.⁴² For instance, there is no right to compensation if the passenger is informed thereof more than two weeks before the scheduled departure time or less than two weeks if they are offered re-routing in accordance with the provisions of Article 5 (c) of Regulation 261/2004.⁴³

Also, there is no right to compensation if the air carrier can prove that the cancellation is “caused by extraordinary circumstances which could not have been avoided if all reasonable measures had been taken.”⁴⁴ The terms “extraordinary circumstances” has been interpreted in a relatively large number of cases by courts in EC Member States. Technical – rather than,

⁴² See, Article 5 of Regulation 261/2004 on Cancellation

“1. In case of cancellation of a flight, the passengers concerned shall:

(a) be offered assistance by the operating air carrier in accordance with Article 8; and

(b) be offered assistance by the operating air carrier in accordance with Article 9(1)(a) and 9(2), as well as, in event of rerouting when the reasonably expected time of departure of the new flight is at least the day after the departure as it was planned for the cancelled flight, the assistance specified in Article 9(1)(b) and 9(1)(c); and

(c) have the right to compensation by the operating air carrier in accordance with Article 7, unless:

(i) they are informed of the cancellation at least two weeks before the scheduled time of departure; or

(ii) they are informed of the cancellation between two weeks and seven days before the scheduled time of departure and are offered re-routing, allowing them to depart no more than two hours before the scheduled time of departure and to reach their final destination less than four hours after the scheduled time of arrival; or

(iii) they are informed of the cancellation less than seven days before the scheduled time of departure and are offered re-routing, allowing them to depart no more than one hour before the scheduled time of departure and to reach their final destination less than two hours after the scheduled time of arrival.

2. When passengers are informed of the cancellation, an explanation shall be given concerning possible alternative transport.

3. An operating air carrier shall not be obliged to pay compensation in accordance with Article 7, if it can prove that the cancellation is caused by extraordinary circumstances which could not have been avoided even if all reasonable measures had been taken.

4. The burden of proof concerning the questions as to whether and when the passenger has been informed of the cancellation of the flight shall rest with the operating air carrier.”

⁴³ See Article 5(c)(i), (ii) and (iii) quoted in the previous footnote

⁴⁴ See, paragraphs 3 and 4 of Article 5 of Regulation 261/2004:

“3. An operating air carrier shall not be obliged to pay compensation in accordance with Article 7, if it can prove that the cancellation is caused by extraordinary circumstances which could not have been avoided even if all reasonable measures had been taken.

4. The burden of proof concerning the questions as to whether and when the passenger has been informed of the cancellation of the flight shall rest with the operating air carrier.”

and not including - financial - failures have been regarded by courts in Germany, Austria, Belgium, Poland, the Netherlands and the UK as 'extraordinary circumstances'. The same is true for bad weather, including a thunderstorm, and closing of an airport.

A narrowing of the airlines' ability to claim "extraordinary circumstances" because of technical factors, foreseen in an August, 2007 decision of a German court,⁴⁵ has, however, just been confirmed by a decision of the European Court of Justice of 22 December 2008, which found that airlines face a strong burden of proof to show that delays due to factors such as emergency maintenance could not have been foreseen and avoided through normal activities.⁴⁶ This decision has been welcomed by the Commission as a confirmation of passenger rights and clarification that only exceptional (or only truly "extraordinary") circumstances can justify exceptions.⁴⁷

However, no plaintiff so far - as far as we know - has claimed that a flight which was "cancelled" due to insolvency of the air carrier could fall under the terms of Regulation 261/2004, so that the carrier could be required to offer assistance and compensation as foreseen in that regulation. An exception to this could, however, occur if the insolvent air carrier were allowed under administration in cooperation with its creditors to keep flying at least temporarily (that is, pursuant to a so-called "insolvency plan" that aims to save all or parts of the company through reorganisation). In such a circumstance it is easy to imagine that some flights will be cancelled but not others. It seems possible that holders of tickets as creditors entitled to services from the firm might also have recourse to Regulation 261/2004 under specific circumstances.

Obviously the practical point that the carrier lacks liquid or other assets to provide assistance and compensation also plays a key role. However, provisions on re-routing, explanations pertaining to possible alternative transport⁴⁸ and indication of periods of time between the announcement and cancellation could be used for a possible future regulation on passengers who are prevented from flying on a carrier who is bankrupt.

All in all, it seems to us that the provisions of Regulation 261/2004, in particular Article 5 on cancellation of flights, may be useful for further examination and application in the context of a possible future regulation on assistance and compensation for passengers who do not fall under the Package Travel Directive (90/314) but suffer damage as a consequence of the insolvency of the air carrier on which they booked a flight (see also Chapter 4). The same is true for the term "air carrier" which must be understood as the "operating" rather than the "contractual carrier" (who may fall under the terms of Directive 90/314).

Also, carriers who are insolvent but are not, or at least not yet, in liquidation proceedings as they find themselves under Administration in a transitory phase of restructuring of their debts, to be compared with the 'Chapter 11' situation in the United States, could do more for

⁴⁵ A German court has held that a technical failure is only deemed to fall under the expression "extra ordinary circumstances" in the meaning of Article 5(3) of Regulation 261/2004 if such failure can be attributed to external circumstances not falling under the responsibility of the airline as an entrepreneur. See, Case No. 21 S 263/07, Court (Amtsgericht) of Darmstadt; decision of 1 August 2007; [2008] *ReiseRecht Aktuell* 88, reported by Ronald Schmid.

⁴⁶ Case C-549/07 *Wallentin-Herman*

⁴⁷ See *Agence Europe* report, Brussels 23 December 2008.

⁴⁸ As foreseen in Article 5(2) of Regulation 261/2004:

"2. When passengers are informed of the cancellation, an explanation shall be given concerning possible alternative transport."

their passengers than carriers who have been declared finally bankrupt. The term “Insolvency” will be further examined in the next sub section.

3.3.7 General Procedures on Insolvency as Governed by Regulation 1346/2000

3.3.7.1 Defining Insolvency and Related Procedures

For the purpose of this study it is essential to be clear on what “insolvency” or “bankruptcy” means. “Insolvency” is a legal term as its meaning is laid down in law, and as a number of legal consequences are attached to the declaration of an undertaking – being an airline or otherwise – as “insolvent”.

Community law only partly harmonises national laws on insolvency. The basic regulation is Regulation 1346/2000 on insolvency proceedings which entered into force in 2002, and which has since been amplified by several amendments.⁴⁹ The background of this regulation was an objective of the EU policymakers to reduce incentives of parties to insolvency proceedings to transfer assets or legal proceedings from one Member State to another in order to obtain more favourable treatment there – a phenomenon also referred to as ‘forum shopping’.

Regulation 1346/2000 does not itself define the term “insolvency”. Thus the relevant provision Article 4(1) refers to the law of the Member State in whose territory the proceedings are opened.⁵⁰

Terms governing the insolvency procedures of EC Member States are laid down in Annex A of Regulation 1346/2000. Rights and obligations of the parties, for instance airline passengers or their representatives, to a payment or settlement system shall be governed solely by the law of the Member State applicable to that system.⁵¹

There is also a duty to inform creditors.⁵² Hence, the court exercising jurisdiction or the liquidator appointed by it must immediately inform “known creditors” – such as airline passengers or their representative organisations, as to which see below – who have their habitual residences, domiciles or registered offices in a Member State on the opening of the insolvency proceedings.⁵³

Annex A of Regulation 1346/2000 also lists types of proceedings in individual Member States. Proceedings which resemble the ‘Chapter 11’ proceedings in the US (designed to

⁴⁹ As amended by Regulations 603/2005 and 694/2006 providing for the accession of new Member States

⁵⁰ Article 4: “1. Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the ‘State of the opening of proceedings’.”

⁵¹ Article 9 *Payment systems and financial markets*

“1. Without prejudice to Article 5, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market.”

⁵² Article 36 *Duty to inform creditors*

“1. As soon as insolvency proceedings are opened in a Member State, the court of that State having jurisdiction or the liquidator appointed by it shall immediately inform known creditors who have their habitual residences, domiciles or registered offices in the other Member States.”

⁵³ See our discussion of the *Air Madrid* case in Chapter 3. below, in which the Spanish court established a procedure for international claims.

enable restructuring and reorganisation of bankrupt companies) are also mentioned in Annex A. For instance, the German *Insolvenzordnung* of 5 October 1994 has replaced the classical *Konkursordnung* and the *Vergleichsordnung*. Meanwhile, the *Insolvenzordnung* has been amended several times especially in connection with Regulation 1346/2000, in such a fashion that there are no longer privileged debtors,⁵⁴ whereas the insolvency plan proceedings follow in general the purposes of the US reorganisation proceedings under Chapter 11 of the US Bankruptcy Code. The goal is to cope with insolvencies in a market oriented manner.⁵⁵

Also, listed under Belgium is the term “le concordat judiciaire”, under the Netherlands the term “surcéance van betaling” and under Spain “Suspensión de pagos” (which means delay of payment of debts), whereby the competent court appoints an administrator for monitoring the debts. Similar procedures exist in other Member States. For instance, in the UK such proceedings are termed “Moratorium of Payments.”

Suffice it to conclude that:

- the law of the EC state in which the insolvency proceedings are opened governs the proceedings;
- the *substantive* rights and duties of the parties to a payment settlement are governed solely by the law of the EC state which is applicable to that settlement;
- the competent court (as defined in the above regulation) has a duty to inform creditors including airline passengers and their representative organisations of the opening of insolvency proceedings;
- the term ‘insolvency’ may include proceedings designed to allow for delay of payments of debts of the airline, in which situation the airline may be capable of providing more service and perhaps even compensation to passengers than in the case of liquidation proceedings. An airline may also restart operations having passed through the ‘delay of payment of debts’ proceedings.

3.3.7.2 Refunding of Taxes and Charges in Case of Insolvency

This is a special point coming under insolvency proceedings that seems to be assuming timely importance in light of trends in charging practices and the formulation of prices.

Airlines now charge passengers independently for taxes and charges to an increasing degree which in former times were mostly ‘bundled’ in an overall price. Under Regulation 1008/2008 air carriers operating from an airport in an EC Member State are obliged to publish air fares and rates including applicable taxes, charges surcharges and fees “which are unavoidable and foreseeable at the time of publication.”⁵⁶ That final price, the applicable taxes, charges and applicable fees must be specified by such carriers. Optional price supplements shall be published in a clear, transparent and unambiguous way at the start of a booking whereas their acceptance by the passenger shall be on an ‘opt in’ basis.⁵⁷

As is known, these taxes and charges can multiply the price of the ‘naked’ carriage by air. In principle, such taxes should only have to be paid when you fly – as the airline will not incur

⁵⁴ See, § 38 of the *Insolvenzordnung*

⁵⁵ See, §§ 217 to 269 of the *Insolvenzordnung*

⁵⁶ See Article 23(1) of Regulation 1008/2008

⁵⁷ See Article 23(2) of Regulation 1008/2008

costs such as landing fees and ATM charges if the flight does not take off. However, passengers have no automatic rights of refund.

The question deserves perhaps more detailed attention. For instance to what extent are airport charges payable if the concerned airline does not carry out the operation? If the airport manager does succeed in obtaining money from the estate of the airline, are those revenues passed to the frustrated passengers in so far as their money was collected for a service not rendered?

The above questions can only be answered by referring to the applicable national legislations on insolvency and other field of laws such as taxation as explained in Regulation 1346/2000 on insolvency proceedings. Refunds are now granted on an ad hoc basis, without automatic rights giving rise to such refunds.

3.3.8 Procedural Remedies: Class Actions and Directive 98/27

Achievement of objectives such as compensation upon insolvency of an airline through procedural remedies such as class actions is an American and perhaps a Canadian rather than a European solution. This said, legal enforcement through group litigation is receiving more attention in Europe.

The Community has made Directive 98/27 on Injunction for the Protection of Consumer' Interests, leaving the EC Member States a rather wide discretionary freedom for implementation. EC states have their own legal traditions so that the Directive has set up broadly formulated and minimum standards on the subjects. The provisions of this directive mark the differences between group litigation in Europe from class actions in the US in two respects.

Firstly, in most EC states, group representation is a matter of public policy, entrusted to public bodies. For instance, Germany knows the *Verbandsklage*, which does not attempt to enforce private and individual claims but is designed to promote broader interests of for instance consumer protection and environmental interests. An EC White paper on private antitrust actions analyses the pros and cons of the introduction of new forms of class action to recover damages for cartel activities.⁵⁸

Secondly, and this is even more important for the subject of this study, the European style of collective actions emphasise remedies based on injunctions rather than compensation of damages. This is due to the tradition that to begin with civil law countries rely on actions undertaken by individuals for recovering individual damages. This said, several countries, including Germany and the Netherlands, know ad hoc groups, sometimes organised in a foundation, representing the members in legal proceedings.⁵⁹ However, legal proceedings for real, material damages are not popular, at least not in Germany.⁶⁰

It goes without saying that the two features of the European approach towards collective action are interrelated.

⁵⁸ See, EC Commission, COM (2008) 165, *White paper on Damages for breach of the EC antitrust rules*, dated 2 April 2008, available at:

http://ec.europa.eu/comm/competition/antitrust/actionsdamages/files_white_paper/whitepaper_en.pdf

⁵⁹ see for instance, Case C-3/95, *Reiseburo Broede v. Sander*, E.C.R. 6188 (1996)

⁶⁰ see, Harald Koch, *Non-Class Group Litigation under EU and German Law*, 11 *Duke Journal of Comparative and International law* 365 (2001)

On the other hand, Sweden has made a start by enacting a law providing for plaintiff class actions in addition to public associations which are created elsewhere.⁶¹ Norway, Spain, the Netherlands, England and Wales are following suit with the establishment of legal measures supporting class actions.⁶² Several other EC states, including but not limited to France and Denmark, are proposing legislation on the subject.

As stated above, EC Directive 98/27 has a limited scope from the perspective of this study, which is designed to lay down available remedies which are available to passengers who are confronted with the implications of an insolvent airline.

Firstly, Directive 98/27 focuses on *injunctions*, such as orders and measures on the publication of the decision. Compensation for damages is not mentioned as an objective to be achieved in a collective action of consumers.

Secondly, the collective action must be aimed at protecting the interests of consumers included in the Directive listed in the Annex to this Directive. That Annex refers to the Travel package Directive (90/314), so that those consumers can make use of the provisions of the directive. As far as we know this has not yet been the case.

3.4 SYSTEMS OF CONTRACTUAL PROTECTION

3.4.1 Individual Airline Assurances of Insurance Protections

The conditions of some airline include a provision on insolvency which implicitly appears to comply with the provisions of the Package Travel Directive. One of them is easyJet, whose Terms and Conditions contain a provision labelled “Packages” reading as follows:

“To protect money that you have paid for a package we have made trust arrangements through the Travel Trust Association (“TTA”). These arrangements provide security for money paid by you for you package and for the cost of reparation in the unlikely event that we go bust.”⁶³

A Package is defined as a:

“Booking which contains a combination of at least two of the following components when sold to you at the same time by us at an inclusive price with full payment being made to us: Flight, car hire, airport car parking or accommodation;”

Hence, pure ‘flight only’ passengers are not protected by this particular provision, but passengers who parked their cars through arrangements with easyJet and subsequently fly on easyJet are.

Arguably easyJet has portrayed its meeting of an apparent legal obligation to protect package travellers (see the legal provisions and interpretations of the Package Directive in Subsection 3.3.3 above) as a service to underpin its marketing to consumers. However, easyJet has also joined forces with Mondial UK to include Scheduled Airline Failure

⁶¹ See, *Swedish Group Proceedings Act (SFS2002:599)*

⁶² See, *Laurel Harbour, Marc Shelley, The Emerging European Class Action: Expanding Multi-Party Litigation To A Shrinking World, 2006 ABA Meeting, Section Litigation, August 3-6, 2006; The Emerging European Class Action*

⁶³ See: <https://www.easyjet.com/en/book/conditions.html>

Insurance (SAFI) which we discuss further below in travel policies offered to its UK passengers.⁶⁴ The move is in response to the concerns highlighted by recent Government and Civil Aviation Authority (CAA) reports looking into the failure of some airlines and the impact this has on passengers.⁶⁵

3.4.2 Inter-Airline Arrangements

Obviously, passengers are not part of inter-airline agreements. Nevertheless it may be relevant to examine whether airlines contract on assistance, re-routing and compensation of passengers, for instance in the event of insolvency.

Inter-airline agreements are mostly not published. However, as far as we could see, some of them included the following provision on insolvency:

“ ... either party may terminate this Agreement with immediate effect and without the need of judicial recourse if and when:

*.....
The other Party becomes insolvent, makes a general assignment for the benefit of its creditors or commits an act of bankruptcy or if a petition for its re-organisation or the re-adjustment of its indebtedness be filed by or against it ...*

Notwithstanding termination each party shall fulfil all obligations accrued under this agreement prior to the time the termination becomes effective. Specifically Article 9 hereof shall survive this Agreement.”

Article 9 of the said agreement lays down provisions on liability for, amongst others, injuries sustained by air crew and other personnel (agents) of the other airline, and damages caused during the carriage of passengers, their luggage and goods.

The combination of the above provisions probably means that the airline partner who becomes insolvent remains liable for the damages mentioned in that provision, so that the partner airline must file a claim with the administrator of the estate of the insolvent airline. There are no provisions on duties to repatriate or to compensate passengers who suffered damage as a consequence of the insolvency.

Hence, as far as we can see, inter-airline agreements do not contribute to passenger protection in case of insolvency directly. However, indirectly they facilitate subrogation of claims so that an assisting carrier could foreseeably become a creditor of an insolvent carrier through honouring its tickets which might have some compensating benefit, especially in cases of successful reorganisation. Of course provision of assistance and repatriation of passengers on a courtesy or ex gratia basis as will be noted in the Sabena case to be discussed in Chapter 4 remains unaffected.

3.4.3 Options for Personal Insurance and Other Forms of Financial Protection

This subsection focuses primarily on two options – so-called Scheduled Airline Failure Insurance and credit card refund guarantees -- that the insurance and financial markets presently provide to individual travellers to protect themselves against the financial risks of airlines having to suspend services for which the travellers have paid in advance. Insolvency would be the primary cause of such suspensions but not necessarily the only cause. That is,

⁶⁴ See sub section 2.3.10.1, below

⁶⁵ See, <http://www.travelmole.com/stories/1114171.php> dated 22 November 2006

failure to provide the service (not connected to a specific cause of failure) may constitute the basic claim standard, especially in the case of credit card refunds.

Before describing certain specific examples of these forms of consumer protection, it may be important to clarify that these remedies – their availability and the costs of providing them – depend on fluid market conditions. That is, insurance companies will as a general matter not provide coverage on new bookings if the airline has gone into receivership or if the market perceives its situation as shaky. Credit card companies will also take measures usually available to them under their contracts with service providers to delay or condition transmission of payments to airlines with weakening balance sheets so as to reduce their exposure to loss if the airline becomes insolvent.

3.4.3.2 *Scheduled Airline Failure Insurance (SAFI)*

While Community airlines increasingly provide services across a wide range of national markets, our research suggests that SAFI insurance tends to be offered, even via Internet platforms, to travellers on the basis of their origin markets, as an add-on to ‘basic’ travel insurance. Discussions with the UK insurance industry suggests an increased interest and uptake of the product, which generally forms part of a wider travel insurance policy. Using the example of the UK, in 2007, some 10% of travel insurance policies included SAFI cover, which in return provide protection for 12.5 million people in the UK. This figure is estimated to rise to 70% by January 2009, more or less making it a standard section of travel insurance policies in future. Currently, worldwide, an estimated 21.5 million are in possession of SAFI as part of their travel insurance. While some insurers indicate readiness to market more generally, there seems to be no EU-wide policy offering as yet, however, following the failures of the recent months, SAFI sales and demand is increasing across Europe, following the UK pattern. In Australia, already, 80% of all travel insurance products sold, contain SAFI cover. In the individual cases we review below, the focus tends to be on offerings concentrated in individual Member States. The passenger is free to contract for travel insurance covering for losses incurred and expenses made as a consequence of the insolvency of the airline. Various options include (but may not be limited to):

- The *International Passenger Protection Plan* (UK) and the broker Hearn sell the “Scheduled Airline Failure Insurance” (SAFI) through “bonded agents” to passengers flying on scheduled airlines. SAFI covers against the failure of any scheduled airline (**not** forming part of an inclusive holiday) booked in the UK with a bonded agent – thus excluding bookings made with a non-bonded agent or directly with a scheduled airline - in the event of the insolvency of an airline as defined in the policy.⁶⁶ The

⁶⁶ See: www.ipplondon.co.uk; *Insolvency* is defined as follows:

“For the purposes of this Policy a scheduled airline shall be deemed to be Insolvent when:

a any of the following occurs in respect of such airline:

- i) it is, or is deemed for the purposes of any law to be, unable to pay its debts (as they fall due) or insolvent;
- ii) it admits its inability to pay its debts as they fall due;
- iii) the value of its assets is less than its liabilities (taking into account contingent and prospective liabilities);
- iv) It suspends making payments on any of its debts or announces an intention to do so; or
- v) A moratorium is declared in respect of any of its indebtedness.

If a moratorium occurs in respect of the scheduled airline, the ending of the moratorium of itself will not end the Insolvency deemed to arise as a result of the moratorium.

b any action, legal proceedings or other procedure or step is taken in relation to or with a view to:

- i) the suspension of payments, a moratorium of any indebtedness, winding-up, dissolution, administration (whether out of court or otherwise) or reorganization (by way of voluntary arrangement, scheme of arrangement, assignment or arrangement with any creditor of the scheduled airline);
- ii) a composition, assignment or arrangement with any creditor of the scheduled airline;

cover of SAFI is underwritten by a consortium of Association of British Insurers member Companies. SAFI pays up to an agreed amount (not specified in the conditions) for:

- irrecoverable sums paid in advance in the event of insolvency of the scheduled airline not forming part of an inclusive holiday prior to departure, or
- in the event of insolvency after the departure the costs of return flights to the United Kingdom or any other EC Member state to a similar standard to that originally booked, or
- additional pro-rated costs incurred by the insured passenger in replacing that part of the flight arrangements to a similar standard to that originally booked;
- No payments will be made if there is “any prospect of insolvency ... known at the date of the issue of the certificate”, or if a third party is liable for such losses. The attachment to the policy defines the term “insolvency”.

Certain airlines, including but not limited to easyJet, also carry SAFI insurance, and offer it to their passengers.⁶⁷

- The *PrimeSport International Travel Protection Plan* covers expenses due to financial insolvency of an airline (as defined in the policy), inter alia, if the financial insolvency occurs more than 15 days following the effective date and if the financial insolvency is not the person, organisation, agency or firm from whom the passenger directly purchased or paid for the trip. ⁶⁸
- The “Gold Travel Policy” of *travelandinsurance.com* provides protection against third party insolvency. This applies both to the option of the “Single Trip travel Insurance” and to the “Annual Multi Trip Travel Insurance”. The offering insurance company refers in its publicity to the increasing need for third party insolvency cover by pointing at the fate of stranded passengers upon the suspension of the Silverjet operations on the 30th May 2008.⁶⁹
- The Swiss insurance company *STA Travel* covers the costs involved with the change of reservation on another airline in case the airline on which the reservation was

iii) the appointment of a liquidator, trustee in bankruptcy, judicial custodian, compulsory manager, receiver, administrative receiver, (court or otherwise) in respect of the scheduled airline or any of its assets;

iv) the enforcement of any security over any assets of the scheduled airline;

v) a meeting of the scheduled airline, its directors or its members being convened for the purpose of considering any resolution for, or to petition for, or apply for or to file documents with a court for its winding-up, administration (whether out of court or with any registrar or otherwise) or dissolution or any such resolution passed;

vi) any person presenting a petition or an application for the winding-up, administration (whether out of court or otherwise) or dissolution of the scheduled airline;

vii) the directors or other officers of the scheduled airline requesting the appointment of or giving notice of their intention to appoint or take any step with a view to appointing a liquidator, trustee in bankruptcy, judicial custodian, compulsory manager, receiver, administrative receiver, administrator (whether out of court or otherwise) or similar officer; or

viii) any analogous procedure or step is taken in any jurisdiction to include, without limitation, filing for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code.”

⁶⁷ See sub section 2.3.7, above

⁶⁸ See: www.tripmate.com/wp431P/faq.htm

⁶⁹ See “www.travelandinsurance.com/information”

originally made goes bankrupt. The premium is 26 Swiss Francs (app. 17 €) for journeys up to 1000 Swiss Francs (app. 650 €), and 37 Swiss Francs (app. 22 €) for journeys up to 4000 Swiss Francs (app. 2500 €).⁷⁰

- When insured through the French company *L'Europe d'assurances - Présence - Assurance tourisme*, passengers will be paid the price of the ticket if it was booked on a flight which was cancelled exclusively as a consequence of the bankruptcy of the airline, whether a scheduled airline, low cost airline or charter airline.⁷¹
- Since scheduled airline tickets do not fall under the protection of the Foundation Guarantee Travel Sums (in Dutch: *Stichting Garantiefondsen Reisgeld*, SGR) the Air Ticket Guarantee Insurance (In Dutch: *Vliegticket garantieverzekering*) may provide a solution. This insurance only covers tickets which are booked on scheduled airlines mentioned in the insurance policy. That "white" list includes all major and well known low cost Community air carriers as well as non-EC airlines such as Japan Airlines, Malaysia Airlines, Qantas, Royal Jordanian Airlines, United Airlines, Singapore Airlines, Thai, THY Turkish Airlines, Air India and Continental Airlines. Curiously enough airlines like American Airlines, Delta and Garuda are not included with this list.⁷² The insurance company pays the sum of the price of the ticket if the airline goes bankrupt up to a maximum of 2000 €. The price of a return ticket is paid back if the passenger is stranded. Bankruptcy is defined pursuant to Article 4.151 of the UK Insolvency Rules.
- *Unigarant verzekeringen* (Unigarant Insurances) Unigarant, also a Netherlands company, compensates up to 1500 € per journey whether the journey has been commenced or not, if the air service has been suspended as a consequence of insolvency of the (scheduled) airline.⁷³
- *Ticketsafe* is a policy offered by the German insurance company Europaeische Reiseversicherung A.G. which offers travellers a range of coverages against events, including personal needs to cancel as well as failure of the provider. Explicit conditions as well as scope of coverage are specified in the case of insolvency. Coverage will not be written if the airline faces bankruptcy risk because of a meaningful deterioration of its balance sheet or has entered a process of protection from creditors. Previously issued policies will either refund the cost of unused transportation or, if travel has already commenced, will cover 100% of the actual repatriation cost. The company also offers assistance in the booking of such transportation.

Caveat: Having set forth the self-published descriptions of these plans above, we obviously do not wish to suggest any endorsement with respect to their actual performance or scope of coverage. Indeed we note that, notwithstanding individual examples, their coverage may well be geographically restricted and not generally available in all Member States.

We note, for example, that in the Community's largest market, namely Germany, SAFI insurance has not generally been offered on websites. The same is true for France. However, in the UK market SAFI is available to passengers flying on non-UK carriers as long as their

⁷⁰ See: http://fr.statravel.ch/cps/rde/xchg/ch_division_web_lived_fr/hs.xsl/assurance.htm

⁷¹ See: www.govoyages.com/assurances/assurancercashback.pdf

⁷² See: www.elvia.nl/ElviaReiziger/reiziger/onze-reisvzekeringen/overige-verzekeringen.nl

⁷³ See: www.unigarant.nl

flights are booked through a 'bonded agent' of the - UK-based - brokers as explained above and if the scheduled flights are booked within the UK.⁷⁴

3.4.4 Credit Card Arrangements and Refund Guarantees

Major international credit cards typically have conditions that provide the purchaser of goods and services recourse if the goods or services paid for through advance purchase (ordering) are not delivered or provided. Thus the purchaser can get a refund when the service supplier has already booked off the payment but then later does not provide the service.

There is legislation on this point, for instance, in the UK.⁷⁵ This legislation makes the supplier, that is, the operating, and insolvent, airline, and the credit card company "jointly and severally liable" to the passenger. The US also knows the Federal Consumer Credit Law to "charge back" a charge on the credit card account.⁷⁶

Credit card regulations typically include a provision on "Disputed Transactions" giving the credit card holder the right to claim his money back, in writing, in specified instances, sometimes also referred to as "Chargeback Process". One of these circumstances refers to "Services not rendered: merchant did not provide services." Reversal is "contingent upon acceptance" by the customer's card issuing bank, under guidelines of the credit company, and subject to mandatory time limits.⁷⁷

Reversal rights are lost if time limits are not respected. In some cases, cardholders must request a charge back within thirty days upon the date in which the transaction was cashed as mentioned in the record of the transactions of that month. In the USA the law provides for 60 days.

In the United States (see also discussion in Section 2.5 below) credit card controls have become virtually the only legal instrument for protecting ticket holders on insolvent airlines, which has heightened their importance. Card companies and processors often withhold ticket revenue from an airline to protect themselves against the possibility that the airline stops flying or seek agreements that the airline maintains a specific level of unrestricted cash or pledges certain noncash collateral.⁷⁸

⁷⁴ On 5 September 2008, SAFI was not available any more to passengers having booked their flights on Alitalia in the light of the developments regarding that carrier See, Times on Line, <http://www.timesonline.co.uk/tol/travel/business/article4675339.ece?openComment=true> of 4 September 2008

⁷⁵ See, the Clause 75(VI) of the Consumer Credit Act of 1974, reading:

"If the debtor under a debtor-creditor-supplier agreement falling within section 12(b) or (c) has, in relation to a transaction financed by the agreement, any claim against the supplier in respect of a misrepresentation or breach of contract, he shall have a like claim against the creditor, who, with the supplier, shall accordingly be jointly and severally liable to the debtor. Subject to any agreement between them, the creditor shall be indemnified by the supplier for loss suffered by the creditor in satisfying his liability under subsection (1), including costs reasonably incurred in defending proceedings instituted by the debtor."

⁷⁶The rather complicated relationship between merchant/airline, in this case United Airlines, the bank that issued the credit card to the holder (issuing bank) and the merchant bank, that is, the bank that has a contractual relationship with the airline (merchant) is illustrated by a case involving 'Chapter 11' questions: *In re United Airlines*, 368 F.3d 720 (7th Cir. 2004)

⁷⁷ See regulations for Visa and MasterCard: bank1.stores.yahoo.net/chargebacks.html

⁷⁸See "Airlines Want Cash. Card Firms Stiffen Terms. Who'll Blink?" > By ROBIN SIDEL and SUSAN CAREY, Wall Street Journal > September 5, 2008; Page C1

Credit card arrangements therefore may be seen as remedies against unexpected expenses caused by suspension of flights. However, the terms of such arrangements and practice reveal that they do not yield certainty as to the compensation of these expenses.

That said, such relief may become more prominent at times when tickets are issued as e-tickets which are in most if not all cases paid with a credit card. Relief may become more certain if these contractual arrangements are backed by public law.

3.4.5 Conclusions

General civil law and consumer law are available for passengers who have suffered damage from the insolvency of an airline, for reasons set out above. They will find them in the same positions as creditors of other private undertakings, so that the chance of success depends on the size of the estate of the bankrupt airline.

The feasibility of collective actions must be examined from one legal system to another. There is no Community law providing for these procedural remedies. The law and policy in EC states differs, and so is the stage of development of legislative action on the subject. It seems that the coming years may provide more relief in this respect by the establishment of new legislative measures.

3.5 REGULATIONS IN NON-EU STATES

3.5.1 The United States

Until recently, the US was the one country which had a formal system in place that provided for assistance to passengers who suffered damage in one way or the other – as specified below – as a consequence of the bankruptcy of their airline. The relevant act was made upon the 9/11 events to provide transportation to passengers of US airlines that had ceased operations due to insolvency or bankruptcy.⁷⁹

Section 145 of this act reads as follows:

“(a) . . . Each air carrier that provides scheduled air transportation on a route shall provide, to the extent practicable, air transportation to passengers ticketed for air transportation on that route by any other air carrier that suspends, interrupts, or discontinues air passenger service on the route by reason of insolvency or bankruptcy of the other air carrier.

(b) . . . An air carrier is not required to provide air transportation under subsection (a) to a passenger unless that passenger makes alternative arrangements with the air carrier for such transportation within 60 days after the date on which that passenger’s air transportation was suspended, interrupted, or discontinued (without regard to the originally scheduled travel date on the ticket).” (italics added)

US (as opposed to non-US) airlines operating scheduled services on the same routes as the airline which ceased operations were required to transport:

- passengers who held valid confirmed tickets, whether hard copy or electronic
- on a space available basis by other carriers operating on that route, perhaps via another point to the same destination as indicated in the ticket;

⁷⁹ See, Section 145 of the Aviation and Transportation Security Act, Public Law 107-71, 115 Stat. 645 of 19 November 2001, as extended in December 2004. However, these provisions have now lapsed.

- Passengers on a cost basis only – estimated at US\$ 25 for a one way and US\$ 50 on a return trip basis.

The last mentioned amounts were later increased in 2005 to US\$ 50 for a one way trip and US\$ 100 return trip.

The term “destination” was a bit flexible in that a passenger had to accept a service to an airport which might not be the ticketed airport of final destination but an airport located in or being part of an airport system of a metropolitan area. The passenger had to make arrangements within a 60 day period which started running on the day when the agreed service was suspended, interrupted or discontinued. Other US carriers were required to transport the passenger on the date shown on the ticket, that is, on a space available basis, or as soon as possible thereafter.

U.S. carriers providing transportation under Section 145 above could do so on their own aircraft, on their own services or on code shared services. The words “to the extent practicable” laid down in this provision gave room for flexibility but also created a source of potential confusion.⁸⁰

For example the cessation of operations of Vanguard Airlines caused confusion on the rights and obligations of the various parties under the above provision. Some carriers carried passengers at no additional cost, either on a confirmed or on a stand-by basis. Other carriers allowed passengers to fly on their service for a payment of a US\$100. – “administrative fee” each way -- whereas yet other airlines offered restrictive positive space fares, while refusing standby travel. In some instances carriers stated that their offers for stranded Vanguard passengers were available for a short period of time only. In this regard, the US Department of Transportation pointed at the 60-day provision of Statute 145.

The US provision expired on 30 November 2006.

Since then the only formal protection for US ticket holders is recourse under credit card regulations. That is, the consumer has a period of 60 days from his/her date of receipt of billed charges to inform the credit card company that the paid-for service has not been provided. In such cases the credit card company, absent proof to the contrary, must refund the billing.

Credit card companies in turn may take contractual measures vis à vis their commercial clients to ensure recovery of funds received for non-provided services. Accordingly funds may be escrowed or insurances required.

As set forth by the US Federal Trade Commission (FTC) it would not appear that payments actually executed more than 60 days before the date of agreed service would be automatically recoverable. However, it is also an accepted practice in the US that companies in travel sectors other than aviation taking credit card information delay actual billing until the services are being provided or could have been provided (in the latter case if the purchaser, for example of a hotel reservation, fails to show up).⁸¹

⁸⁰ See: airconsumer.ost.dot.gov/rules/20020808.doc

⁸¹ For a useful discussion of these matters (with also linkages to government sites) see: [HTTP://WWW.JONESDAY.COM/PUBS/PUBS_DETAIL.ASPX?PUBID=2372](http://www.jonesday.com/pubs/pubs_detail.aspx?pubid=2372)

3.5.2 Canada

The Air Transport Regulations of the Canada Air Transport Act, henceforth also referred to as the Act - provides for protection of stranded passengers who have travelling on advanced booking charters, henceforth: ABC.⁸² Carriers who participate in ABC may transport stranded passengers who have missed his/her return flight beyond the passenger's control, subject to conditions mentioned in the Act.

The Public Interests Advocacy Centre has raised its voice in order to promote policy and legal measures for passengers who suffer damage as a consequence of an insolvent airline.⁸³ The Airline Passenger Bill of Rights made by it does not, however, draw up a rule which provides for compensation or assistance in these cases.⁸⁴

In Canada, protection for passengers travelling via a journey booked through travel agent is organised at the state level. Under state law, funds are created which serve as a fall back position for travellers who are unable to obtain compensation via their travel insurance, credit card or other mechanisms.

For instance, travel agents established in British Columbia must be licensed. Pursuant to the terms of their license, they are required to contribute to the Travel Insurance Fund, henceforth referred to as: TAF - which is managed by the Business Practices and Consumer Protection Authority (BPCPA). The TAF is designed to compensate passengers who did not receive the travel services that they purchased, for instance as a consequence of business failure. The TAF only reimburses up to the cost of the original contract services, thus excluding expenses pertaining to alternative or replacement services.⁸⁵

The Ontario Travel Industry Compensation Fund - henceforth referred to as: OTICF - specifically refers to compensation from the fund in case a passenger did not receive the travel services because of the bankruptcy or insolvency of the travel agent. The travel agent must be registered in Ontario. The conditions of the OTICF specify that the payments out of the Fund are limited to Can \$ 5,000 per passenger and Can \$ 5 million per event. The claim for compensation must be related to non-provision of travel services, and not to the cost, value or quality of the travel services provided.⁸⁶ Contrary to the TAF, the Terms of Reference of the OTICF do not state that they may only be sued as a "fall back" position.

3.5.3 Conclusions

Between 2001 and 2006, the US was the only country in the world providing for remedies to passengers who were faced with the consequences of a bankrupt airline by virtue of public law regulations. Under specified conditions, they could embark on other (US) carriers who were obliged to take those passengers. The terms of those provisions were not always clear as demonstrated by a few cases which came under the scope of these regulations.

Since 2006, credit card protection must bring relief for passengers in the US who find themselves in a situation examined in this study. Absent public law on the subject, that

⁸² See: Part II, Division VI on Advance Booking Charters, <http://www.tc.gc.ca/acts-regulations/GENERAL/c/ct/regulations/001/ct004/ct004.html>

⁸³ See: <http://www.piac.ca/transport/>

⁸⁴ See: http://www.piac.ca/transport/airline_passenger_bill_of_rights/

⁸⁵ See: http://www.bpcpa.ca/index.php?option=com_content&task=view&id=257&Itemid=5

⁸⁶ See: <http://www.tico.on.ca>

protection may compensate them for the costs of the air travel as purchased from the insolvent seller, that is, the airline or the travel agent. Contractual terms agreed upon between the various parties, that is, the purchaser/passenger, the credit company and banks or other financial institutions with which they conduct their business in this respect explain the availability of remedies in the cases foreseen in this chapter.

Similar conditions on the extent of the costs which may be recovered apply in Canadian states. In British Columbia, the Travel Fund only serves as a last resort, that is, when all other remedies such as personal travel insurance and credit card provisions have been exhausted. The Travel Fund created in Ontario has capped liabilities of that fund. As explained above, the level of protection depends on the applicable conditions which vary from one Canadian state to another.

3.6 INTERNATIONAL RULES AND REGULATIONS

3.6.1 The Montreal Convention, 1999

The Montreal Convention, 1999, does not address the specific issue covered by this study, as it is only concerned with airline liability in relation to an accident.

However there was some concern among the drafters of the Montreal Convention, 1999, in regard to insolvency. That is why a provision on insurance was inserted into the convention.⁸⁷ The idea behind inclusion under the Convention was to ensure that claimants were sufficiently protected against bankruptcy of the carrier.⁸⁸

3.6.2 Other Global Approaches

The Guatemala City Protocol of 1971 has no legal relevance at all for current day liability questions, as it has not entered into force and will not enter into force. However, one provision may be of interest, namely, that on the establishment of a Supplemental Compensation Plan which provision could be used if and when the Commission wants to promote a fund in order to compensate damages arising from insolvency of airlines.⁸⁹

Obviously a number of terms must be changed; for instance those on death and personal injury should be replaced by “insolvency of the airline” and “Convention” by an EC

⁸⁷ The second sentence of Article 45 on Insurance of the Convention states that: “A carrier may be required by the State into which it operates to furnish evidence that it maintains adequate insurance covering its liability under this Convention.”

⁸⁸ Report of the First Meeting of the Special Group on the Modernization and Consolidation of the “Warsaw System”, ICAO Doc. SGMW/1 (1998) at 2-19.

⁸⁹ “No provisions contained in this Convention shall prevent a State from establishing and operating within its territory a system to supplement the compensation payable to claimants under the Convention in respect of [death, or personal injury,] of passengers. Such a system shall fulfill the following conditions:

- it shall not in any circumstance impose upon the carrier, his servants or agents, any liability in addition to that provided under this Convention;
- it shall not impose upon the carrier any financial or administrative burden other than collecting in that State contributions from passengers if required to so;
- it shall not give rise to any discrimination between carriers with regard to the passengers concerned and the benefits available to the said passengers under the system shall be extended to them regardless of the carrier whose services they have used;
- If a passenger has contributed to the system, any person suffering damage as a consequence of [death or personal injury] of such passenger shall be entitled to the benefits of the system.”

Regulation on the subject. The idea here is a passenger-based insurance system which has also been suggested in the context of liability for damages caused by aerial hijacking.

3.6.3 IATA Conditions

The International Air Transport Association – henceforth: IATA – has an interest in avoiding bankruptcies of its airlines. As evidenced by the Sabena and Swissair bankruptcies, it mediates and offers assistance to its member airlines, whether publicly or behind the scenes.

IATA also has a direct ‘business’ interest of avoiding bankruptcies of its member airlines as it exercises the so called “Clearing House” function with and on behalf of its member airlines. The primary function of the Clearing House is to effect monthly clearances and to pay or collect from IATA member airlines the balance found to be due by or to the Clearing House. This method enables airlines to avoid having to make and receive numerous payments to and from each others as the Clearing House settles credits and debits among IATA airlines. The Clearing House has no direct link with the legal position of passengers but its role in relation to an insolvent airline became clear in the context of the bankruptcy of Ansett of Australia. That role was clarified in legal proceedings before the High Court of Australia in 2008.⁹⁰

IATA’s General Conditions of Carriage, version of 2008, do not refer to the possibility of the bankruptcy of the operating airline. All they do is lay down the provision pertaining to the cancellation of a flight beyond the control of the carrier, in which case the passenger is entitled to assistance, re-routing, and/or a refund, in accordance with the rules drawn up in IATA’s Conditions of Carriage. However, the legal question attached to this provision in relation to a passenger whose flight was not carried-out is whether the said provision on cancellation can be interpreted so as to cover cessation of operations due to insolvency of the airline. The practical problem is that, because of cessation of operations and bankruptcy, the operating airline has nothing to offer in terms of compensation and re-routing. Reference is made to similar remarks set out in the context of the DBC regulation (discussed in Section 2.2.6 above).

Finally, IATA’s Resolution 818g on Passenger Sales Agency Rules requires from applicants, that is, offices in specified states which want to act as an IATA Agency Services Office, that they provide “accounts showing a satisfactory financial standing and ability to remain solvent and pay bills.” To that effect, “the applicant shall submit independently produced financial statements prepared in accordance with local accounting practices.”

The above resolution does not give entitlements to passengers but should probably help avoid bankruptcy of IATA accredited travel agents. The legal question is whether lack of IATA’s supervision in this respect may or may not imply liability of IATA. As far as we know there have been no court cases on this so far.

3.6.4 Conclusions

There is practically nothing at the international, that is, world wide level of regulations which can directly help passengers who suffered damage as a consequence of the failure of an insolvent airline to operate the contracted flights. IATA appears to mediate between the insolvent member airline and other member airlines amongst others, to help stranded

⁹⁰ See, *International Air Transport Association v. Ansett Australia Holdings Limited*, [2008] HCA 3, decision of 6 February 2008, available at: www.austlii.edu.au/au/cases/cth/HCA/2008/3.html

passengers to travel to their point of original embarkation but such assistance can hardly be said to have a formal legal dimension.

3.7 APPLYING COMMUNITY RULES TO THIRD COUNTRY AIRLINES

For the sake of maintaining a level playing field between EC and non-EC carriers, financial controls and marketing regulations that regulate operator responsibility toward Community consumers should arguably also be applied to non-Community air carriers. Indicative scope for such coverage is given under standard clauses in bilateral air services agreements that regulate application of laws and which typically provide that all regulations applied by a state to international air services that are consistent with the Chicago Convention are to be respected by foreign operators.

While the issue of applying national laws arises most immediately when it comes to entry of aircraft and persons coming from outside (and such issues are dealt with expressly in air services agreements), the question of marketing rules and conditions has also arisen. For example, a number of states have included provisions on access rules for computer reservations systems in their air services agreements.

As a general matter in international trade, the principle of national treatment sets forth the idea that in a liberalised trading and doing business environment that the foreign-owned company will have the same obligations as well as the same rights of a domestic competitor. Arguably, it is therefore unreasonable that a third country airline should have fewer compliance obligations with regard to consumer protection, or any other area of law, than a national or Community company.

In practice third party states recognise this principle. For example the United States issues operating permits (so-called "402" Permits) to foreign airlines who have been authorised to operate and sell international air transportation in the United States which may stipulate economic as well as technical conditions of doing business. The same legal approach is practiced by Canada, and we note, for example, that Canadian permits expressly include the need for foreign airlines receiving advance payments for charter operations to make secured deposits of such funds.⁹¹

⁹¹ At the following website are listed orders issued by Canada to foreign operators (including all Community carriers then operating to Canada) in 1990 affecting amendment of their permits as a consequence of changes in Canadian national law re the protection of charter passengers. See: http://www.cta-otc.gc.ca/rulings-decisions/orders/1995/A/1995-A-282_e.html.

An extract from a typical permit amendment follows:

"WHEREAS by Order No. 1990-A-231 dated June 8, 1990, Licence No. 880622 was amended pursuant to subsection 96(1) of the National Transportation Act, 1987, R.S.C., 1985, c. 28 (3rd Supp.) by adding Condition No. 5 which reads:

The Licensee shall not operate a charter flight, other than an entity charter flight, unless it has filed documentary evidence with the Agency showing that all advance payments received from any charterer under charter contract are fully protected, for the benefit of and in the name of each charterer participating in that charter, by one of the following arrangements for securing those advance payments:

(a) an agreement of guarantee between the air carrier responsible for the outgoing portion of the charter and a Canadian banking, trust or financial institution whereby the full refund of all or part of the advances made to the air carrier, to which the charterer may be entitled under the contract for unperformed charter transportation, is guaranteed to be paid promptly to the charterer by that institution;

(b) a performance bond provided to the air carrier responsible for the outgoing portion of the charter by a Canadian bonding or insurance company under which the company agrees to refund promptly to the charterer, if that air carrier fails to do so, all or part of the advances made to that carrier to which the charterer may be entitled under the contract for unperformed charter transportation; or

Thus, subject to the conditions spelled out there, and in accordance with recent case law made by the European Court of Justice on that matter,⁹² examples such as Regulation 261/2004 setting terms of denied boarding compensation can be made to apply to non-EC carriers. Hence, 'national treatment' as regards EC- and non-EC carriers may lead to the imposition of local, that is, Community rules to non-EC carriers, operating into, from and between points in the EC market.

Under such circumstances, Community and national authorities need legal tools for enforcement of these rules regarding financial supervision of airlines. Directive 2004/36 on the safety of third country aircraft may set an example in this respect. However, a difference between the envisaged situation on expansion of the financial supervision from Community air carriers to air carriers generally, and the situation regulated under Directive 2004/36 is that the latter Directive refers to international safety standards which third countries and operators of third country aircraft are obliged to apply by virtue of the provisions of the Chicago Convention, bilateral air services agreements and ICAO Standards. Such is not the case with financial standards which are not based on international regulation.

3.8 GENERAL CONCLUSIONS

The position (and remedies for the benefit) of passengers who have booked their flight through a travel agent or individually on a troubled airline have been variously addressed in this chapter.

One case of insolvency is different or even very different from another. The forms and frequency of cases, however, respond to general economic conditions and the general rules governing the air transport industry.

In an earlier period, before the Third Package reforms, insolvency risks to travellers were associated in the laws of Member States with the need to protect consumers making advance payments from the risk of tour operator default. This thinking was taken over into the Package Directive. The traditional flag carriers were not perceived to be at risk. Many of them enjoyed protected market positions and their owners (often the government) were even less likely to face an insolvency risk.

In a changed operating environment, a few traditional carriers and a great many new entrant operators of scheduled airline services face increased risks. As a consequence travellers who book individual flights or individual packages directly, and who therefore have not been covered by the terms of the Package Travel Directive, have become the subject of policy discussion. As described in this chapter, a range of tools exist and are being added to in order to provide them with help, insurance or rights of cost recovery.

(c) performance insurance covering the charter price, whereby, if the air carrier responsible for the outgoing portion of the charter fails to perform the charter or any part thereof, the charterer shall be reimbursed to the extent of the entitlement of that charterer under the contract for the unperformed charter transportation."

⁹² Case 172/07, *Emirates Airlines v. Dieter Schenkel* Decision of 8 July 2008; not yet published

Regulators also possess new scope through recent reforms of licensing regulations to strengthen financial oversight over airline operations. However, arguments are still being made for a more general and systematic approach to address changing market conditions.

These changing conditions (as will be discussed in the following chapters) also suggest that market forces and acts of industry cooperation as well as proposals for new regulation need to be taken into account in analysing and addressing the problem. In considering solutions, it will also be necessary to pay perhaps increased attention on the potential impacts of any reforms on competition and to ensure conditions of a level playing field among all classes of operators including third country airlines.

4 CHANGES IN THE TRAVEL MARKET

The travel market has changed significantly across Europe in recent years. This is particularly marked in the case of holiday makers. The market, as it exists today, includes very different sales channels and methodologies to those commonly employed in, for example, 1990. This chapter will review the changes that have taken place in the market and the extent of implications for consumer protection. New patterns of consumer behaviour are assessed, most notably caused by the change in supply through the rising importance of low cost carriers on the holiday market.

We have examined several research studies, based on surveys within and across the 27 Member States that suggest that there is a clear trend away from package travel towards self-organised 'dynamic package' travel.

The travel industry describes dynamic self packaging as "giving consumers the ability to configure all aspects of their vacation travel needs as an interrelated whole"⁹³. However, the consumer is not booking a package in the traditional way, as defined by the EU Package Travel Directive (PTD), but rather compiling a set of individual elements. The consumer is therefore not financially protected under the EU PTD against failure of any provider of elements of their holiday, including airlines, unless the final transaction includes an agreement with a provider to provide a set of services that will qualify as a package under the law (see Section 3.3.3 above).

This means that the number of consumers vulnerable in the event of an aviation bankruptcy has increased, not merely because the number of people travelling has risen, but also because increasingly their method of booking leaves them unprotected. Overall, the picture that emerges is one of more passengers flying more frequently, more people booking flights independently of travel agencies, and therefore more people potentially at risk. This, combined with the rocky economic times ahead for airlines, means more people are facing a higher risk than before.

It is helpful at this point to set out how the travel industry has evolved over the last decade.

In the past,

- Travel Agents and Tour Operators sold many (PTD protected) package holidays, flights, hotels and car hire and provided advice;
- Airline websites sold flights;
- Hotel chain websites sold hotel reservations;
- Newspapers and magazines reviewed destinations and travel products (The travel industry provided a strong source of revenue for them);
- Travel / product review websites published reviews, however, had only a limited presence.

Currently,

- Travel Agents and Tour Operators sell less (PTD protected) package holidays;

⁹³ "Customer Focused Online Travel Distribution for the 21st Century"; Joe Buhler, netStrategic LLC

- Many travel shoppers visit an agent or operator for inspiration or to obtain the information they need before returning to their computers to make the booking online;
- Airline websites sell flights, hotel and car hire and offer reviews;
- Newspapers and magazines continue to review destinations and travel products, however, to a lesser extent than before due to a shift in advertisement from print to digital media;
- Travel and product review websites have increased in presence and importance, and do not only provide reviews, but also advise and serve as booking portals for airlines, hotels and car hire companies.

In future,

- Travel agents and tour operators are likely to find it more and more difficult to find sufficient 'valued added' package travel products to differentiate themselves from the 'self packaging options' available to the consumer via the internet.

This chapter will investigate the changing behaviour of European consumers in booking their travel, distinguishing between travel for leisure, business or other purposes.

Our consideration of the changing market will consider the drivers changing both consumer behaviour, and the supply side, that is the airlines and other agencies which sell tickets and holidays. This will be followed by an exploration of the impact this has on state of the market as a whole.

4.1 CHANGING SUPPLY

As the air transport market has evolved, so too have methods of supply. Of particular note are the rise of low cost carriers, the decreasing market share of chartered carriers and the evolution of "self-packaging" – that is, the ability for consumers to compile their own holiday package via airline websites. These changes are discussed in the following sections.

4.1.1 Low Cost Carriers: a New Business Model

Since the early 1990s, the European market has seen the rapid growth of low cost scheduled carriers. Amongst their key characteristics has been a direct sales channel with the customer: initially through call centres, and soon after, as use of the internet increased, selling the majority of their tickets online, rather than through agents or packages. Their websites have increasingly offered ways to purchase associated services, ranging from travel insurance to car hire and hotel bookings.

The business model adopted by LCCs is based on minimising costs, simplifying operations and maximising yields. At the time of introduction, this model stood in contrast to the offerings then provided by traditional airlines (both charters and full service carriers). Typical elements of the low cost and 'traditional' airline models have been:

	Low Cost Carrier	Traditional Airline
Destinations	Short haul destinations, utilising secondary / regional airports	Variety of destinations, using major airports
Fleets	A simplified fleet structure, often a single aircraft type	A varied fleet to cope with short and long haul destinations
Load factors	Above 75%	Typically around 60%

	Low Cost Carrier	Traditional Airline
Network	Point to point, with no connections or code shares	Full Service Carriers only: Hub and spoke model, with connections and code shares
Utilisation	High frequencies with high utilisation and quick turnaround	Typically lower utilisation (regulations, e.g. labour law, make high utilisation impractical for long haul destinations)
Fares	Fares made available in “buckets”, with regular recalculation of prices, so as to maximise yield	Fares fixed in advance
“Extras”	Stripping out optional items with charges for “extras”, including check-in services, bags checked in, sales methods other than on-line, as well as food & drink and entertainment onboard	Ticket price is all-inclusive

Source: Booz & Co analysis

Table 7: Comparison of (Historic) Airline Business Models

It must be noted, however, that in more recent years there has been convergence between business models as traditional airlines operating short haul, both full service carriers and charters, have responded to the competitive pressures and adopted many of the business practices first implemented by low cost carriers.

Ryanair was the first EU carrier to structure its company along those lines, using the model introduced by Southwest Airlines in the US. The liberalisation of the EU market in the early 1990s, in particular through the “third package” of measures to liberalise EU air transport beginning in 1993, under which most frequency and carrier designation restrictions were removed, enabled the low cost model to expand. EasyJet, a UK carrier, began operations in 1995 with two aircraft, offering flights between London Luton and Scotland, and started its first European route, to Amsterdam, in 1996.

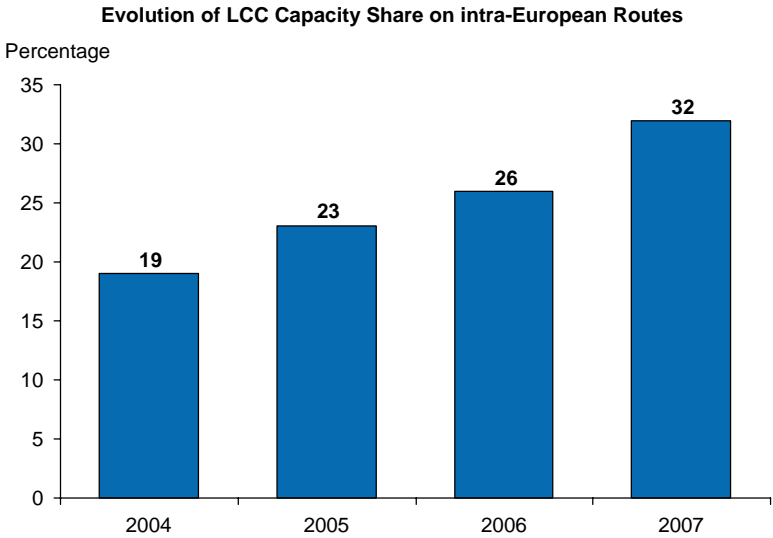
The LCC model took hold more slowly among other European operators, reflecting the aggressive expansion and relative dominance of the two UK-based operators at the low cost price point. In France, strong competition from Air France and SNCF’s Train à Grande Vitesse (TGV), and the loss-making Air Liberté retarded the development of indigenous LCC operations – in which an Air France-KLM subsidiary is now the main actor. In the Federal economy of Germany, there was more opportunity for point-to-point carriers, and Air Berlin and Germanwings flourished, while in Italy, Volare, Meridiana and Air One challenged Alitalia, which was hampered by its twin base structure and persistent financial and political difficulties. Meanwhile, easyJet established its first European base, at Geneva, in 1999, and Ryanair, two years later, at Brussels Charleroi.

In 1998, BA responded by establishing a Stansted-based subsidiary, Go, which was eventually purchased in 2002 by easyJet. Go’s routes were a mix of whole and partial transfers from BA’s main operation. In 2007-08, easyJet also purchased BA’s European and North Africa tourist-destination franchise partner, GB Airways. KLM UK attempted to follow suit, rebranding as “buzz” in 2000, and sold to Ryanair in 2003. British European re-launched itself as an LCC carrier, flybe, in 2002, which acquired the majority of BA Connect, BA’s regional carrier in November 2006. In the last few years, several holiday companies

and charter carriers have launched scheduled LCC subsidiaries, such as Monarch and Thomsonfly.

By 2007, the leading LCCs in terms of passengers carried, were Ryanair and easyJet, carrying respectively 50.9 million passengers on 688 routes between 150 destinations, and 37.2 million passengers on 289 routes between 77 destinations (2007-08). EasyJet has focused on Western Europe and has grown to include some longer routes, including expansion beyond Europe to Morocco and Tunisia. Ryanair, by contrast, has focused particularly on routes in Eastern Europe, in particular to Poland, operating as far East as Rzeszow, on the Ukrainian border, and with a major base at Frankfurt Hahn airport, a former military base.

According to IATA comparative data, in 2007, Ryanair and easyJet were respectively first and fourth largest airlines in the world by number of scheduled passengers carried, with Lufthansa, Air France and British Airways respectively second, third and fifth. The growth of LCCs has been facilitated by the increased willingness of governments to divest themselves – partly or fully – of national flag carriers, either through a planned process, or through a restructuring at a financial crisis (as in the case of Sabena and Swiss). Figure 8 below shows the rise of the LCCs’ share of the intra-European scheduled passenger market.



Source: OAG Data

Figure 8: Evolution of LCC Capacity Share on Intra-European Scheduled Services

In 2006, the total number of passengers carried by LCCs exceeded 150 million. The dominant carriers remained Ryanair and easyJet, with Air Berlin holding the third place, as is shown in Figure 9 below.

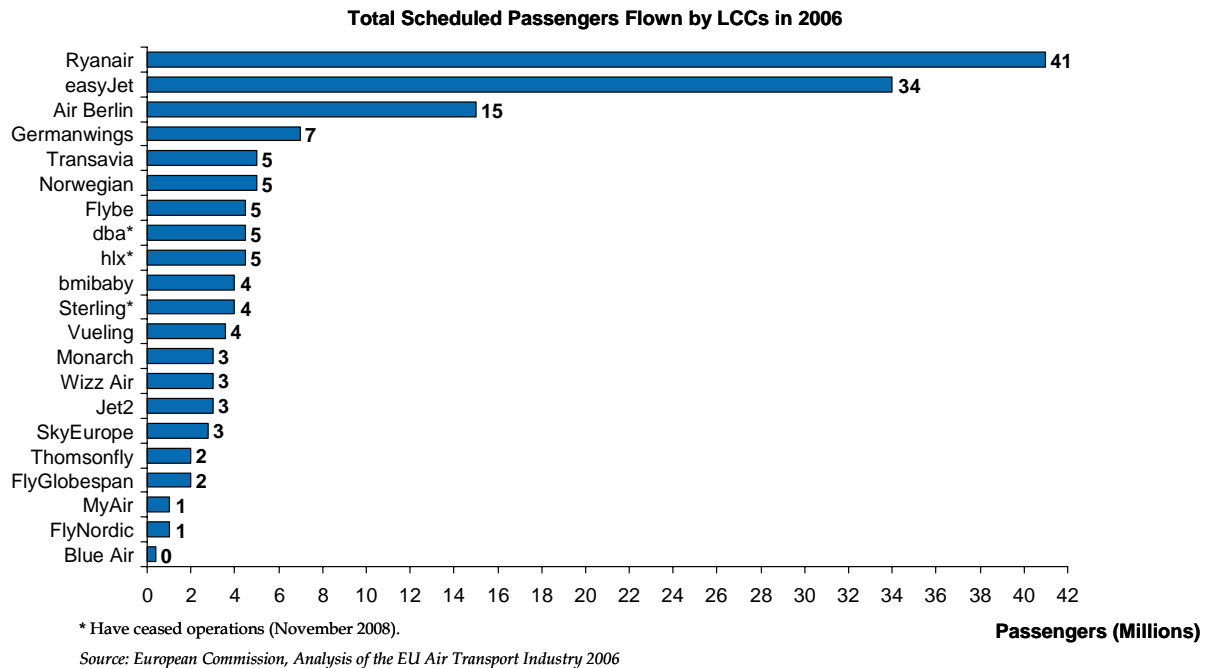


Figure 9: Scheduled Passengers on LCCs in 2006

4.1.2 Market Impact and Market Response

Low Cost Carriers have affected the overall scale of the market in the following key ways:

- Growing the market in overall scale;
- De-concentrating the market in terms of destination;
- Frequent point-to-point versus point-to-hub-traffic, often (re)developing secondary airports;
- Reducing the market share of charter carriers, and refocusing charters on longer distance routes;
- Reducing the market share, and in some cases operations, of full service carriers.

Through the last two points, LCCs have potentially contributed to a greater number of people flying without explicit protection against airline bankruptcy.

There is also some evidence to suggest that LCCs have had an effect on the distribution within society of use of air transport and that, within an overall increase in access to air services, there are trends towards the more price-conscious members of society being disproportionately represented among the customers of remaining charter carriers and smaller LCCs. In certain circumstances, a result could be that more vulnerable people come to be travelling without protection.

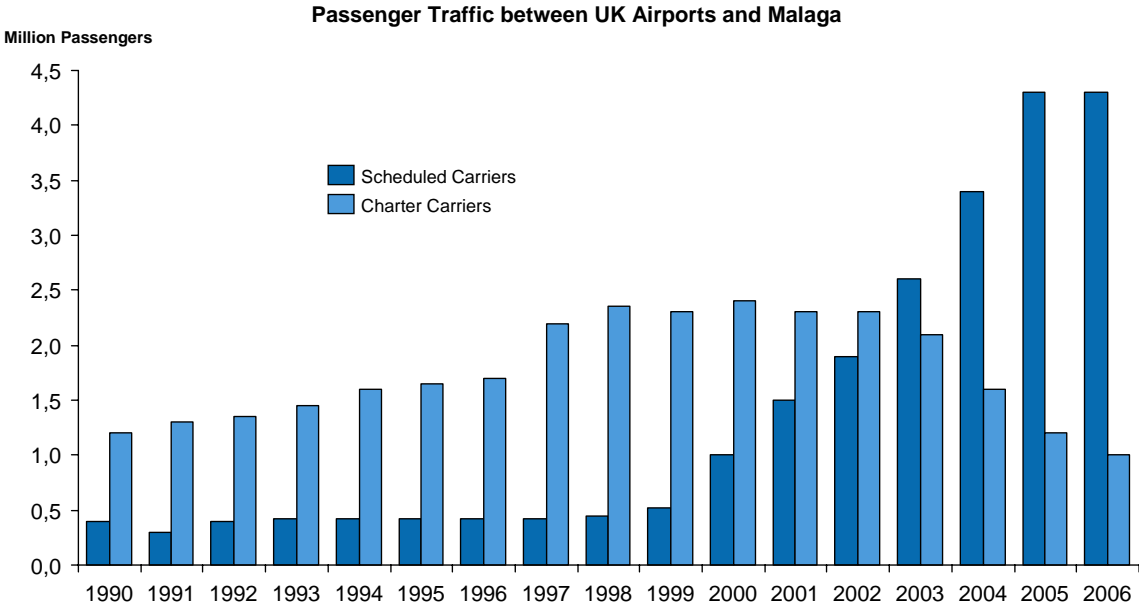
4.1.3 Impact of LCCs on the Holiday Markets

LCCs have had a significant effect on the distribution of traffic between carriers. Particularly on intra-European routes, their market share has increased, at the expense of both full-service and charter carriers. In addition, through the utilisation of a point-to-point business model, an increased number of passengers travel between regional airports rather than via major hubs.

While LCCs initially took on the legacy carriers, it is increasingly charter carriers that have lost market share, as was noted by the UK CAA in their 2006 report⁹⁴ "Low Cost Carriers: Evolution or Revolution?". This comprehensive report noted that "between 2000 and 2005, UK to EU charter traffic declined at an average annual rate of 4.1% while full-service scheduled traffic contracted at a rate of 2.2% a year... charter traffic shows no signs of recovery, having contracted by 13% in 2005 alone".

LCCs offer greater flexibility, access from regional airports, lower costs and – more importantly – the ability to create a tailor-made trip utilising internet distribution channels. This has had a significant impact on the charter market. Demand for short-haul charter traffic fell by 20% in the UK between 2003 and 2006.⁹⁵ EU-wide, many charter airlines have either failed, demised or changed their business model. Focus has shifted from short to long haul markets, in which the LCCs are not currently represented. The medium-haul market, most notably Turkey and North Africa (Morocco, Egypt, Tunisia) is also being increasingly penetrated by LCCs with both easyJet and Ryanair offering services to Egypt and Morocco, thanks to the increasing liberalisation of the market. Charter airlines have therefore moved to offering longhaul charters, mainly to Central America, the Caribbean and the United States. Other charter airlines have transformed themselves into LCCs or so-called 'hybrid' carriers (e.g. Monarch in the UK and Transavia in the Netherlands); offering both low-cost and charter services. The sector has also seen an increase in consolidation, initiated by the main tour operators.⁹⁶

As an example of these trends, we consider Malaga airport in Spain, a popular holiday destination, which has experienced a dramatic increase in scheduled air services alongside a similarly dramatic decline in charter traffic. These changes are shown in the figure below.



Source: European Commission, Analysis of the EU Air Transport Industry, 2006.

Figure 10: Change in Air Service Type at a Typical 'Holiday Airport'

⁹⁴ Civil Aviation Authority, No-frills Carriers: Revolution or Evolution, 2006.
⁹⁵ Idem.
⁹⁶ European Commission, Analysis of the Air Transport Industry, 2006

However, although travelling on LCCs has many benefits for passengers, including increased flexibility and lower prices, this combination of new destinations available and flexibility of travel have contributed to a growth in independently booked travel, and thus to reduction in protection against airline bankruptcy. The aforementioned UK CAA reports that in 1997, 98% of leisure trips had ATOL cover, by 2006 this figure had fallen to 60%. We understand from discussions with the CAA that current figures are in the region of 55%, which suggests that the number of trips covered by ATOL will continue to fall.

Business and 'visiting friends and relatives' (VFR) travel has also grown in recent years: two market segments that would rarely be afforded protection under the package tour directive.

Across Europe, Eurostat records that, from 1995 to 2004, air transport passenger kms within the EU-25 grew, despite the severe setbacks of 2001 and 2002, by almost 49%, far outstripping the growth across modes of less than 18%. Eurostat draws particular attention to high growth rates among Member States joining in 2004-2007, with some year-on year growth rates from 2003 onwards of more than 50%. In the majority of cases, the new air services are offered by scheduled air carriers (on which services, package travel protection is unlikely to apply).

4.2 CHANGING CONSUMER PURCHASING BEHAVIOUR

More and more bookings are made by travellers directly via the internet, bypassing the middle man, the travel agent and/or tour operator. This is a result of the increased penetration of the internet, the resulting greater transparency in the market and a change in the supply available on the travel market (as described earlier, initially by LCCs but increasingly also by full service carriers).

It is worth considering here research on consumer behaviour. Traditionally, economists have viewed consumers as rational agents making their purchase decision according to their individual preference on the basis of the price and quality of the product offered, with the consumer's income influencing that trade-off.⁹⁷ The term 'quality' can cover a multiple characteristics of the good, including the reputation of the producer of the good and the durability of the good. In the case of air travel, clearly a consumer can take into account both the quality of the experience, comparing the difference between that offered by a full service carrier compared with a low cost carrier, and weigh that up against the difference in price. They may also take into account the probability of the good being delivered, as in, the flight actually taking place. Whether this is a relevant factor will depend on their assessment of the risk of this occurring; if they do not consider that such an event could occur then it will have no influence on their purchasing decision.

Recent research⁹⁸ has suggested that certain product types are more amenable to being sold online. These products include items like books, music and travel tickets – products that do not require personal inspection in order to assess their suitability. Furthermore, when buying over the internet, it was found that consumers were highly time-conscious, and were

⁹⁷ This picture of a rational agent is complicated by research done in this area by consumer behaviour theorists who apply sociological, psychological and anthropological analysis to the consumers. Under this rationale, consumers base their purchase decision on a vast array of influences, such as their socioeconomic class, their culture, their personality, their 'feelings' and 'aspirations', the implications of this are perhaps of more relevance to advertising agents than to us now, but it does emphasise the important point that consumers are not necessarily 'rational' when making their purchasing decisions.

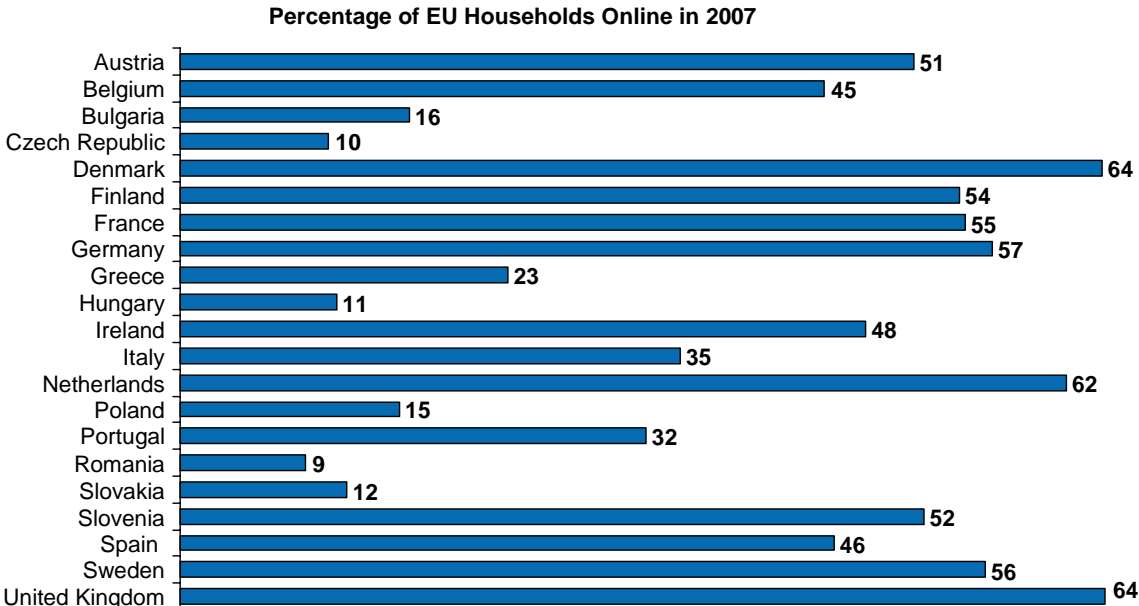
⁹⁸ See, for example, Shun & Yunjie (2006)

not willing to read extensive amounts of data, preferring to quickly scan through the information briefly looking for key points. Such research goes some way to explaining the popularity of booking flights over the internet, but also cautions us that consumers may not spend time reading the small print, either of the terms and conditions of tickets bought online, or of insurance packages they may purchase.

The following section will examine the degree to which internet and e-commerce is increasing as a whole, and the effect this has on consumer behaviour when booking flights and holidays.

4.2.1 Increased Penetration of the Internet - E-Commerce in the EU

There is increased penetration of the internet across all 27 Member States, which represents an increase in the availability for consumers to access the internet and to take advantage of the convenience of shopping from home and dynamically self package their holiday.



Source: IDC 2007

Figure 11: Proportion of EU Household Online by Country (2007)

IDC, a market intelligence firm forecasts that by 2010 more than 57% of households across the EU will be online. Additional evidence for this consumer behaviour trend could be the increase in e-commerce activity across the EU States. IDC observed an increase in e-commerce activity of 22% from 2006-2007 and predicts that this increase will rise to 73% by 2010. These trends are outlined in the table below.

Increasing Percentage of Households Online							
	2006	2007	2008	2009	2010	Change 2006-07 (%)	Forecast Change 2006-10 (%)
Austria	47.4	51.1	55.1	59.1	63.4	3.7	16.0
Belgium	40.7	44.9	49.3	53.8	58.3	4.2	17.7
Bulgaria	13.5	16.0	18.8	21.8	24.9	2.4	11.4
Czech Republic	8.8	10.3	11.7	12.9	14.0	1.5	5.2
Denmark	60.6	64.2	67.2	70.3	73.0	3.6	12.4
Finland	50.0	54.3	58.2	62.0	65.5	4.4	15.5
France	49.2	54.7	60.2	65.9	71.7	5.5	22.6
Germany	52.9	56.6	60.4	64.5	68.7	3.7	15.8
Greece	19.7	22.8	26.2	29.7	33.6	3.0	13.8
Hungary	9.3	10.9	12.2	13.6	13.6	1.6	4.3
Ireland	41.2	47.7	54.5	61.7	69.4	6.5	28.1
Italy	30.9	34.8	38.7	43.0	47.5	3.9	16.6
Netherlands	57.4	61.7	66.3	71.5	76.9	4.3	19.4
Poland	13.7	15.3	16.6	17.8	18.8	1.6	5.0
Portugal	27.7	32.4	37.1	42.4	48.2	4.7	20.6
Romania	7.5	8.7	10.0	11.3	12.5	1.3	5.1
Slovakia	10.3	11.6	13.1	13.9	14.7	1.4	4.4
Slovenia	47.1	51.8	56.6	57.8	59.1	4.6	12.0
Spain	39.1	45.5	52.2	59.0	66.2	6.4	27.1
Sweden	53.2	56.1	58.6	60.9	62.9	2.9	9.7
United Kingdom	59.7	64.4	68.9	73.3	78.0	4.6	18.2

Source: IDC 2007

Table 8: Internet Penetration - Households Online in the EU⁹⁹

Gross internet penetration is greater than the number of those who can access the internet at home given that, in practice, many workers have access to the internet at their office, and some of them will use this access more than their connections at home.

4.2.2 Increasing Internet Penetration and E-Commerce: Focus on the UK

As noted above, the UK has one of the highest rates of internet penetration in the EU. According to the UK's Office of National Statistics Omnibus Survey, an estimated 13.9 million UK households, equalling 57%, could access the internet from home between January and April 2006. This represents an increase of 26%, or 2.9 million households since 2002.

Furthermore the UK's Office of National Statistics states that the UK is Europe's most advanced E-Commerce market. Estimates by the internet analysis company, eMarketer indicate that 77% of all UK Internet users, ages 14-plus will conduct purchases online in 2008. Travel represented the 2nd most popular product purchased online in 2006.

⁹⁹ Data excludes: Cyprus, Estonia, Latvia, Lithuania, Luxembourg, Malta

Type of Product	Percentage of UK Adults
Film, music	53%
Travel or Holiday Accommodation (incl Air Travel Tickets)	51%
Books, Magazines, Newspapers, e-Learning Material	37%
Clothes, Sports Goods	37%
Tickets for Events	35%
Computer Software and Upgrades (incl. Games)	29%
Electronic Equipment (incl. Cameras)	25%
Household Goods (Furniture, Toys, etc)	24%
Share Purchases, Financial Services, Insurance	24%
Computer Hardware	22%
Food, Groceries	21%
Other	11%
Lotteries or Betting	7%
<i>Source: National Office of Statistics, Internet Access, Households & Individuals, August 2006</i>	

Table 9: Internet Purchases by UK Adults in Last 12 Months (2006)

In the future, not only is gross penetration likely to increase, but more people are expected to access the internet by mobile means, from mobile phones, “blackberry” or other portable devices. This will have implications for gross penetration, but also for the types of content people receive: 12” screen content, at a desktop, enables the relatively easy display and, if the client, chooses, reading of “small print”, or a large range of options; viewing of content on a mobile handset screen, on the move, will inevitably reduce the complexity of content presented – and thus, for example, opportunities to inform customers about the range of protection they may have.

4.2.3 Impact of Internet on Flight and Holiday Bookings

Travel and tourism are amongst the industries most affected by the increase in e-commerce. The internet affects the travel industry in two major ways:

- Consumers can research trips abroad for themselves, lessening the need for professional advice from a tour operator or travel agent
- Consumers can buy flights, hotels, car etc direct online, bypassing the travel agent altogether.

Research provides evidence¹⁰⁰ that consumers spend more and more time investigating and arranging their own travels on the open market, ‘dynamically self packaging their vacation’ according to their individual needs and preferences. By opting against the ready-made travel package, compiled by travel agents and tour operators, these consumers are forgoing protection against airline bankruptcy under the European Council Directive on Package Travel - perhaps unknowingly.

The Travel Agent/Tour Operator’s traditional role of adviser and organiser has changed as consumers can, with the help of the internet, research and review any product. Social networking sites, such as facebook, Myspace and WAYN, and product review portals such as tripadvisor.com, offer the consumers product/service reviews and the benefit of other traveller experiences; whilst travel portals, such as expedia.com, allow them to carry out transactions and receive an instant confirmation of availability of products and purchases.

¹⁰⁰ Mintel - Holiday Booking Process, Leisure Intelligence, March 2008, 2007, 2006

In other research, a survey carried out by Foolproof, published via the European Travel Commission¹⁰¹, indicates that, in the UK, the internet is the most popular place for people to research and book holidays and short breaks. The study found that 87% intended to use the internet to research their next holiday or short break, with only 24% saying that they would go to high street travel agents or call operators.

According to a study recently undertaken by the Centre for Regional Tourism (CRT)¹⁰², online travel sales increased by 24% from 2006 to 2007 and reached €9.4 billion in the European market in 2007.

Year	Total market (€bn)	Internet sales (€bn)	Online share of market (%)	Increase in internet sales (%)
2000	227	2.5	1.1	216
2001	223	5	2.3	99
2002	221	8.9	4.0	77
2003	215	13.9	6.5	56
2004	220	20.8	9.5	50
2005	235	30.2	12.9	45
2006	247	39.7	16.1	31
2007	254	49.4	19.4	24
2008	260	58.4	22.5	18
2009	266	68.9	25.2	15

Source: CRT, January 2008

Table 10: Trends in Overall Online Travel Market Size - Europe¹⁰³ (1998 - 2007 Projections to 2009)

From 2000 to 2007 European internet sales relating to travel went up from €2.5 billion to €49 billion. The compound annualised growth rate (CAGR) was a massive 64%, this compares with a growth rate of 2% for the industry as a whole. The data also indicate that the online travel market in Europe may be expected to be worth €69 billion by 2009, representing over a quarter of the total market for travel and tourism services.

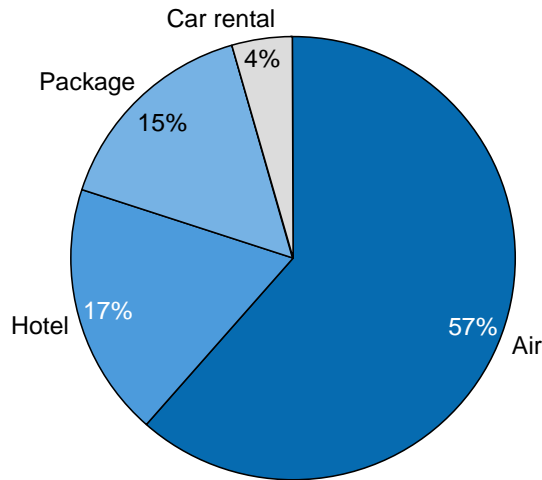
Research conducted by EyeforTravel, a travel market analysis firm, gives the shares of the different services of the online travel market as shown in the pie chart below.

¹⁰¹ New Media Review, The European Travel Commission, Online Travel Market, Travel Planning (<http://www.etcnewmedia.com/review/default.asp?SectionID=11&CountryID=53#online>)

¹⁰² Trends in European Internet Distribution of Travel and Tourism Services, January 2008, CRT, Denmark

¹⁰³ Note: these figures include the EFTA3 (Iceland, Norway, Switzerland), as well as the EU27

European Online Travel Market, by Service Type 2007

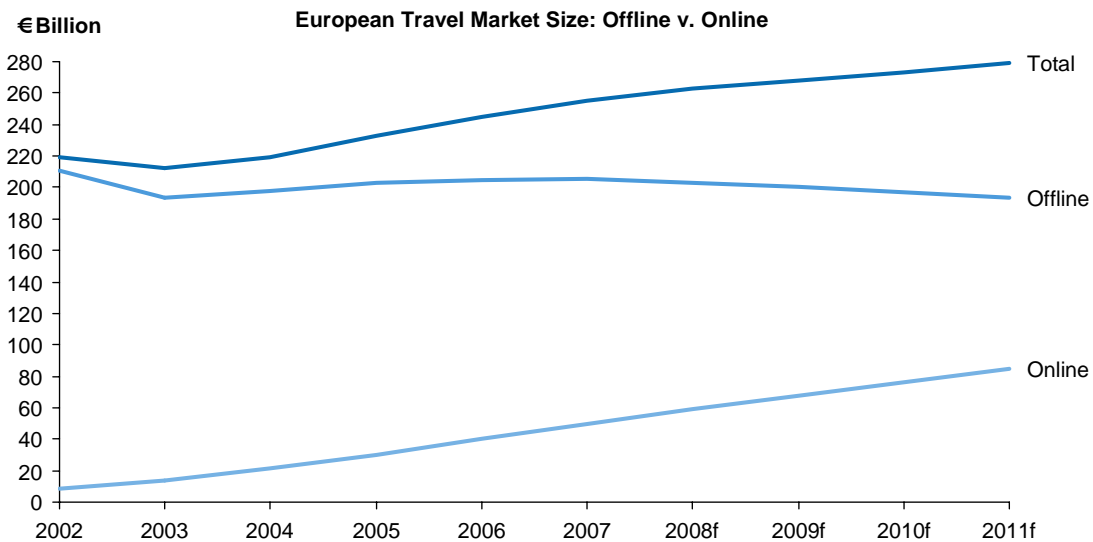


Source: EyeforTravel Research, European Online Travel Report 2008

Figure 12: Service Type Shares in the European Online Travel Market

This confirms other findings that air travel is the most popular online travel item to be purchased.

Furthermore, their data indicates significant growth of online bookings across the EU, enabled by increased internet penetration. The increase of online booking, and forecast increase to 2011, as a proportion of the total travel market is shown below¹⁰⁴.



Source: EyeforTravel Research, European Online Travel Report 2008

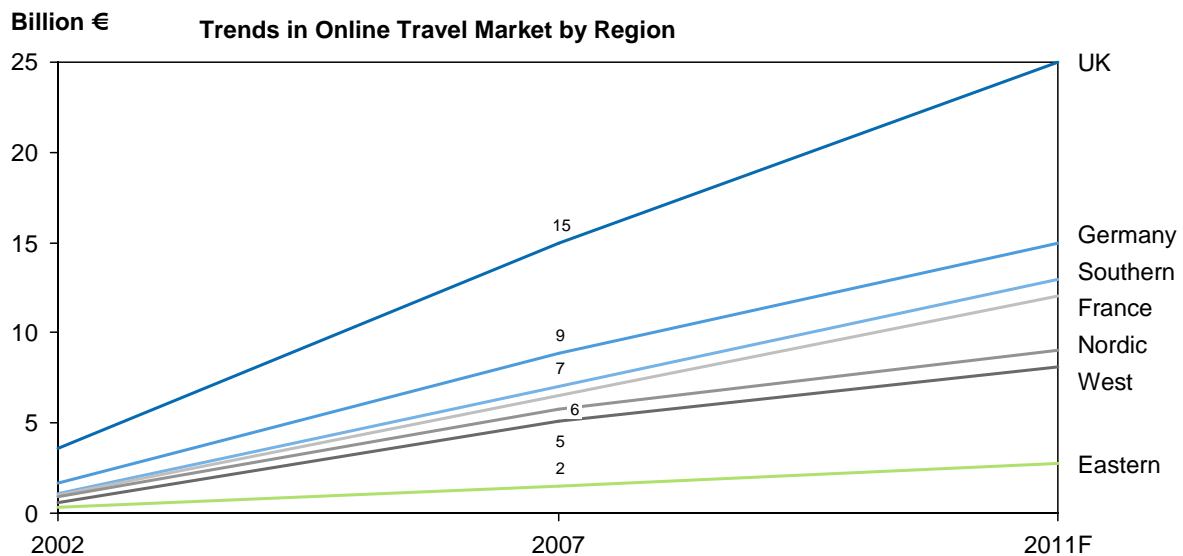
Figure 13: European Travel Market Size, Online v. Offline

¹⁰⁴ Note that this represents the total travel market, not only air travel.

4.2.4 Self-Packaging and the Online Market as it Varies across the EU Member States

The previous section defined the growth of the online market, particularly those of low-cost airline bookings, much of which has replaced package travel. This trend towards dynamic self packaging is occurring across the EU, not only in a few Member States. In the following section, we will examine variations across the EU, as well as the specific cases of major regional or individual travel markets.

Many airlines, both low cost and full service carriers, as well as online travel portals (e.g. expedia.com and lastminute.com) are now providing dynamic self-booking facilities to a different extent throughout the 27 EU Member States. The inherent risk of this tendency is the increasing exposure of passengers to the risk of airline default through self-packaging on the web. Tailor-made online holidays and independently booked low cost scheduled carrier flights are not covered by the travel package directive, nor ATOL (or similar) schemes. It is important to review the scope of the online market in order to measure the relative risk of passenger exposure. Extensive research on the online market has been carried out by EyeforTravel, showing different situations throughout Europe. The main trends identified in the development of the online market are shown in the figure below, including future forecasts. In the short term, considerable growth of the online market is expected, particularly in Southern and Eastern Europe.



Source: EyeforTravel Research, European Online Travel Report 2008

Figure 14: Trends in the European Online Travel Market, by Region

An overview of the per capita online expenditure is given in the figure below. The figures naturally reflect the level of internet penetration, which, in part, explains the high per capita values of the UK and Nordic markets.

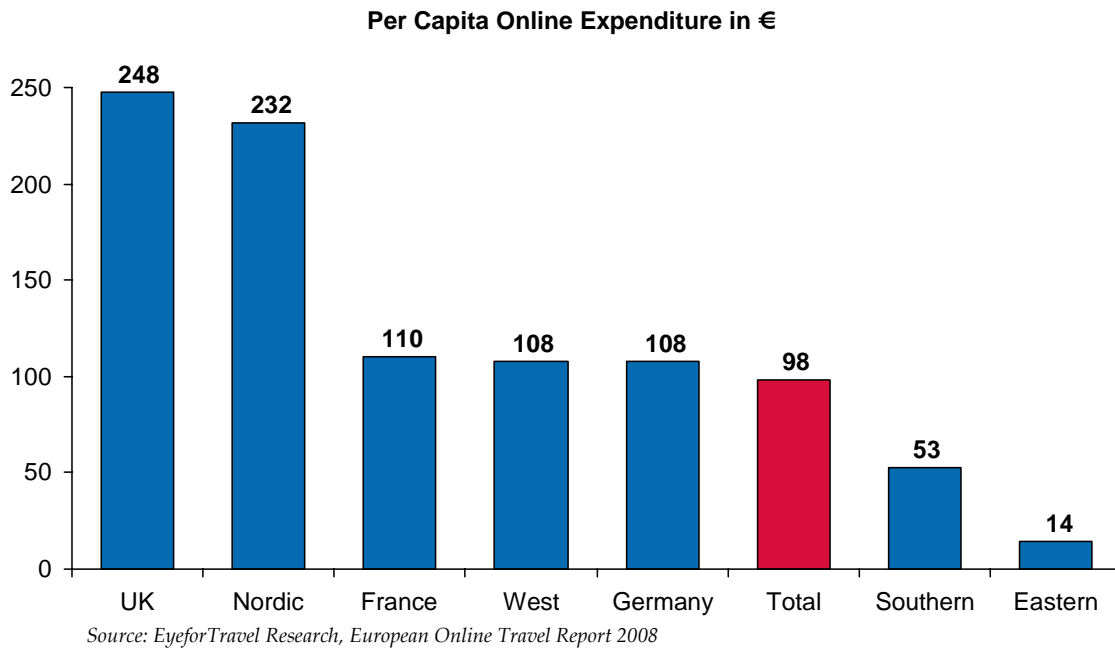
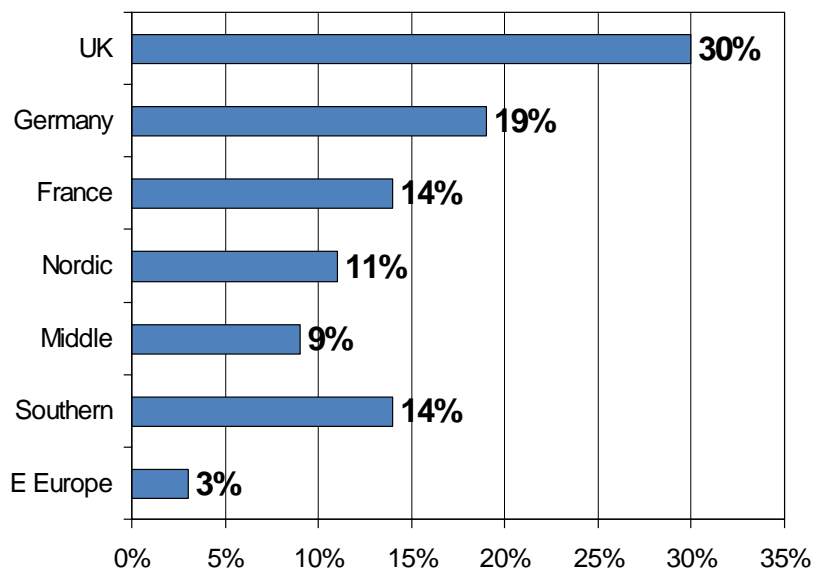


Figure 15: Per Capita Total Online Expenditure

While consumer habits are changing in many of these countries, the tendency to book holidays independently remains more developed in the UK and Nordic region than in other Member States. This could be down to cultural reasons, caused by different levels of accessibility of other countries by different modes of transport (e.g. short/city breaks are often taken by car on the continent), geographic location and a difference in service offerings by the airlines/supply pattern, and perhaps also to the level of internet penetration, which is higher in the UK than in any other EU Member State.

Considering the online travel market by country, it is the UK, Germany and France that currently spend the most, together accounting for 63% of the total European online travel market (or around 31 billion euros).

Geographic status for the European online travel market 2007 (EUR 49.4 bn.)



Source: Carl H Marcussen, Centre for Regional and Tourism Research, www.crt.dk/trends, 28 Jan 2008

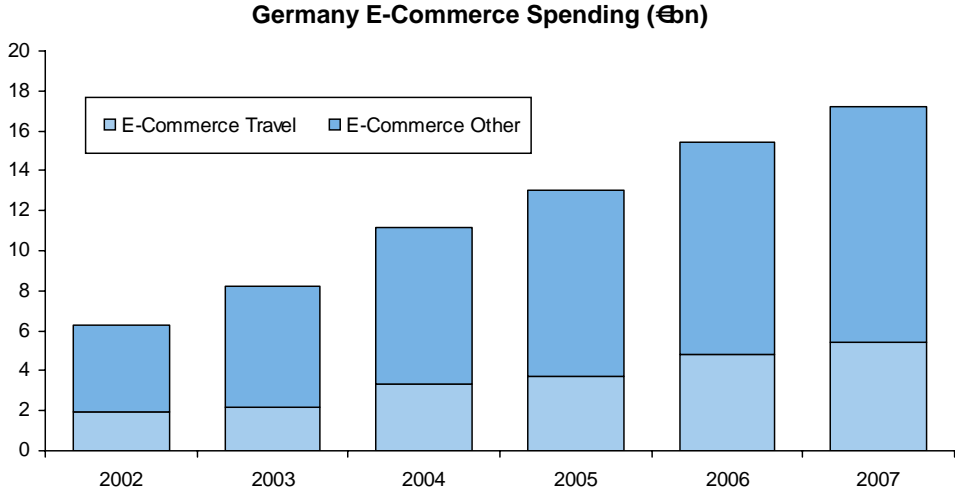
Figure 16: Purchases of Travel Online by EU Country / Region

As the chart above illustrates, the UK remains the largest purchaser of online travel in Europe, with Germany in second place. Together, these two markets account for almost 50% of the European online travel market in 2007.

After the UK, which will be discussed in a separate case study, Germany and France have the largest share of the online travel markets.

4.2.4.1 Germany

The German online travel market amounted to nearly €9 billion in 2007. Of this, the airline sector accounts for the majority of online travel consumption (53%), followed by hotels and car rental, as indicated in the figure below. Online travel bookings have grown by over 280% between 2002 and 2007, whereas the online travel market itself experienced an averaged growth of 39% during the same period.



Source: GfK Germany, GfK Consumer Tracking (27/03/2008)

Figure 17: E-Commerce Spending Germany (2002-2007)¹⁰⁵

The strong representation of air travel in total online travel sales signifies a growing tendency towards independent self-packaging. As indicated earlier in this report, much of this growth has been driven by the rise of LCCs (low cost airline Air Berlin is currently Germany’s second largest airline) and the increasing adoption of similar distribution channels by full service carriers. Most tickets are booked through intermediaries, (e.g. travel portals such as expedia.com or lastminute.com).

Traditionally, German travellers are large package travel consumers. The online segment of this sector experienced an average growth rate of 29% between 2002 and 2007, and is expected continue to grow by a further 12% between 2007 and 2011; package and charter operators TUI and Thomas Cook, the two largest EU tour operators, are under majority German ownership. The largest share of the travel market is still the offline (high street/travel agent) market for package travel, accounting for 30% of the total German travel market in 2007. Based on the German travel market as a whole, only 8% of the market share is derived from the sale of online airline tickets, compared to 19% of market share for offline. Germans are thus relatively unexposed to unprotected travel, although the expected growth

¹⁰⁵ www.gfk.de

of the online LCC market, as well as the clear tendency towards more self-packaging requires attention.

4.2.4.2 France

The travel market accounted for 46.5% of total online revenues in France, equivalent to approximately €3.5 billion. The market experienced faster growth rates than Germany or the UK, enabled by a steep increase in internet penetration. Airline bookings account for only 42% of the online travel market. The main reasons for these lower figures were the relative delay in LCC entry to the French domestic market and the strong competition of the extensive (high-speed) railway network.

The airline sector experienced growth in the online segment, but unlike other markets, this growth is driven by legacy carriers and intermediaries. The travel portal of French national railway SNCF is by far the most popular travel website, also offering flights and hotels. Growth of the online LCC market was a mere 28% between 2002 and 2007, compared to 54% of legacy carriers and 47% of travel portals. At present, the majority of airline tickets are booked offline through travel agents, but significant growth is expected in the online segment for both legacy carriers and intermediaries. Package travel is relatively limited in France; market shares are 2% of the total travel market for online and 9% for offline bookings. Hotel and car rental bookings accounted for 17% and 4% of online bookings respectively, while trains are the most popular purchase with 30% share of the online travel market. Growth is expected for both online train and accommodation bookings, signifying a trend towards more self-packaging.

The degree of independent bookings and the limited number of package travel is leaving the French customer relatively unprotected in case of airline failure. However, this is somewhat balanced by the large domestic holiday market and competition from the railways.

4.2.4.3 Western Europe

Considering other major countries in Western Europe - the Netherlands, Belgium, Luxemburg, Ireland and Austria, as well as Switzerland, airline tickets account for 59% of the online travel sales, quickly followed by hotels at 23% and package travel at 14%. Train sales are negligible. It is interesting to note that online package bookings have experienced faster growth rates than air tickets, and are expected to do so until 2011. There is a clear trend to booking directly through the supplier, usually after extensive online research to the best deal. Direct online booking with LCCs and other airlines leaves this region as exposed to airline failure as the others, but the higher tendency towards package travel generally leaves customers better protected.

4.2.4.4 Southern Europe

Turning now to the southern European countries of Italy, Spain and Greece, as already shown in Figure 15, per capita online spending in Southern Europe is relatively low, reflecting, perhaps, the limited internet penetration compared with northern Europe. National long and short breaks are increasingly popular. The majority of the travel is still booked offline, but there is a tremendous potential for the online market as internet penetration increases. Between 2002 and 2007, online airline bookings increased by 56%. Southern Europe also experienced the birth of several LCCs such as Vueling in Spain and Volare in Italy. Most of the online bookings are made through intermediaries. As in France, package travel is very limited. The potential for this region is high with internet connections becoming increasingly available. The large growth forecast of hotel and airline ticket

bookings signify a tendency towards self-packaging, with considerable risk exposure for passengers in case of airline failure. This region has already experienced a major bankruptcy in the case of Air Madrid and other airlines, such as Alitalia, in turmoil.

4.2.4.5 Eastern Europe / New Entrants to the EU

This market, comprising of the three Baltic states (Lithuania, Latvia and Estonia), and those countries which entered the EU as of May 2004 (Poland, Hungary, Czech Republic, Slovakia, Slovenia, Malta and Cyprus), is the smallest in Europe, but has a significant growth potential. Although internet penetration remains relatively low, the online market has grown very fast over the last years. The abandonment of visa requirements gives the Eastern Europeans much more opportunity to travel, which they increasingly do. The online market is still relatively small, but has risen from near non-existence in 2002. Airline ticket sales experienced a growth of 169% between 2002 and 2007, predominantly driven by LCCs.

Eastern Europe has multiple LCCs of which Wizzair and SkyEurope are the most important ones. EasyJet and Ryanair have also entrenched themselves firmly in the region. LCC ticket sales have grown by 204% between 2002 and 2006. Not surprisingly, 68% of the online market is through direct sales of the LCCs, but intermediaries have increasingly found their way to the market. The market for package travel is very small. The predominance of LCCs, price-consciousness and the limited amount of package travel arguably leaves Eastern Europeans more vulnerable in case of airline failure.

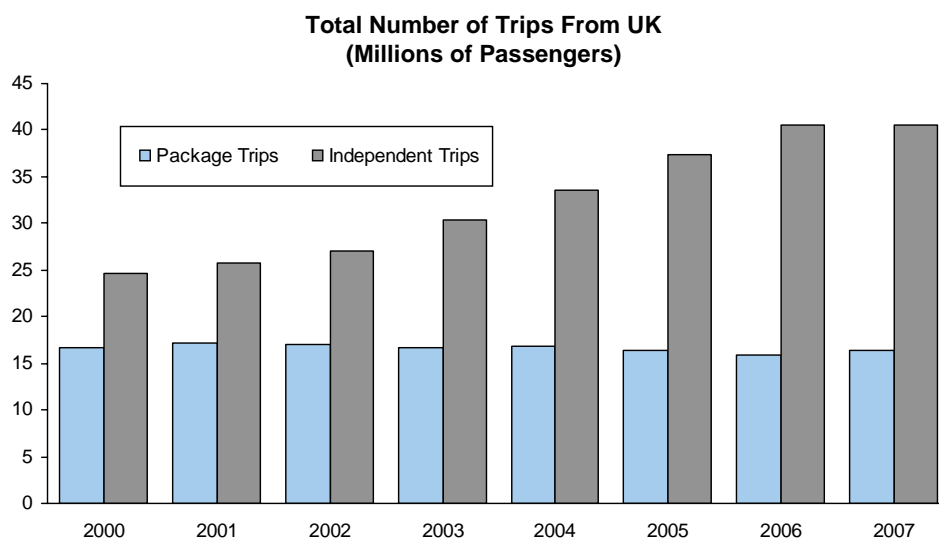
4.2.5 The United Kingdom: A Case Study

The UK market requires particular examination because of the country's unique position amongst the larger EU countries. Being an island state, its travellers are more dependent on air transport than is the case in most EU Member States. In addition, as we have seen in the previous sections, the UK, with its high internet penetration and multiple LCCs, has led the way in many of the trends affecting the travel industry. For this and other reasons, the aviation market in the UK may be considered more developed and, as such, the forces shaping it can be taken as indicative of markets in the future.

We have analysed Travepac data, published by the UK's Office for National Statistics¹⁰⁶, which carries out the International Passenger Survey (IPS). IPS surveys a random sample of passengers entering and leaving the UK by air, sea or the Channel Tunnel, conducting over quarter of a million face-to-face interviews each year. However, for the purpose of this study, we have investigated the travel behaviour of passengers travelling by air only.

In 2000 a total of 41.4 million trips were taken by air from the UK. This increased by over 15 million passengers (a total increase of 37.5%) to 56.9 million in 2007, with the growth driven by an increase in independent trips.

¹⁰⁶ <http://www.statistics.gov.uk/STATBASE/Product.asp?vlnk=14013>



Source: TravelPac Data, Office of National Statistics

Figure 18: Total Trips by Air from the UK to all Destinations by Booking Method (2000-2007)

As the figure above illustrates, the number of trips independently organised has increased significantly over the last seven years, while the number of package trips has largely remained static, if not decreasing very slightly. Independent trips have grown at a compound annual growth rate (CAGR) of 7.4% while package trips have a negative growth rate of -0.3%. The table below draws a comparison between 2000 and 2007.

Total Trips by Air from the UK					
	Absolute Numbers (millions)			Market Share (%)	
	2000	2007	Change (%)	2000	2007
Package	16.8	16.4	-2.4%	40.5%	28.8%
Independent	24.6	40.6	65.0%	59.5%	71.2%

Source: TravelPac Data, Office of National Statistics

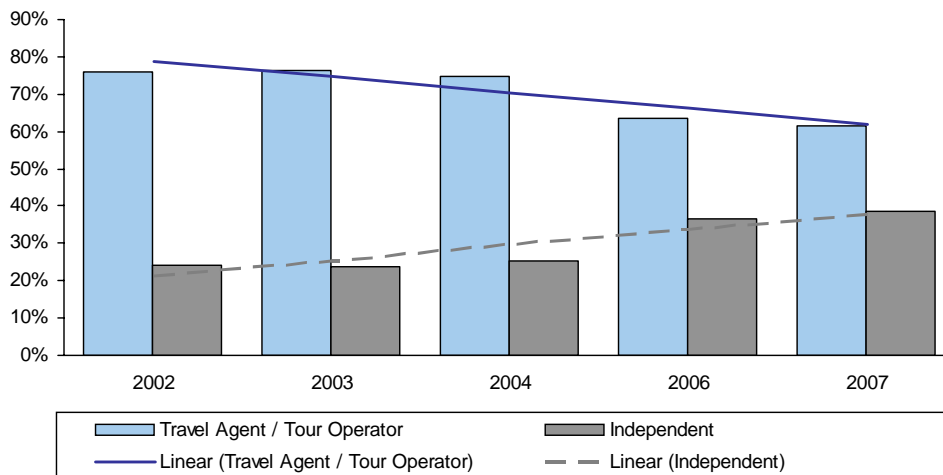
Table 11: Trips by Air from the UK to all Destinations by Booking Method (2000-2007)

In terms of market share developments, package trips accounted for 40.5% of the market in 2000, but only 28.8% of the trips taken in 2007. The absolute number of passengers taking package trips has declined only slightly, however, the overall market has grown and this growth has been exclusively in the independent travel sector. Independently arranged trips have increased by 15.9 million trips in this period, meaning that the independent market is now more than double the size of the package market in terms of number of trips taken.

Similar evidence of the trend toward independent travel is presented by Mintel¹⁰⁷ research, which finds that around 39% of all leisure travellers chose to book their holiday independently in 2007, compared with 24% in 2002.

¹⁰⁷ Holiday Booking Process, Leisure Intelligence, March 2008

Holiday Booking Method



Source: Mintel Report "Holiday Bookings Process, Leisure Intelligence (March 2002-07), Booz & Company

Figure 19: Booking Method for Last Holiday Abroad (2002-07, UK)

Consumers of all age groups are represented in online travel booking. The table below indicates the age distribution of UK holidaymakers booking through the internet.

Age	Always	Often	Rarely	Never
16-19	26%	32%	29%	13%
20-24	35%	26%	21%	19%
23-34	33%	33%	19%	15%
35-44	35%	29%	24%	12%
45-54	38%	19%	31%	12%
55-64	28%	30%	25%	18%
65+	15%	31%	38%	15%

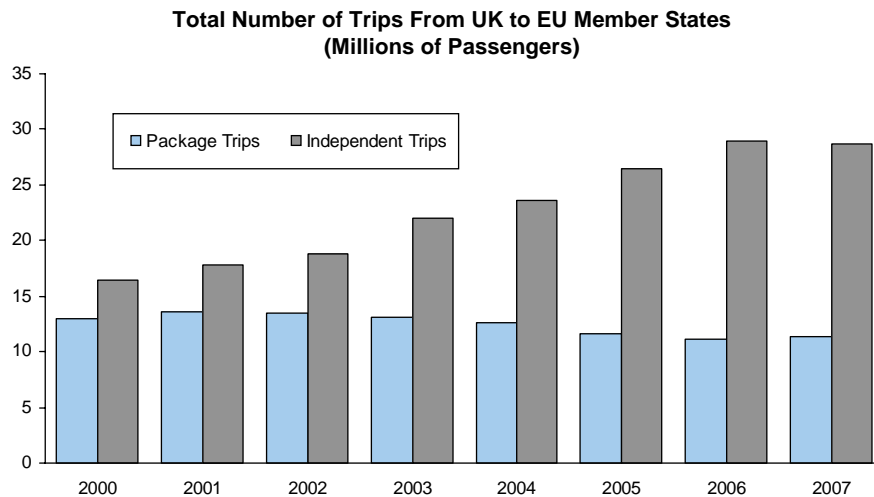
Source: Holiday Booking Process, Leisure Intelligence, Mintel, March 2008

Table 12: Age Demographics of UK Holidaymakers who Book through the Internet

According to Mintel, people aged between 20 and 54 prefer to book their holidays through the internet rather than over the phone or in a high street travel agent. People aged under 20 or over 54 are less likely to book their holidays online often or all of the time, but even in these age groups between 46% and 58% book holidays over the internet "always" or "often". In all age categories, there remains a significant minority of people do not use the internet to book their holiday, preferring the service of a travel agent or tour operator, but it is noticeable that the number of people who never use the internet to book their holiday is less than 20% across all age categories.

4.2.5.1 Trips by Air from the UK to other EU Member States

Considering trips between the UK and other EU Member States, a similar picture is presented, though in this case the number of package trips has declined slightly, from 13 million in 2000 to 11.4 million in 2007, a decline of 12%. This result is not unexpected, as consumer perceptions of safe/unsafe travel destinations is likely to be affected by EU membership, and the inclination to 'self-package' is likely to be higher in those markets perceived as 'safe'.



Source: TravelPac Data, Office of National Statistics

Figure 20: Total Trips by Air from the UK to EU Member States by Booking Method (2000-2007)

In total, since 2000 the overall number of trips by air from the UK to other EU Member States has increased dramatically from 29.4 million travellers to 40 million in 2007.

Trips by Air from the UK to EU					
	Absolute Numbers (millions)			Market Share (%)	
	2000	2007	Change (%)	2000	2007
Package	13.0	11.4	-12.3%	44.2%	28.5%
Independent	16.4	28.6	74.4%	55.8%	71.5%

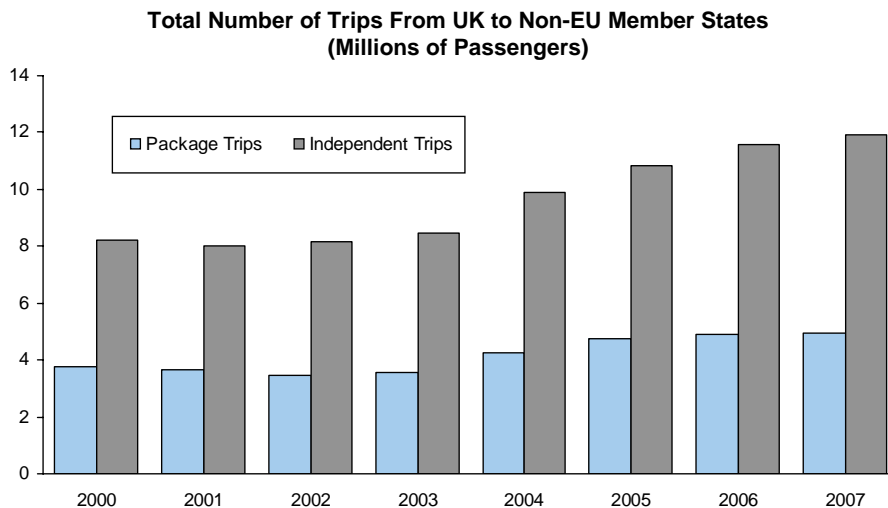
Source: TravelPac Data, Office of National Statistics

Table 13: Trips by Air from the UK to EU Member States by Booking Method (2000-2007)

As the table above demonstrates, in 2000, independently planned and booked trips by air to EU destinations accounted for a share of almost 56% of all total trips. By 2007, this share had increased to almost 72%. Absolute numbers of travellers purchasing package travel arrangements have declined by around 12%: a greater decline than that experienced by the market overall. Nonetheless, the major reason for declining market share of package travel is that market growth has been driven by an increase in independent trips.

4.2.5.2 Trips from the UK to Non-EU Member States (3rd countries)

The picture that emerges in respect of travel to non-EU markets is not dissimilar. In these markets, the number of package trips has grown, albeit at a lesser rate compared with independent trips. This could indicate that passengers are more cautious when booking trips over greater distances. Another factor may be the purpose of travel, as long haul trips are more likely to be holidays.



Source: TravelPac Data, Office of National Statistics

Figure 21: Air Trips from the UK to Non-EU Destinations by Booking Method (2000-2007)

The total number of trips by air taken from the UK to non-EU Member States increased by over 40% between 2000 and 2007 to 16.9 million. This sector includes major (mid- and long-haul) traditional package holiday destinations such as North Africa, Middle East, Caribbean, Asia and others.

Trips by Air from the UK to Non-EU Destinations					
	Absolute Numbers (millions)			Market Share (%)	
	2000	2007	Change (%)	2000	2007
Package	3.8	5.0	31.6%	31.5%	29.4%
Independent	8.2	11.9	45.2%	68.5%	70.6%

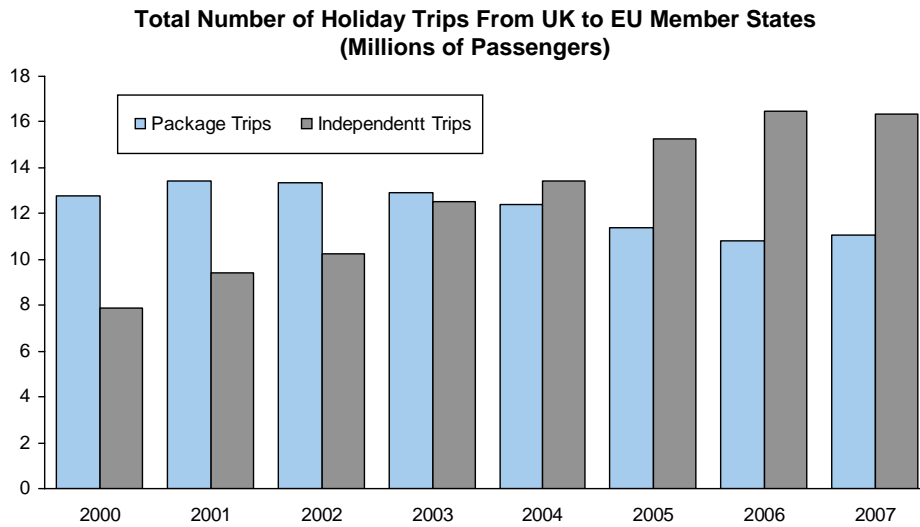
Source: TravelPac Data, Office of National Statistics

Table 13: Trips by Air from the UK to Non-EU Member States by Booking Method (2000-2007)

In contrast to travel to EU destinations, package travel to non-EU destinations has increased. The rate of increase of independent travel, however, has been significantly higher and the market share of independent travel has increased by 2.1%. Although less pronounced than the case of intra-EU travel, extra-EU travel from the UK thus also exhibits a trend toward independent construction of travel arrangements.

4.2.5.3 Purpose of Travel and Booking Method in the UK

This final section considers variation between booking methods and the purpose of travel. Data is available for intra-EU travel from the UK, but it is acknowledged that patterns may vary for extra-EU travel. As indicated by the figure below, in 2000 the majority of leisure trips were booked as packages. However over the last seven years, the number of independently organised trips has overtaken the number of package holidays.

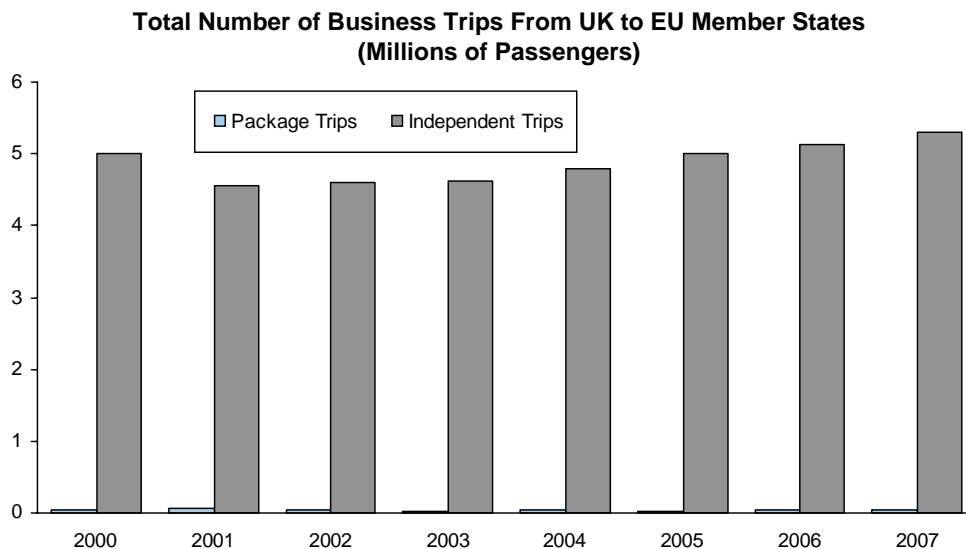


Source: TravelPac Data, Office of National Statistics

Figure 22: Total Number of Holiday Trips by Air from the UK to EU Member States by Booking Method (2000-2007)¹⁰⁸

In 2000, 20.6 million holiday trips from the UK to other EU countries were taken by air. This increased by 32.5% to 27.4 million in 2007. Reflecting similar trends as total trips by air (discussed above), package holiday trips have declined by over 13%, whereas independently booked holidays trips have more than doubled. The overall total number of holiday trips, by air, taken from the UK to other EU Member States has risen by 34% in 2007 from 2000.

In contrast, almost all business trips are arranged independently. The number arranged as “package trips” is minimal, representing less than 1% of all business trips.



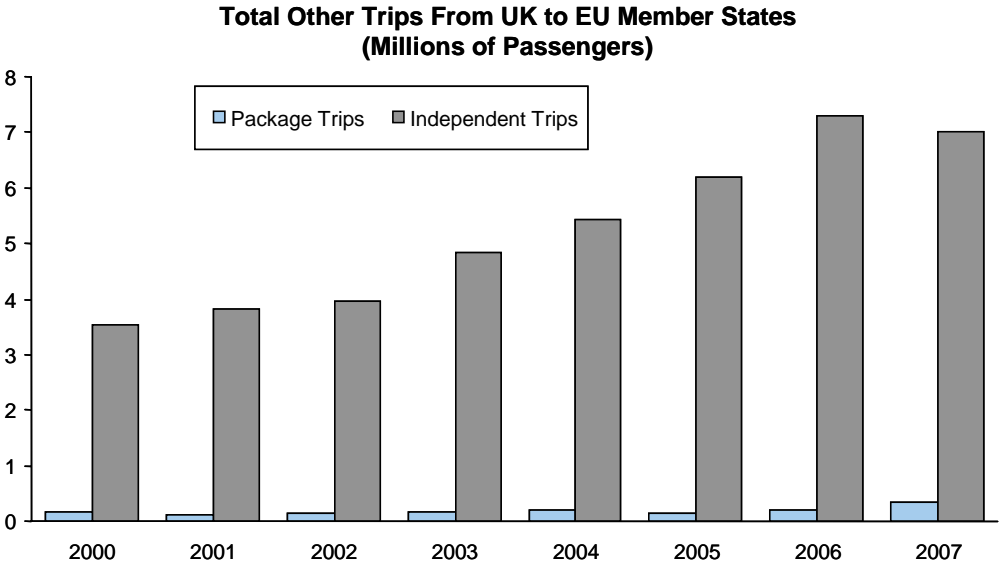
Source: TravelPac Data, Office of National Statistics

Figure 23: Business Trips by Air from UK to EU Member States by Booking Method (2000-2007)

¹⁰⁸ Includes miscellaneous trips

In total, 5.1 million business trips from the UK to other EU countries were taken by air in 2000, increasing by 5.5% to 5.3 million in 2007. For business travellers, lack of protection in case of an airline bankruptcy is not new, nor is it growing significantly.

Finally, there are the trips taken neither for business nor leisure, but for reasons of study or to visit family and friends.



Source: TravelPac Data, Office of National Statistics

Figure 24: Total Other Trips by Air from UK to EU Member States by Booking Method (2000-2007)

3.7 million other air trips from the UK to other EU countries were taken in 2000. This increased by over 98% to 7.35 million in 2007. As with business travellers, independently arranged trips account for the vast majority, almost 96% of all trips, by air, taken from the UK to other EU countries.

As with business travellers, this category of “other” travellers is accustomed to travel without package cover, and indeed the market share of package vs. independent has not shifted at all in the last seven years. This confirms that the area of growing vulnerability is with holidaymakers rather than with those travelling for other reasons, including business and visiting friends and relatives.

4.3 SELF-PACKAGING AND POSSIBLE ASSOCIATED CONFUSION

4.3.1 Context

“Traditional packages offered by tour operators and travel agencies tend to be effective in bundling separate products, but only with limited flexibility. However, the increasing trend towards individualisation of tourism demand requires more flexible, dynamic packages. Despite the fact that technological and organisational barriers for truly dynamic packaging are considerable, a number of players have managed to develop feasible solutions for dynamic packaging.”¹⁰⁹

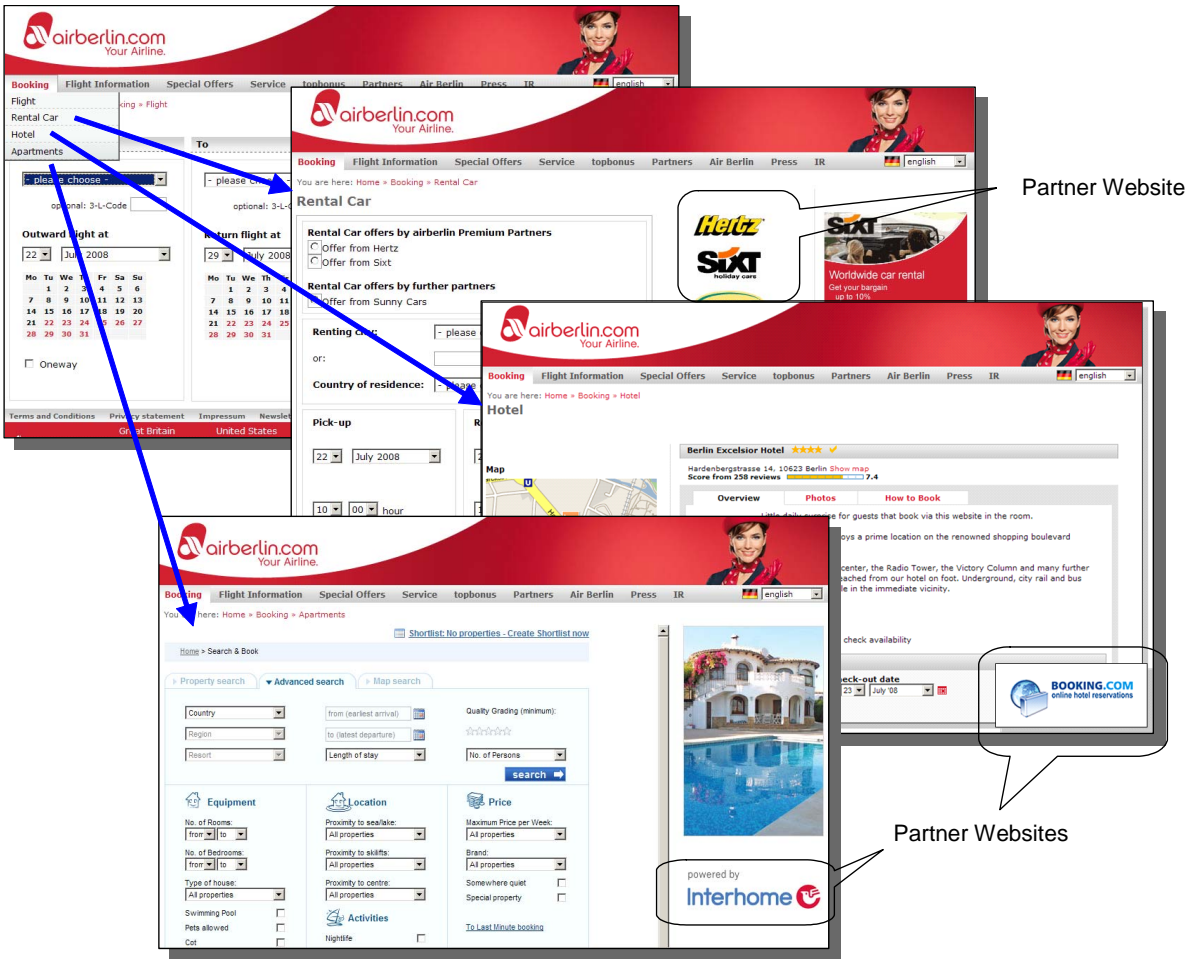
Airlines, scheduled and low cost carriers (LCCs), embrace this development in consumer behaviour, and provide the ‘convenience of shopping from home’ via the internet. They are

¹⁰⁹ http://www.ebusiness-watch.org/studies/sectors/tourism/documents/Tourism_2006.pdf

offering more than just air tickets through their websites, by providing 'click through' facilities or links to partnering websites (companies), they have become a 'one stop' shopping portal. This enables the consumer to pick and chose different products, such as hotel accommodation, car hire, and other, which best suit their needs, at any time, and therefore allows the consumer to self dynamically package his or her own holiday.

These products are often branded under the airline's website, perhaps unintentionally giving the consumer the impression that he or she might be buying a package, whereas transactions are actually channelled through different providers. The consumer is therefore not buying package travel as defined by the EC Directive on Package Travel and is not, therefore, protected against loss or damages.

We confirmed this by conducting a brief survey of online airline booking portals. As illustrated in the figure below, a customer booking a flight direct with an airline (in this case, Air Berlin, but the same holds true with most major EU carriers), will also be invited to book car hire, hotels and holiday homes through the same website. Although the customer will actually be booking these extra goods and services through other companies, the airline's banner remains on screen which may be misleading (unintentionally or not). Some airlines, however, make clear that care hire and hotels are clearly offered as 'travel extras '. Moreover, although staying on a similar website, there are slight differences in the design and clear mentioning of the third parties (e.g. stating 'in partnership with...').



Source: www.airberlin.com

Figure 25: Online Booking Example

4.3.2 Distributional and Social Effects

As set out in Chapter 3, from a legal standpoint, prospective or stranded passengers are creditors of bankrupt airlines, and take their place in any distribution. In reality, both face a range of associated costs – abortive costs for other elements of their trip for the former, and potential high costs, as a distressed last-minute buyer, of repatriation.

There are specific and obvious concerns, highlighted in recent coverage of airline bankruptcies, about:

- The extent to which low income members of society may disproportionately be victims of airline bankruptcy
- The disproportionate financial and practical effect airline bankruptcy may have on them

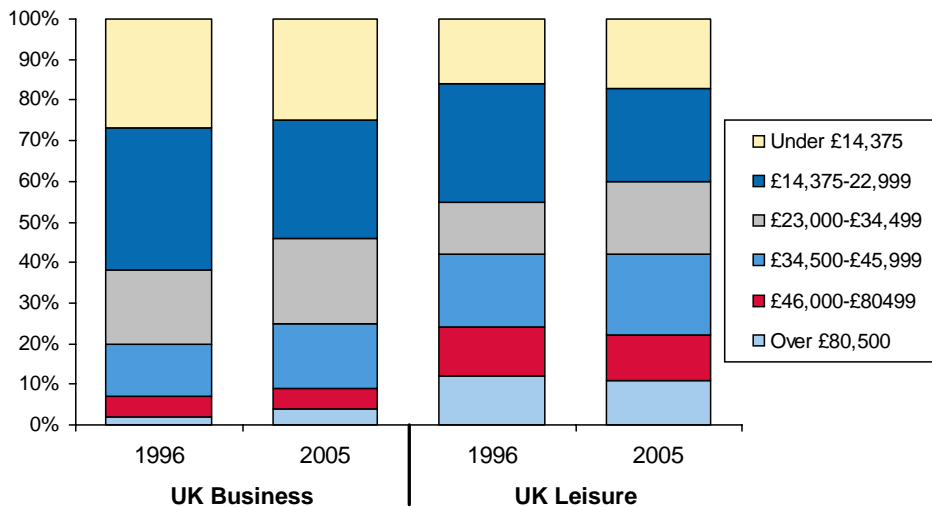
Two assumptions typically underpin these concerns:

- That the exposure of low-income members of society to airline bankruptcy has in the past been limited because, if these people travelled by air, they typically did so as part of a package tour, and so were protected under the Package Tour Directive or a predecessor scheme, such as the ATOL bond scheme
- That poorer members of the community are now disproportionately represented among the customers of low-cost airlines

These assumptions may not reflect reality. In its 2006 report on low cost carriers in the UK¹¹⁰, the UK CAA examined the perception that “lower air fares have led to a change in the income profile of passengers”. It concluded, as shown by the figure below, that for flights from the UK: *“There is little evidence of any major change in the type of people who are flying today as compared to a decade ago, particularly in the leisure market. There has been a significant increase in the total number of people flying from all groups. The more observable effect is of middle and higher income and socio-economic groups flying more often than in the past, and often on shorter trips.”*

¹¹⁰ See: UK CAA, “No Frills Carriers: Revolution or Evolution”, 2006

Income Levels of UK-EU and UK Domestic Business & Leisure Passengers (1996 & 2005)



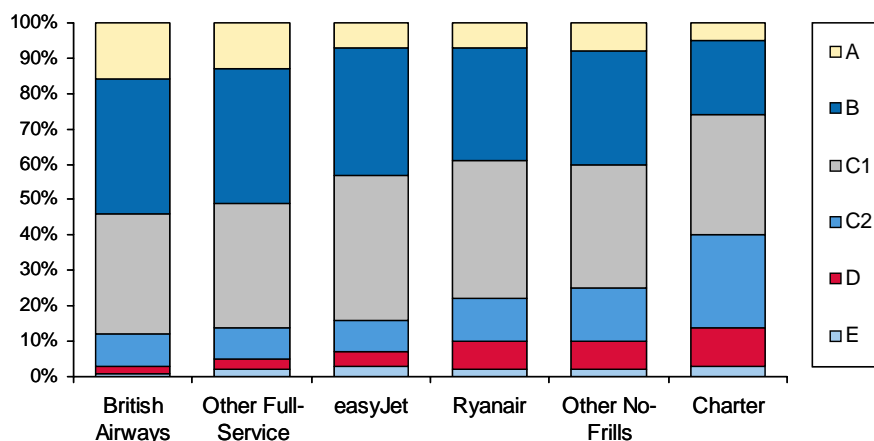
Source: UK CAA, "No-frills Carriers: Revolution or Evolution?", 2006

Figure 26: Income Levels of Passengers (1996, 2005)

However, the wide range of incomes across the EU-27, both in absolute terms and relative to the scale of the Union in the early 1990s (before the LCC boom), could mean that this finding is not necessarily representative across the EU.

While the CAA did not conclude in 2006 that the LCC boom had resulted in a greater proportion of lower income people flying, it did note that lower socio-economic groups were disproportionately represented among the customers of smaller LCCs, and charter carriers.

UK Passengers (UK-EU & Domestic), By Airline and Socio-Economic Grouping All UK airports (2005)



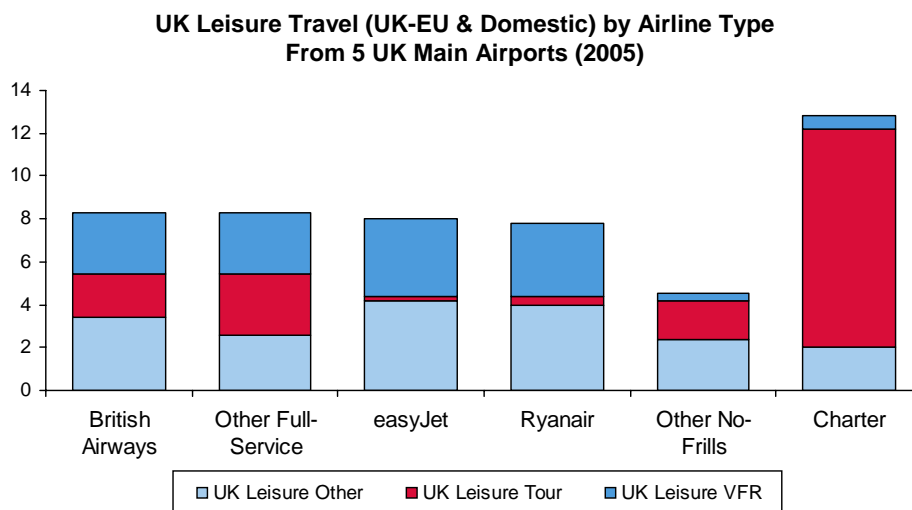
Source: UK CAA, "No-frills Carriers: Revolution or Evolution?", 2006

Key

- A: senior managerial, administrative or professional roles
- B: middle managerial role or equivalent
- C1: junior management or supervisory roles
- C2: skilled manual workers,
- D: semiskilled and unskilled labour
- E: those with no income other than a state pension or benefit.

Figure 27: UK Passengers by Airline & Socio-Economic Grouping

It may be considered that lower socio-economic groups are therefore disproportionately vulnerable to the contraction of the charter market and the protection consequences of its contraction, and to a group of airlines among which are some that may be at higher risk of bankruptcy. As the figure above illustrates, full service carriers have a higher percentage of passengers who are in professional or managerial roles (socio-economic classes A & B) compared with LCCs and especially compared with charters. Those travelling on chartered flights would be protected if they book a package, but since increasingly this is not the case, there is some cause for concern that such passengers are inherently more vulnerable (less able to cope with risk) than those flying on traditional carriers.



Source: UK CAA, "No-frills Carriers: Revolution or Evolution?", 2006

Reasons for leisure travel: Visiting Friends and Relatives (VFR); Tours; Other;

Figure 28: UK Leisure Travel by Airline Type

The CAA also make the point, demonstrated by the figure above, that on some carriers, visiting friends and relatives (VFR) is now the majority leisure purpose of their passengers. VFR travel is less likely than other leisure travel to be afforded package travel protection.

As noted above, in section 4.2.5.3 of the UK case study, the vast majority of passengers visiting friends and relatives have not historically had protection under the package directive, since, for the most part, they book flights only. By the same token, they are in less need of such protection since, generally speaking, they do not need to book hotels and all the other extras that a leisure traveller requires. Furthermore, in the event of being 'stranded', they are less likely to need accommodation and external assistance, since, by the nature of their travel, they have friends or relatives to stay with and provide support. Thus, those flying in order to visit friends and relatives may be more numerous than in the past, but they are not facing greater risks than they have previously, they are financially less exposed than holidaymakers who self-package, and they are likely to be relatively well-placed to deal with a crisis should one occur.

4.3.3 Insurance Offerings on Airline Websites

In the previous chapter we outlined the principle of Scheduled Airline Failure Insurance (SAFI). The coverage against airline bankruptcy offered by travel insurance can vary greatly across providers. However discrepancies can occur within the same company, depending on the specific details of the journey. For example, the travel insurance offered when booking a flight with easyJet differs when you do the same route in reverse. The images below show the results of a simple test that we conducted, whereby easyJet's UK website was used to

first book a return journey from London to Paris, and then the same website was used to book a return journey from Paris to London.

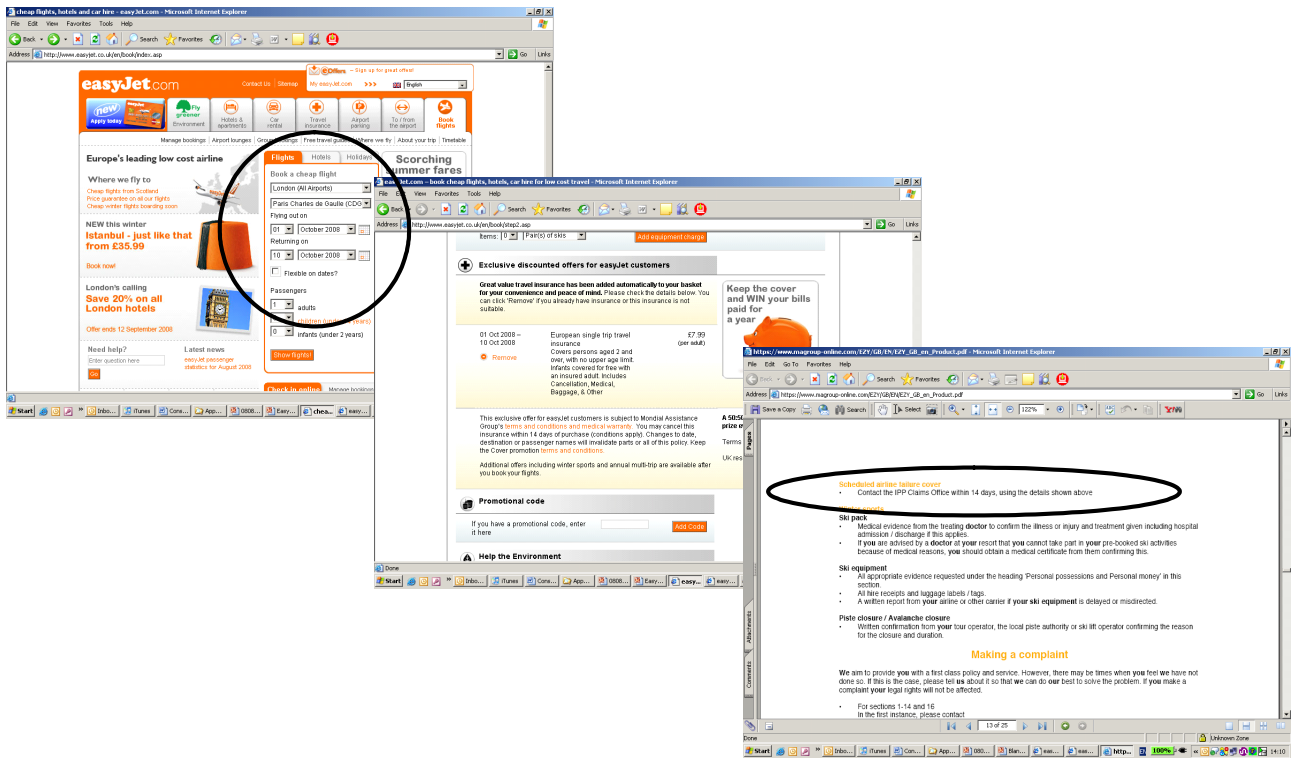


Figure 29: Example Insurance Offering (London-Paris)

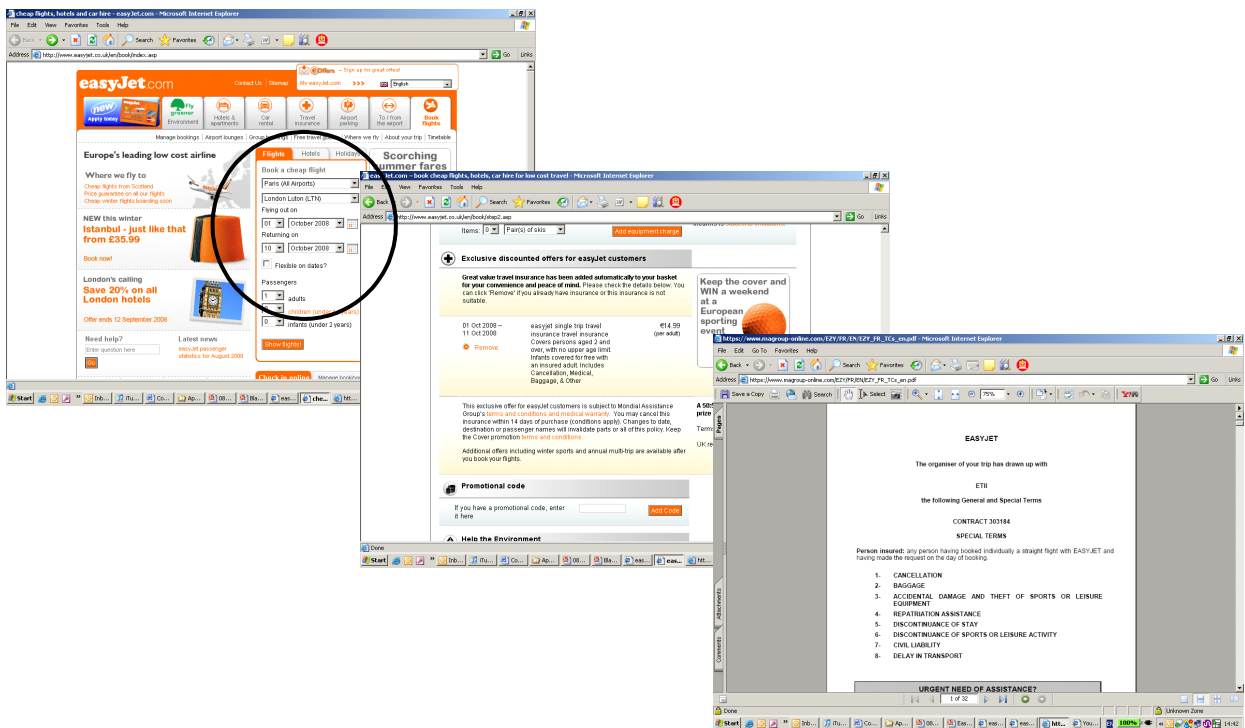


Figure 30: Example Insurance Offering (Paris-London)

As shown in the example above, booking via easyJet’s UK website for both journeys, the process is the same in each case - the consumer is given an ‘opt-out’ option for the travel insurance. However, the travel insurance available is actually different in the two instances, as the Paris to London booking offers a French insurance product. Consequently there is no opportunity to obtain SAFI on a Paris to London booking, although it is available London to Paris. The end result is that the consumer’s opportunity to get coverage against airline bankruptcy is actually completely different, even though the all of the other variables have remained constant. The requirement for the consumer, then, is to read the fine print on each and every booking, even if a regular traveller with a particular airline. This does not, however, remedy the situation of coverage not being available on some sectors or in some directions of travel.

4.4 ADEQUACY OF EXISTING MECHANISMS

As noted above, a particular feature of air travel, which sets it apart from many other industries - where consumers also face the risk that their chosen supplier may become bankrupt - is that this industry increasingly operates on the basis of direct and forward sales. Once the domain primarily of low-cost carriers, the majority of all airlines have now made investment in online booking and simplified electronic ticketing systems, enabling them to reduce their ticket prices and cease paying commission to travel agents. Passengers are thus increasingly likely to book and pay for their air travel directly with the airline and to do so some weeks, or even months, ahead of service delivery. This contrasts with most other goods and services, which are more often paid for on delivery.

Where an air carrier becomes bankrupt prior to the passenger commencing their flight, passengers are unlikely to be able to purchase an alternative ticket at similar cost (especially if the bankruptcy occurs close to the intended date of travel), and if travel has already commenced, the passenger may find themselves stranded.

In addition, as noted above, air passengers are increasingly likely to “self package” the purchase of additional goods and services (for example, hotel rooms and rental cars, for which uptake or use is dependant upon the air travel). In the event of an airline bankruptcy preventing the passenger from arriving at his intended destination, the other elements of the holiday “package” may be forfeited¹¹¹. In short, the overall impact of an airline bankruptcy on the consumer, whether stranded or not, may be considerably greater than the price paid for the air ticket.

There may also be an issue around consumer awareness or information. As ‘self packaging’ may be initiated via the airline website - that is, via links to ‘partner’ sites offering hotels or rental cars, consumers are able to construct their own package holiday. However, as all of the elements in this chain are paid for in separate transactions with different companies, they do not constitute a package under the Package Travel Directive and the consumer lacks the protection afforded by national legislation under that Directive. Some airline websites may also offer package holidays, which would be protected by Package Travel legislation. The potential for consumer confusion can be significant.

¹¹¹ Note that this would be dependent upon the individual cancellation policies relating to the goods and services purchased.

4.4.1.1 Advance Bookings

In the past, when many, if not most, airline tickets were booked through travel agencies, the airlines only received cash payment for their tickets a week or so ahead of providing the service, when the paper ticket was issued. Now that people are increasingly booking direct with airlines, the airlines receive payment weeks or months in advance of providing the service, particularly if the tickets are paid for by debit card (note: availability of, and financial incentive to use debit cards varies by Member State, see discussion on credit cards below).

It has now become a feature of the air travel industry that it operates on the basis of direct and forward sales, setting it apart from many other industries where consumers also face the risk that their chosen supplier may become bankrupt. Once the domain primarily of low-cost carriers, the majority of airlines have now made investments in online booking and simplified electronic ticketing systems, enabling them to reduce their ticket prices and cease paying commission to travel agents. Passengers are thus increasingly likely to book and pay for their air travel directly with the airline and to do so some weeks, or even months, ahead of service delivery.

However, by being able to finance operations in advance of the delivery of service, airlines have become increasingly dependent on this advance cash flow. In the same way that the “futures” market is more volatile than the “spot” one, so too are revenues based on services to be rendered in the future. Keeping revenues and costs balanced is relatively easy when the market is growing, but in the event of an economic downturn, there is a danger that this use of “advance cash” will dry up, leaving carriers financially overextended.

4.4.1.2 Credit Card Bookings

As already discussed in Chapter 3, booking by credit card offers the consumer protection if the airline goes bankrupt as it passes the liability onto the card issuer, which, however, will not cover any indirect costs incurred. The full price paid for the ticket will be covered (including any additional charges such as taxes etc.). At the same time, some airlines charge higher fees to those customers paying by credit card, which may deter some cost-conscious customers from utilising this payment method and paying rather by bank transfer or debit card. This range of choices does not arise in all Member States, as the option of paying by debit card, for example, is not universally available.

4.4.1.3 Scheduled Airline Failure Insurance (SAFI)

The collapse of several airlines in recent years has highlighted the issue of stranded passengers, including those not protected by the travel package directive. A number of insurance companies have sought to fill this gap, offering an insurance against the results of airline collapse. SAFI is one such product, and is offered in a number of countries; though most developed in the UK. The principle of SAFI is that repatriation in case of airline failure is covered by a fixed amount. Contrary to probable consumer assumption, general cancellation clauses in travel insurance do not cover flight cancellation by reason of airline bankruptcy. Insurances like SAFI will not, however, cover every airline collapse. Airlines that are known to be in trouble (e.g. Alitalia and Olympic Airways) are not covered under the policy; the insurance companies operate a regularly updated list of excluded airlines, but it is up to the consumer to check whether or not their intended carrier is excluded.

SAFI is currently offered on some airline websites (e.g. easyJet, Ryanair, BA) and booking engines, although not from every destination or country (see further discussion in Chapter 4). The extent of different SAFI offerings within the EU remains unclear at this point. The

grey area between SAFI and travel insurance deserves extra emphasis. Self-packaging passengers are probably not aware that their regular travel insurance does not cover airline failure¹¹², small print and terms & conditions do not sufficiently underline this important limitation. At the same time, passengers with SAFI insurance are often not aware of the many restrictions, especially the changing lists of included and excluded airlines.

4.4.2 Industry Responses to Bankruptcy Cases

In multiple recent cases of airline bankruptcies, other industry players have responded by offering affected passengers relatively cheap alternative travel. That is, airlines operating similar routes are prepared to make available any unsold seats on existing flights for a marginal fee. A recent example is British Airways and Virgin Atlantic carrying passengers booked with Zoom Airlines Ltd on transatlantic routes. Another is airlines including Ryanair, easyJet, and Flybe offering special fares to passengers affected by XL Airways bankruptcy.

In the case of the EuroManx bankruptcy in 2008, a substantial industry response was mounted by peer-airlines (i.e. primarily the low cost sector). For example in the first week after Euromanx's collapse, Flybe flew over 3,000 Euromanx passengers to and from the Isle of Man, which included both outbound and return legs of customer journeys, at minimal additional cost to each passenger. Furthermore the Flybe offer extended to Euromanx's advanced bookings right through to Easter 2009, providing service to approximately 20,000 affected passengers¹¹³. Another peer airline, Manx2, also stepped-in to service stranded customers, perhaps sharing Flybe's view that helping these passengers was a wise strategic move in the longer-term. One industry insider referred to this response as 'enlightened self-interest'. A similar example occurred in Poland, where Wizz Air – one of Central Europe's biggest low cost airlines – rescued stranded passengers of insolvent Air Polonia, asking for only taxes and charges to be paid by the customer. In this instance estimates put the number of affected passengers carried by Wizz Air at almost 15,000¹¹⁴.

Although recognising the importance of industry responses to bankruptcy, especially in repatriation of affected travellers and longer-term facilitation of travel arrangements, it should be noted that these arrangements are of a purely voluntary nature – there is no formal obligation on carriers to provide services. This sort of industry response does not function in the way of an insurance scheme: that is, there is an additional cost to the traveller, even if it is far below the price airlines might normally charge for reservations made close to the date of travel.

As such, although industry should be commended for the responsible and helpful approach taken to bankruptcy cases, the response and service level is not guaranteed. Whether or not there may be a case for formalisation of this sort of arrangement will be further discussed in the concluding chapters of this report. It is unlikely that a justifiable case could be made for mandating industry players to take responsibility for their less competitive counterparts (nor a reason setting the aviation industry apart from other industries or transport modes), however we note that the willingness of this industry to use voluntary ad-hoc measures is significant.

¹¹² Directive 261/2004 specifically excluded bankruptcy as a valid ground for cancellations. This distinction is unlikely to be known by general consumers.

¹¹³ Source: ELFAA

¹¹⁴ Wizz Air press release

4.5 SUMMARY OF CHANGING RISK

This chapter has demonstrated that the airline industry has changed, in particular through the growth of Low Cost Carriers and changing channels of distribution. Low cost carriers primarily sell tickets direct to customers, rather than through packages, and have taken substantial market share from the charter sector where package travel is prevalent. Across the entire air transport sector, there is a trend toward consumers choosing to book their travel independently of an agent or pre-packaged tour. In some instances, self-packaging options may lead customers to believe they have the same protection they would enjoy under the package travel directive. In others, customers may believe, from past awareness of “package” protection schemes, that they are protected, when in fact they are not. In addition, the distribution methods of the ‘full service’ sector are also increasingly direct to consumer rather than via travel agents.

The result these factors is thus that more people are travelling without protection against airline failure. This includes a growing number of people travelling for reasons of VFR who would not have been subject to such protection in the past and who have less need of it compared to holiday-makers, since they – considering the purpose of their travel - usually have no auxiliary accommodation booked. However, there are also a larger number of holiday-makers who are more frequently booking in such a way that they are not protected, and who, in general, are the most financially exposed (in terms of having booked additional items, such as hotels, car hire). It is this section of the market who have been the most protected in the past, and who are now left increasingly vulnerable.

When it comes to consumer protection in case of airline bankruptcy, there is a clear difference between scheduled air transport and package travel since the latter is subject to more regulatory constraints. Package travellers within the EU are protected through various protection schemes based on the implementation of the Travel Package Directive. Scheduled carriers are not part of this directive and are generally less vulnerable since they rely on yield management (i.e. selling seats at variable rates), compared to flat fares on package travel often agreed a long period before the service. However, with the rise in online bookings, scheduled carriers have become increasingly dependent on advanced cash flow through early booking passengers, making them more vulnerable to shocks in demand. In case of failure of a scheduled carrier, passengers are unlikely to be able to purchase alternative products at similar costs or find themselves stranded.

The only means by which scheduled passengers may find themselves protected are through credit card refunds, a Scheduled Airline Failure Insurance (SAFI) or by voluntary arrangements of other airlines offering alternatives to travel.

5 CASE STUDIES

This chapter is devoted to a number of case studies, which will place a recent number of bankruptcies with significant passenger impact into perspective. We specifically examine the scope of the passenger consequences, as well as the different approaches that were taken to limit the effects.

5.1 XL AIRWAYS

The origins of XL Airways lie in a charter airline called Sabre Airways, operating from London Gatwick Airport since 1994. Sabre was rebranded as Excel Airways following the acquisition in November 2000 of a 67% stake by Libra Holidays Group, and subsequently increased. In March 2004 the Avion Group, later known as Eimskip/Eimskipafélag Íslands, an Iceland-based aircraft and surface transport leasing specialist, purchased 40.5% of Excel Airways Group.

A key event in the assembly of the group was the buyout of XL Airways in October 2006 from Avion Group, by management led by Philip Wyatt, under the banner of XL Leisure Group plc, but financed by a loan from Eimskip.

In 2007 XL Airways had carried 2.3 million passengers – and projections for the whole group (including its French and German-based operations) had been for 5 million passengers, with a fleet, that, at end 2006, had been planned to encompass 26 aircraft, including 16 Boeing 737-800s, three 757-200s, two 767-200s, three 767-300s and two 747-300s. In Summer 2008, it was to operate from 12 UK airports, to 50 destinations, and had added a fully-scheduled service, on the Gatwick-Knock (Ireland) route. According to *Flight*, in Summer 2008 XL Airlines UK has been operating an all-leased fleet of a dozen Boeing 737-800/900s and four Boeing 757/767 aircraft, the latter being used for Caribbean routes – i.e. significantly less capacity than 2007. A Boeing 747-300 acquired from Air Atlanta of Iceland had been disposed of. Two 737s were wet-leased to Nok Air of Thailand for Summer 2008. At the time of bankruptcy the firm had 1,700 staff, according the Administrators.

5.1.1.1 Narrative of Bankruptcy

Press reports state that Barclays bank called in its loans to XL on August 14. These were reportedly associated with fuel hedging positions. On August 26th, XL cancelled all its Autumn Caribbean schedule, but issued statements to the effect that this was within the normal run of business.

By the end of August, it was openly known that XL was seeking refinancing, was in discussions with Barclays and the Icelandic Straumur investment bank, and that Kroll had been appointed to advise.

The Times reported that Kroll had been brought in by Eimskip, which had guaranteed the loan used by XL's management to buy the company in 2006. Eimskip valued this loan at \$292 million. Eimskip published a statement saying that "the likelihood that the loan guarantee will fall on Eimskip has increased."

There were several press reports about the progress of refinancing negotiations. On 2nd September XL issued a statement that refinancing negotiations had "no impact on the XL Leisure Group's operations, which continue as usual," and reported that it was "experiencing strong trading", with "encouraging booking figures for 2009".

A point here is that the interconnection of the industry, with complex networks of leasing and banking support by publicly traded companies, can make it more difficult to execute a rescue, given the disclosure requirements on a range of parties.

A clear issue in the bankruptcy was timing: the company's eventual bankruptcy was after the peak of the summer tourism season – when its revenue inflow for the year was likely to have peaked. By managing to continue to operate to mid-September, the impact on passengers and on the protection schemes involved was significantly mitigated; on the other hand, this put the company in the position where it was continuing to accept bookings at a point where its likelihood of fulfilling them was being progressively reduced. As described elsewhere in this report, a key issue is the treatment of solvency, and the timing of a cessation of business: it is illegal in most jurisdictions to trade while insolvent, but a key issue is whether, as in this case, that should entail running to the line of being insolvent, or whether there should be provision for putting into administration firms that are likely to become insolvent: this approach is already adopted in the UK for the regulation of the railways, through the arrangements for Special Railway Administration established under the Railways Act 1993 and Transport Act 2000.

On Thursday 11th September, an XL aircraft was reportedly grounded by BAA on concerns about payment, leading to XL entering administration early on Friday 12th September, after running out of cash to meet fuel bills due that day. Kroll were appointed administrators at the request of the directors. The Times reported that Barclays, which was owed about £10 million by XL, having demanded more than £2 million in immediate payment, had reached a standstill agreement, but that a last-minute appeal for working capital to Straumur and Landsbanki, its main – Icelandic – banks, was declined. The administrators announced the immediate suspension of flights, and that they did not anticipate being able to resume trading.

Phil Wyatt, the chief executive and founder of XL, blamed the airline's collapse first on oil prices, saying these had increased its operating costs by \$82 million in 2008 – and then the rise of the dollar against the pound, which had offset reductions in the headline oil price since its July peak.

Straumur bought XL's French and German operations, and their holiday packages were honoured, while Eimskip announced that a group of its Icelandic investors would acquire the claim in relation to its guarantee.

5.1.1.2 Repatriation of Stranded Passengers

CAA briefings stated that XL's bankruptcy affected 80,000-85,000 people on holiday ("stranded passengers"), and another 240,000 booked for travel in coming months.

As XL was primarily a tour operating group, the majority of its passengers were protected by the UK ATOL scheme. Following the collapse of this tour operator, the CAA as operator of the ATOL scheme was obliged to repatriate those passengers protected under the package travel Directive. In addition, in a "good citizen" initiative, the CAA was asked by the UK government to also offer space on repatriation flights to XL passengers who had had purchased only flight tickets (i.e. who were not covered by package travel protection). Had a repatriation mission *not* already been required for those on package travel, these flight-only passengers would have had to make their own arrangements for the return journey (as was

the case with other scheduled airline bankruptcies, for example, Silverjet). Discussions with the CAA indicate that only a proportion of these passengers chose to accept the CAA repatriation flights; at the time of writing, that proportion is not yet known.

Final numbers of affected and repatriated passengers are not yet available. Indications from the CAA are that - of the 80-85,000 stranded passengers:

- About 45,000 - 50,000 had booked their packages with XL, and were thus eligible for repatriation (and were repatriated) under the ATOL scheme
- A further 25,000-30,000 had travelled on XL, but in fact booked their tickets through other (non-bankrupt) tour operators. These passengers thus did not require ATOL assistance, but were re-booked by their tour operators onto other flights
- 8,000 - 10,000 were "flight-only" passengers, for whom no protection was applicable under ATOL. These passengers were offered seats (for sale, not free) on repatriation flights, but it is not yet known how many took up the offer.

The CAA was thus in a position of needing to arrange repatriation of between 53,000 and 60,000 total passengers.

In consideration of options for achieving this, the most obvious alternative would have been to utilize the grounded XL fleet, crews, etc. However, there were multiple difficulties arising from this:

- The XL fleet of aircraft were leased, rather than owned by the company. Negotiation for their use would therefore have had to be undertaken with the aircraft owner as well as the appointed Administrator of XL
- Government would have needed to provide indemnity (e.g. against terrorist attacks) for the aircraft
- Every aircraft would have had to be checked and its condition documented, so that any later claims over damages could be settled with the Administrator and aircraft owners
- Agreement and compensation would have had to be negotiated with staff
- There was a risk that aircraft might be seized by creditors at destination airports

Although discussions were entered into, it was not possible to reach agreement with the Administrator in light of the above risks, and the CAA needed instead to go to market to procure flights for the repatriation mission. It should be noted that the above list of issues would apply in any bankruptcy case. A further issue is assurance of airworthiness of aircraft. This was not a factor in the XL case: the CAA already knew the status of the aircraft. But in many bankruptcy cases, this might not be known in advance and further delays whilst checks were carried out could be significant.

A particular lesson learnt in this case study, and stressed by the CAA in our discussions with them, is there will *always* be a delay between the collapse and any repatriation mission. Even if the existing fleet & staff of an operator can be utilised, there is a period where every aircraft has to be checked, and agreements made with the Administrator. In a case like XL, those aircraft are 'normally' utilised for up to 22 hours per day. A delay of 2-3 hours for checking each aircraft can mean that services cannot be initiated for 2-3 days.

The CAA thus had to go to market to find a replacement fleet. This was an enormous logistical exercise, that effectively meant replication of the XL fleet.

A number of industry actors were involved in the ATOL-funded repatriation operation, with TUI subsidiaries Thomson and First Choice, in partnership with rival Thomas Cook, leading in the Mediterranean, and Virgin Atlantic in Orlando, Florida, and the Caribbean. The CAA has praised the tour industry for their aid in the repatriation – and said it would not have been possible without them. Monarch was the main operator providing the repatriation effort. The CAA took an oversight & coordinator role (getting the right people talking to each other): industry were the implementers (and often, the organisers). In addition to helping to find aircraft, crews, organise and operate the flights, tour operators were invaluable for doing things like:

- holding passengers back from going to the airport (to the point that if the queue was too big, they'd delay the next bus)
- providing refreshments to passengers waiting at airports
- contacting affected passengers. Charter operators had the advantage of knowing where tour passengers were located and how to contact them (by virtue of having put them in hotels, in contrast to flight-only passengers, whose location was unknown). This a particular note as obtaining information of any sort from a bankrupt operator is extremely difficult (requires negotiations with the IT supplier, for example).

Particular problems encountered were:

- A need to effectively replicate the XL fleet in order to have the large enough aircraft available. This was difficult, as the fleet included some unusual aircraft types/sizes, such as B737-900
- Logistical problems around things like flight crew hours. An operator like XL was running its fleet up to 22 hours per day, making this a complicated question. It also flew to some unusual destinations where specialized approach ratings were needed by the flight crew to be qualified to land aircraft at the airport
- Difficulties with the authorities of some other countries. We understand there was a problem with at least one country, which refused to allow (replacement) flights with a non-EU callsign to operate, citing bilateral restrictions. Finally the problem was solved by all flights operating under Monarch callsigns
- Problems created by the media frenzy, which resulted in large numbers of passengers showing up for repatriation days ahead of their scheduled return. Despite assuring people that there would be a flight for them on the scheduled date, and they could continue their holiday, many made a run for the airports. So instead of having an adequate number of seats, often there was a shortfall.

In respect of those flight-only passengers whose repatriation was *not* covered by ATOL, repatriation was not free of charge. Instead, these passengers were offered space on repatriation flights at a modest price (set depending on distance of flight). These passengers were not charged up-front the cost of the flight. Instead, every passenger was provided with an information sheet setting out why and for whom travel was free of charge (and the cost for those required to pay). Those required to pay were informed that the ticket cost would be sought after their return to the UK.

The reasons for retrospective charging were two. First that the tour operators didn't want to have to deal with irate passengers, demanding to know why they had to pay and others didn't (which was considered a potential safety risk to their staff). And second, setting up some means of taking/processing the money would have been very difficult in the time frame.

The processes of sorting through flight coupons to determine how many passengers owe money for their repatriation is still being undertaken, which is the reason why the CAA is (at the time of writing) unable to confirm how many flight-only passengers were carried. They were, however, able to indicate that they believe it was a far lower number than the total number of this group stranded. There is no current information available about how many flight-only passengers who had not yet commenced travel may be affected (i.e. they are not included in the 220,000 estimated to be due refunds under ATOL).

Two further significant points arise from the XL experience. These are:

- Response to the repatriation effort by XL's peer operators was outstanding, and key to its success. Offers made by other airlines, however, were either not followed through with, or were offered at a rate that the CAA considered extremely high
- The number of purchasers of package travel who used credit cards to pay for their packages was extremely low. The CAA estimates the proportion of credit card users to be below 10%. This is likely to be because credit cards incur charges that are a percentage of the total cost of the package, which can mean significantly higher charges than those passed on to users of scheduled air travel, and hence is likely to act as a greater deterrent to their use. Additionally, as package travel is often purchased through an intermediary, the protection normally available in cases of non-supply of goods and services is less likely.

5.1.1.3 Comment

XL had expanded rapidly through acquisition. The majority of its financing was through debt – both in terms of its fleet (we have not established whether leases were operating or finance), and in terms of the original debt-financed management buy-out – meant that it did not have the liquid resources that, for example, an airline that owned all or part of its fleet, might have had to call on.

The collapse of XL caused considerable comment in the UK press about the condition of the airline industry as a whole, with issues raised including:

- Potential fragility from the fragmentation of the sector, citing claims by the Chief Executive of BA that another “thirty airlines” could go bankrupt
- How airlines are financed and capitalised, with the Times claiming that “as many as 80 of the 120 airlines operating out of Britain have fallen behind in payments of departure tax receipts to the Government”
- Calls by the tour industry for a “rescue levy” on airline tickets, with Peter Long, CEO of TUI Travel quoted as saying, with regard to the 10,000 unprotected passengers: “These customers probably thought they were protected and that is ridiculous. There will be more airline failures because they cannot cope with this pressure”

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- There was criticism of the use of other operators' aircraft to repatriate stranded passengers, rather than XL aircraft, where these were present in a location (the reasons for which are described above)

5.2 AIR MADRID

Air Madrid suspended all flights on 15 December 2006. Media estimates of the numbers of passengers left stranded at the time ranged from up to 100,000 to more than 120,000, principally in Spain, Romania and Latin America. Many of those left stranded in Spain were migrants from Latin America and Romania who were trying to get home for Christmas. Air Madrid was Europe's only long-haul budget airline.

On 16 December the Spanish authorities suspended Air Madrid's AOC, with the government citing the privately-owned airline's repeated failure to manage its aircraft adequately. Spain's transport ministry was able to charter flights to help around 8,000 travellers get home but thousands were still left stranded. It also promised to help passengers win compensation for cancelled flights.

On 19 December, the Spanish Government rejected a plan to let staff run Air Madrid on a limited basis to help stranded passengers return home. On the same day, travel agents, who had announced they would return money on tickets bought in November and December, said they could not do so without Air Madrid's go-ahead.

After the cessation of the operations, the Spanish authorities and the Spanish Airport administration (AENA) helped frustrated and stranded passengers as a matter of courtesy, *ex gratia*. The Spanish public authorities do not have legal or other remedies at their disposal in order to solve the problems of the passengers.

Legally speaking, frustrated passengers of Air Madrid could:

- Submit their claims before the court mandated with the insolvency proceedings;
- Sue the travel agent if they contracted the air travel through a travel agent.

Option (1) is available to all passengers. However, the chance of success is very limited, as there are many claims, including claims with priority rights made against Air Madrid.

Option (2) is only available to passengers who made their booking on an Air Madrid flight through a travel agent. The travel agent, that is, the seller in the contract in relation to the passenger, must answer that claim as apart to the contract. *Spanish travel agents have created a fund in the Spanish Ministry of Department, amounting to about €60,000, which should provide coverage for claims falling under its terms of reference.*

In accordance with Spanish law on bankruptcy, administrators draw up a proposal for a plan regarding the settlement of claims, reductions of claims, and the period in which such claims must be paid, between the debtor – in this case Air Madrid – and creditors, in this case including Air Madrid's passengers, henceforth referred to as 'the Plan'.¹¹⁵

¹¹⁵ See: <http://administracionconcursal.airmadrid.com/>

In its decision of 11 January 2007 the commercial court of Madrid has declared the insolvency – “el concurso de acreedores”, as recognised as insolvency proceedings in Annex 1 of Regulation 1346/2000 on Insolvency proceedings, as to which see Chapter 3, above.

Creditors could put forward their claims one month after the date of publication after the said decision, that is, 20 February 2007. On that date, Air Madrid proposed a Plan to the Court, which is subject to the latter's approval (see below). The Plan refers to passengers and other creditors.

The Plan excludes claims pertaining to passengers who could actually fly thanks to the financial support of persons, bodies or organisations, whether private or public and whether Spanish or foreign. The Plan also excludes claims pertaining to flights performed by creditors who themselves performed the carriage of the passengers.

Other creditors were to be paid with a reduction of fifty per cent. The final amount has to be paid as follows: ten per cent three years after the approval of the Plan by the Court, and the remainder five years after the said approval.

Hence, passengers receive a preferential treatment in comparison with other creditors. The reason thereof is not disclosed, but it is felt that this is a consequence of the strong social pressure that this bankruptcy has generated, and a sympathetic attitude to push the Court to approve the Plan.

The Plan must be approved by the competent court in a formal decision.

In May 2008 the bankruptcy administrators for their part submitted an inventory of Air Madrid's assets and their listing of qualified claims. These have not, however, yet been approved by the Court, as some 200 challenges to these findings, including by Air Madrid, were then filed.

As at 9 December 2008, the liabilities and claims have not yet been definitively fixed. Once approved by the Court, the settlement will be binding for all the ordinary and subordinated credit. We understand that the outlook for significant recovery is not good.

5.3 EUJET

A similar state of affairs applies to passengers who had booked flights on the collapsed Irish carrier EUJet. Passengers can file a claim with the administrator of the estate of EUJet but the chances of success are limited.

In isolated and exceptional cases passengers who have paid their booking through credit card may get a refund for the services they have not used from their credit card firm. The same is true for passengers who have booked their flights via a travel agent, as mentioned in the previous sub section.

Stranded passengers must find alternative flights for the return trip. There is no legal obligation for other carriers to taken them on board – as opposed to the repealed law of the US ex briefly explained in section 3.5.1. In practice some low cost airlines have made offers to stranded passengers for amounts which are not far from the amounts mentioned in the repealed US law as a matter of courtesy.

EUJet grounded all flights after its parent company, Planestation, filed for bankruptcy on 26 July 2005. The airline could no longer operate once Planestation went into administration as the parent company owns its hub at Kent International Airport at Manston. Media reports estimated that 5,000 to 5,400 passengers were left stranded when EUJet collapsed, and that there were a further 50,000 to 100,000 affected customers who had bought tickets in advance. Passengers were stranded in locations across Europe, including: Prague, Alicante, Ibiza, Amsterdam, Geneva, Malaga, Nice, Salzburg and Valencia.

Low-cost carriers Monarch Scheduled and easyJet offered to fly holidaymakers back from Portugal and Spain for £25 plus taxes, but only when they had seats available. Passengers also had to return from London airports to EUJet's base at Manston in east Kent to pick up their cars. Coach firm Eurolines UK offered people who have booked flights to Amsterdam a reduced return fare of £39 to the Dutch capital if they produced their EUJet booking details. At the time, EUJet's Commercial Director, Stuart McGoldrick said that the 100,000 tickets bought in advance would be refunded.

5.4 SABENA

The case of Sabena has been examined in Chapter 5 of the AIRREG study. The legal situation is different from and more complicated than, those of the above cases.

Sabena was declared bankrupt on 7 November 2001, that is, one month after what in Belgium law is called "concordat judiciaire" – the equivalence of "Surséance van betaling" in the Netherlands.¹¹⁶ Hence, many passengers were aware of the financial problems of the Belgium carrier so that there were considerably less bookings made. All aircraft were repatriated.

On the eve of the formal Sabena bankruptcy, the Belgian government and a group of Belgian investors formed a consortium which granted a bridge loan to short haul daughter DAT in order to keep a limited number of flight operations going. After permission of the European Commission, DAT resumed flying on the 9th November 2001 by taking over 1000 Sabena slots, using its own (regional) fleet. The plan was quickly to resume Sabena's European operations, as well as services to a small number of destinations in the US and Africa in due time. Sabena's IATA code (SN) was left intact under conditions that DAT would compensate all amounts due by Sabena to IATA, which DAT has done, with governmental support (state aid).

DAT guaranteed the bookings made on Sabena flights to the (limited number of) destinations it was currently offering, and also left the previous Qualiflyer frequent flyer programme intact.¹¹⁷ Numerous airlines were quick to take over Sabena's Zaventem slots to several European destinations. By mid-November DAT and Virgin Express entered into a code-share agreement which made the main European destinations available again. The bridge loan enabled DAT to keep flying for three months (after which the loan had to be repaid) and it offered flights at very competitive prices in order to keep the load factors at a decent level.

¹¹⁶ These are reorganisation procedures comparable to Chapter 11 proceedings in the USA.

¹¹⁷ Interview with DAT CEO Johan Vanneste, *Gazet van Antwerpen* (22 November 2001).

There were no significant complaints by long haul flights passengers who were rebooked on other carriers.¹¹⁸ After the bridge loan expired, DAT was taken over by a group of investors united in SN Air Holdings (apparently under favourable conditions offered by the Belgian government). DAT changed its name to SN Brussels Airlines in February 2002. Meanwhile, DAT has merged with Virgin Express Brussels and was recently bought by Lufthansa. The merged company is now known as Brussels airlines.

There have been no class actions since this procedural remedy does not exist under Belgium law.

A similar situation may now arise for passengers of Alitalia and other European carriers. Common and public knowledge on the delicate financial health of these airlines may have legal implications. Administrators of estates or courts may argue that these passengers knew or at least should know or should have known, for instance, in July 2008, that their purchase of tickets on those carriers was a risky investment, especially so when the flight is operated a couple of months after the purchase.

Within the framework of the Sabena default, it is also worth mentioning the bankruptcy of Swissair, since it was the parent company of Sabena. Although the case of Swissair has been discussed extensively in the AIRREG study, we note that neither Belgium nor Switzerland have special laws regulating the situation of passengers who suffer damage as a consequence of the insolvency of an airline. Passengers have to submit their claims to the administrator of the estate like any other creditor.¹¹⁹

Swissair passengers who had made a booking through a travel agent as part of a package tour were helped by a fund designed to protect such travellers.¹²⁰ In the Swissair case, passengers who could not fly and had paid their ticket via credit card could be reimbursed by their credit card company (see also Chapter 3).

Stranded passengers were carried either on Swissair which operated its flights again two days after the grounding, or by other carriers. The Swiss government granted financial help to pay for extra accommodation in hotels and alternative means of transportation. Apparently there was much solidarity among other airlines to help SR passengers.

There were no court cases upon the demise of Swissair. It seems to us that problems were resolved on an *ad hoc* basis, with the assistance from IATA, the Belgium government and the successor airline. There is no public record of such interventions.

There were (strong) legal arguments in court on the responsibility of the management for the grounding, as well as questions on preferential treatment of certain creditors.¹²¹

¹¹⁸ *There were some complaints by consumers at the time, for example in the US, that they were charged high fees by travel agents incident to rebooking or recovering advance payments.*

¹¹⁹ *See: www.admin.ch/ch/sr/c281_1.html*

¹²⁰ *See: www.garantiefonds.ch/site-d/site/rgf-txt1.htm*

¹²¹ *See, www.liquidator-swissair.ch*

6 CONSIDERATION OF POLICY OPTIONS

Against the backdrop of recent economic developments, this chapter seeks to lay out and contrast the various policy options and tools identified in the course of the study with the objective of identifying their advantages and disadvantages in the context of an overall approach to the problem. It consists of the following four sections:

- General findings on the near term outlook and the risks of bankruptcy for the airline industry considered from the standpoint of consumer interest.
- Presentation and evaluation of the lessons learned from the case studies of selected bankruptcies as presented in Chapter 5.
- Basic considerations to be applied in evaluating the advantages and disadvantages of various courses of regulatory action for dealing with the problems of ticket holders on airlines which suspended service abruptly.
- Review of possible remedies for averting financial distress or personal hardship of persons ticketed on airlines that have had to suspend operations.

6.1 SCOPE OF THE PROBLEM: GENERAL FINDINGS ON BANKRUPTCY RISK

As is well known, historically rates of profitability in the airline business have been much lower than most other business sectors. Very few airlines have made profits consistently and most have made losses, at least periodically.

As described in preceding chapters, the first years of the 21st Century have constituted an exceptionally difficult period for airlines in the North Atlantic market. While EU carriers have on the whole fared better than their counterparts in North America, this industry – operating in the vigorous competitive environment created by the Third Package of Community air transport policy reforms – has also experienced a significant level of bankruptcy. Factors producing this situation have included:

- Dynamic growth of new entry (throughout the period) including start-ups with ambitious/optimistic business plans that in some cases were thinly capitalised
- Economic factors that have dampened demand including significant periods of slow or near flat growth of consumption in leading EU economies
- Non-economic factors dampening demand such as public apprehension because of acts of terrorism against both civil aviation and tourism facilities
- Significant growth of operating costs – notably through steeply rising or volatile fuel prices but also because of increased user fees.
- Difficulty in raising fares to cover rising costs in the face of: strong competition, still high levels of capacity and low growth of effective demand.

Under these difficult conditions, airlines have looked to all areas of operation to reduce costs where possible and put pressure on suppliers such as travel agencies who have experienced a restructuring of sales and marketing. The various economic players seek to maximise use of instruments such as internet booking that can replace sales agents and classical distribution networks; the consumer works increasingly with automated tools to design and purchase travel packages as well as air transportation.

As a general matter, the buyer of air transport makes choices as does the purchaser of any other good and in so doing assumes certain risks. The question to be addressed by this study is whether the current situation merits a new level of protection against such risks.

As a point of departure for considering the issue of “new” levels of protection, we had first to review the existing instruments that under Community and national laws as well under contractual frameworks have underpinned the marketing and sale of air transportation for many years (see Chapter 3). Such regulations and procedures have always included elements such as “conditions of carriage” that aim to provide airlines, travel agents and travellers with certain guarantees on which they can depend with respect to service and financial obligations.

With the notable exception of the (historically very important) European charter industry, governments have on the whole not intervened through regulation to protect consumers against the risk of airline failure. With respect to charters, there is, however, a considerable history of States requiring various forms of bonding or insurance to protect purchasers of package travel, as reflected in the EU today by the Package Travel Directive. The theory behind such legislation has been to ensure the financial soundness of organisations, notably tour operators, who historically have played a significant social and economic role by contracting-in at wholesale prices services from a range of travel and accommodation providers and then selling them in individually packaged arrangements.

This system has depended on advance payments from a client base that has included many families and individuals with moderate to low incomes seeking affordable vacations. Thus there has been what one can term a “social component” in past regulation as governments sought to minimise the risk that an unscrupulous or adventurous organiser could collect large sums of money from trusting consumers and walk away or, through over-extension of obligations, otherwise put their advance payments at risk.

As we have described in Chapter 2, the phenomenon of financing business operations (working capital) by collecting payments for services (and even user fees) in advance of their actual delivery has become a significant element of scheduled airline business planning and execution for scheduled as well as charter service airlines. Such financing has been around for a long time; for example, in the form of so-called APEX (advance purchase) fares, but its use has significantly accelerated in recent years – forming in fact the central marketing element of Low Cost Carrier (LCC) business models (whose services have experienced the most dynamic growth in recent years).

At the risk of over-simplification, a financial situation has ensued in which many scheduled airlines, especially but not only in the LCC sector, may be asking tomorrow’s traveller to pay for today’s travel. That is, when profits and even positive cash flows disappear, today’s financing system can be seen as a form of borrowing against the hope that revenues will rise and costs fall. Thus there have been calls for regulation in an area where, paradoxically there was less regulation before.

6.2 IMPLICATIONS OF RECENT AIRLINE BANKRUPTCIES IN THE EU

In Chapter 5 we have provided short histories of some recent bankruptcies in the European Union; lessons that may be learned from these cases are discussed below. The one general lesson that emerges from these and the numerous other airline bankruptcies that have

occurred since the turn of the Century is that: While they will all possess some familiar characteristics, each bankruptcy is unique. That is – and this applies particularly to the resolution of immediate problems such as stranded passenger repatriation – each will require an individual approach.

Reliance on a single, general solution such as – for example – establishing a universal charge on each ticket sold to create a reserve fund such as the ECTAA/GEBTA¹²² Passenger Protection Plan proposed could, however, seem to be attractive. As discussed in more detail below, it would seem to be transparent, equitable and simple. It could help cure the problem of discriminatory treatment perceived by Tour Operators and travel agents who must establish reserves or third party financial guarantees to protect purchasers of packages when such guarantees are not required on sales of individual transportation.

Charging everyone a fee, even a small fee, will, however, add a universal tier of costs to deal with a problem whose emergence in a well-run industry should be an exception rather than the rule. The price will either be passed through to the consumer or there will be a reduction of profitability adding to the likelihood that more bankruptcies will occur. If business conditions are good and airline performances sound, then such a universal fund will rapidly build capital balances whose administration may not prove simple. For example, while a case for the idea of an equal charge on all sales can be made, should it then be a charge per sale or a charge *ad valorem* (that is as a percentage of the price)? It would not seem fair to charge the same for a short haul discounted service as for a full fare long haul ticket, as there will be huge variations in both the amount of money being insured for the customer and the percentage of gross income for the operator. On the other hand, given the LCC pricing structure, it is now very difficult to know what a true base price is. In any event, it would likely prove to be necessary to reset such charges periodically as balances in the fund rise or fall in accordance with operating experience. A new institution (or multiple institutions, e.g. one per Member State) would need to be established.

Another single solution approach could be to formalise and extend current practices and rules for credit card refunding. That is, to give the consumer an absolute right to receive a full refund on an advance payment for any service that is not delivered because of fault of the seller. Such a rule could of course not be limited to air transportation. It would have sweeping ramifications affecting business models and cash flow management.

Thus, rather than looking for a single solution, we believe, consistent with AIRREG's earlier findings, that experience shows that it may be more valuable to think of a combination of measures in the framework of a general responsibility of governments, industry and the courts to create and provide rapid ad hoc responses if and when emergency conditions arise as well as ensuring fairness in the treatment of all damaged persons and bodies. This situation implies a key role for individuals such as bankruptcy administrators but also for governments in their oversight and response-coordination capacities.

Response coordination importantly includes working with all industry stakeholders to mitigate the impact of a financial collapse. Voluntary willingness by other airlines, for

¹²² *The European Travel Agents' and Tour Operators' Associations (ECTAA) and the Guild of European Business Travel Agents (GEBTA)*

example, to honour tickets of the bankrupt carrier,¹²³ and/or to transport stranded persons at low or marginal cost, may be critical for solving immediate problems.

Having stressed the individual nature of bankruptcies, it is also true that one can discern certain types of situations; these may also call for certain more general forms of approach. As illustrated by the case studies examined in Chapter 5, these include:

- The failure of an established and major market player such as a national flag airline. In Europe, cases such Sabena, Swissair and most recently the difficulties of Alitalia come to mind
- The failure of a scheduled services long haul operator who relies on marketing lower cost travel to tourists and persons travelling privately
- The failure of a regional operator, that is, one with emphasis on intra-EU services or on programmes in neighbouring regions such as the Mediterranean.

6.2.1 Failure of a National Flag Carrier

A number of national carriers in Member States have experienced deficit operations, often because of their inability to control costs as well as their competitors. Demand for air travel in their markets, however, clearly exists, and their exit from markets – especially on an abrupt basis – will cause significant disruption unless replacement services materialise quickly.

Thus, when such carriers run out of cash and can no longer pay bills, simple liquidation will not only be an unpalatable option socially and politically in the state concerned; it may also be very disruptive economically in the affected market. Therefore, a reorganisation that will permit rapid resumption of operations will be a preferred tool, and/or efforts to restructure the most viable elements of the enterprise in cooperation with another firm are likely to be pursued.

Unique in the situation of such a carrier is that the owner in whole or in part may be the state. Then it will not be the owner but its instrumentality that has gone bankrupt. Such an owner is also likely to be the issuer of the AOC and have oversight responsibility over the financial as well as technical fitness of the operator. For an airline of this type, only a small amount of its carriage is likely to have been insured pursuant to the terms of the package directive.

These factors taken together imply in our view a clear public responsibility to ensure that problems such as repatriation of stranded passengers require the attention of the regulator to ensure that they will be equitably and efficiently resolved (with industry assistance as appropriate).

With respect to ticket holders who have not commenced travel, the use of instruments such as credit card refunds coupled with rebooking on replacement carriers will probably cover the great majority of cases – though some individual claims may still be a matter for settlement.

¹²³Theoretically the passenger could transfer his claim on the bankrupt carrier to a substitute carrier, which, if it carried a sufficient volume of such traffic could aggregate such claims and appear as creditor at a bankruptcy proceeding.

6.2.2 Failure of a Long Haul Low Cost Operator

While until now most LCC operations in the EU have taken place in short to medium haul markets of <1,500 km stage length, the future entry of such operators at increased scale is a distinct possibility. The case of Air Madrid, moreover, strikingly illustrates how such an operation can have a major impact when it goes bankrupt. More than 100,000 passengers were stranded, mainly in Spain, Romania and Latin America. This took place during a peak travel period with many of those affected needing to return to distant points of travel origin. Spain's transport ministry was able to charter flights to help around 8,000 travellers get home but thousands were still left stranded.

In the Air Madrid case, the Spanish government and the Spanish courts appear to have initiated deliberate efforts both to provide immediate relief and to create an avenue to recover financial damages, at least in part. While we lack insight into the asset mass available to satisfy financial creditors and other damaged parties such as the employees, it would appear that the ticket holders were treated as creditors with recognised standing.

We find as positive the development of an individual claims procedure and form by the Spanish court and the dissemination of information by the Spanish government (also to non-EU residents) to enable individual travellers to report their financial losses directly. This way the organisational issues of adding up the claims of thousands of small creditors and the need for adversarial class action representation to protect them could be mitigated.

In such cases, however, it would also be important to reconcile the electronic booking records of the company. Depending on what the technology supports, an early responsibility of Administrators in airline bankruptcy cases might be to produce a full bookings inventory and then advise all ticket purchasers who have clear addresses. E-mailings could be an efficient tool for such notifications.

The Air Madrid case also casts light on what may be a growing demand phenomenon for holiday travel to visit friends and relatives by alien residents of the Community returning on vacation to their homelands. These persons do not require tour packages yet their social-economic situations are in many cases more modest than the European family traveller that present package regulations seek to protect.

6.2.3 Failure of a Low Cost Carrier Serving the Intra-EU and EU Neighbourhood Markets

Most LCC services in the EU serve short and medium haul markets. As shown in Chapter 1, LCCs in fact are becoming major providers on point-to-point routes in Europe. These airlines often provide frequent services to holiday destinations, and they are used increasingly by persons that might formerly have booked through tour operators.

In the case of EUJet discussed in Chapter 4, it was determined by UK authorities that a significant number of travellers were not covered by the ATOL system -- suggesting that new approaches may be needed, for example, in the areas of information and disclosure requirements to encourage travellers to purchase insurance or have contingency plans.

The EUJet case has also importantly demonstrated the value of mobilising industry support under government leadership. In this case, this went beyond the immediate provision of airlift. It included offers by other carriers to provide ticket holders who had not commenced

travel with sharply reduced rate transportation which in many individual cases have been essential to keep travel plans intact.

In contrast to the stranded passengers in South America (Air Madrid case), repatriation in intra-EU markets such as UK-Spain is primarily a financial issue rather than one of airlift capacity (since return by surface means is also a theoretical alternative).

6.2.4 Lessons of the Case Studies

Each of the case studies presents unique challenges, but collectively they demonstrate that risks for consumers that used to be perceived as occurring mainly for advance purchasers of package travel now exist to a greatly increased degree for purchasers of scheduled services.

Scheduled service airlines no longer operate in protected markets, and government owners stand less and less frequently behind them. Competition is sharp; operating margins are under intense pressure; and pricing strategies aimed at getting consumers to pay money long in advance to obtain the lowest possible fares has encouraged a bargain-hunting mentality as well as risk taking by airlines that future costs can be controlled and kept low. The new entrant failure rate (as also documented by the AIRREG Study) remains high, but bankruptcies can also claim legacy carriers who cannot cope with low cost competition.

Under the circumstances, the risk exposure has shifted meaningfully toward the 'unpacked' traveller. Public authorities are challenged to rethink the traditional tools of consumer protection. This need not and probably should not include protecting bargain hunters against risks they are prepared to accept; however, reasonable and cost-effective rules that ensure they have been made aware of such risks may not only help individual travellers; they may also reduce the need for public efforts to assist them in distress.

6.3 HOW TO EVALUATE COURSES OF REGULATORY ACTION

6.3.1 General Observations

In the subsection that follows we shall describe seven parameters that can be applied to estimate and compare the benefits and costs of particular courses of regulatory action. Whether these parameters or others are used, we believe that -- because there seem to be no obvious single measures that persons concerned with the problem agree on -- that care and rigour are called for in considering new legislation to protect airline ticket holders in cases of bankruptcy or withdrawal of operating authority.

Solutions can sometimes cause more damage than the problems they are designed to address. As has been described to us by a number of stakeholders we have consulted, this type of risk is particularly great when it comes to regulating the activity of potentially insolvent airlines. The dangers of vicious circle effects are evident. If actions by regulators, reports in the media or reactions by other parts of the industry, including suppliers suggest lack of confidence, then consumers too will logically react and this will make recovery and survival yet more difficult.

If airlines face cash flow problems and struggle to control costs, they will attempt to defer expenditures and may be tempted to extend maintenance cycles, for example.

Such behaviour should attract, and indeed it has attracted, the attention of European regulators on the financial as well as the technical sides of airline oversight. Such oversight

demands skilled and dedicated judgement. The regulator walks a clear but delicate line. On the one hand, he or she must insist on safety first and when signs of slippage begin to appear to intensify monitoring and act as needed to impose more stringent adherence to standards.

On the other hand, the regulator is also aware that such measures will necessarily impose some direct costs on a financially stressed company and, more importantly, any signs of demonstrated concern and lack of confidence will (perhaps rightly) create concerns among customers and also creditors. For example, the costs of voluntary insurance products such as Scheduled Airlines' Failure Insurance (henceforth SAFI) may go up as insurers perceive risk; indeed they may stop coverage altogether.

Thus, before describing parameters that might be used to evaluate alternative forms of new regulation, it is important to stress that market reaction will play a role under any form of regulation and that no matter what the regulations say, the operational actions of both regulators and the market players may affect outcomes in unforeseen and unintended ways.

6.3.2 Parameters for Evaluating the Need for New Rules

The following seven *standards of evaluation* will be applied when we consider the possible advantages and disadvantages of regulatory or contract law solutions below:

- *Relevance.* Does the proposed solution address a clearly defined and agreed problem; or does its rationale relate in part to other concerns that could or should be addressed by different measures?
- *Acceptance.* Is there a consensus among the stakeholders that the measure is sound and is likely to work positively; or is there significant opposition from one or several affected groups (including consumers, airlines, travel agents, financial institutions, courts and bankruptcy administrators or aeronautical authorities)?
- *Clarity & simplicity.* Is the solution clear in its content and scope? Will consumers as well as the travel industry understand its terms and the procedures it may introduce? Could it have indirect and negative effects that could produce unintended consequences that would undermine or even cancel-out achievement of objectives?
- *Legal soundness.* Are the terms of any proposed legislation consistent with the treaties, EC Law and national laws (as harmonised through the EU) and do they comply with sound and established precedents?
- *Efficient/fair enforceability.* Does the reform pose enforcement problems? Can it be applied in a transparent, non-discriminatory, uniform and cost-effective way to all firms in the market including third country airlines marketing international air services to EU consumers so that its standards will be respected and followed?
- *Market impact.* What impact will the reform have on current marketing and sales practices? Can all or nearly all companies adapt to its requirements easily and quickly or will this measure be hard to implement; or could it affect certain business models disproportionately? Will it increase direct or indirect costs significantly?
- *Cost-benefit proportionality.* Considering the full range of its possible impacts in preceding or any other areas of evaluation (see also next paragraph below), does the reform seem likely to produce worthwhile benefits overall in light of the known or probable costs?

Note: While we believe that the above parameters should be taken into consideration they should not be considered complete. The objective here is to suggest a standard set of

questions or tests should be applied when comparing the benefits and costs of various courses of action, and to give considered evaluations of the individual options for the purpose of providing illustrations rather than answers.

6.4 POSSIBLE ACTIONS

In the previous Chapters we have identified a range of actions or rules that have been under discussion (many also having been mentioned in the AIRREG Study) as possible measures to provide new or added protection for ticket purchasers on airlines that have gone bankrupt or who have abruptly lost their operating licenses. This has led to the development of the following menu of solutions (which are individually analysed in the subsections that follow below):

1. *Strengthened Oversight.* Raised standards/pro-active monitoring of financial fitness, as well as possibly intensifying technical oversight of airlines on the edge;
2. *Strengthened information requirements.* Requiring marketing websites and other sales outlets to advise ticket purchasers of risks, insurance options, terms of credit card protection and/or alerting vacation planners to the protections they could have under the PTD if they book through an accountable organiser;
3. *Clarifying the role of sovereign responsibility.* It may be relevant to clarify the responsibilities of Member States and EASA to travellers on airlines operating under their aircraft operator certificates (AOCs). One can for example, postulate an obligation of Member States in principle both to provide or facilitate *ad hoc* protection under special circumstances to stranded travellers but also, through planning and coordination procedures, to create contingency plans and obtain commitments of assistance from industry;
4. *Airline self-insurance.* Mandating insurance by all airlines for all classes of travellers against bankruptcy risk. By amending Regulation 785/2004 requiring airlines to extend the same scope of coverage now required under the Package Travel Directive (PTD) to purchasers of scheduled airline transportation that is not part of a package;
5. *Consumer self-insurance.* Mandating availability of some form of scheduled airline failure insurance and/or compensation by credit card companies to recover advance payments for services not rendered to be offered to travellers;
6. *Creating general reserve funds* on the basis of fixed levels of contribution per traveller (as opposed to risk-based premiums on insurance);
7. *Considering standards under the bankruptcy laws* such as steps to: a) ensure fair and efficient treatment of ticket holders as a creditor class in cases of liquidation; and b) encourage the use of reorganisation procedures under which companies with prospects for restructuring can maintain services.

Broadly speaking these measures can be thought of as applying as either:

- I. *Precautionary measures* designed to prevent the problem in the first place; and/or
- II. *Relief measures* designed to work *ex post facto*.

The first two measures are precautionary, designed respectively to avert bankruptcies in the first place and to mitigate consumer risk and exposure before the fact should they threaten to occur. The third measure, sovereign responsibility, also emphasises precautionary planning,

but its ultimate purpose is to deal effectively with ex post facto consequences, notably the problem of repatriating stranded passengers.

The 4th and 5th measures, the insurance of airlines or of consumers, are designed to provide reimbursement to consumers after the event. However, such instruments also create important market pressures on airlines to remain solvent and maintain financial reserves before the fact. For example, insurance and credit card companies have a vital interest to monitor the financial performance of the services they would be voluntarily insuring and therefore can and do deploy contractual controls to preserve liquidity.

The creation of a general reserve fund (the 6th measure) is fundamentally an instrument of ex post assistance.¹²⁴ Focus on ex post facto compensation or relief to creditors is also a basic function of the bankruptcy laws (the 7th measure).

6.4.1 Format for Analysis and Comparison

In the following subsections (6.4.2 - 6.4.8) each measure is described alongside its advantages and disadvantages. In the first six cases, an indicative Team evaluation is provided, using a scoring range of +5 (best) to -5 (worst) under each of the seven evaluation parameters defined in Section 6.3 above. In the case of bankruptcy reform, because of a variety of considerations (see 6.4.8 below) we confine ourselves to a qualitative consideration of two possible areas of action or policy attention, scope for which exists under existing laws. We should state at the outset that in some cases there was a considerable range of views within the Team. This outcome thus may reflect what the AIRREG Study also found, namely that: There is no general agreement on a single or best solution.

For this reason, we re-emphasise that the evaluations that follow should not be understood as recommendations but rather as examples of how the measures can be evaluated individually as well as considered collectively. In addition, we observe that if several of these options were to be applied in concert, then the overall effect may be greater than the sum of the parts.

6.4.2 Strengthened Oversight

Description: Present Community regulations (Regulation 1008/2008) establish the principle that financial fitness is a condition of receiving an Air Operator Certificate (AOC) to operate and hold out flying services to the travelling public. The regulation also sets forth minimum standards of enterprise liquidity. One course of action might be to make such standards or at least their enforcement more rigorous.¹²⁵ A judicious but clear step in this direction has been taken in the 2008 reforms of market access embodied in Regulation 1008/2008 (see discussion in Chapter 3), which encourage if not require national regulators to control the financial fitness of their AOC holders in a more active and systematic way than heretofore.

A sensitive but relevant question is how to monitor the operations of companies after start up? The regulator has the power, for example, to curtail as well as suspend an existing license; that is, for example, to make it temporary.

¹²⁴ Theoretically administrators of the fund might also monitor financial performance a priori, but they would lack the tools of insurance and credit card companies to encourage financial discipline.

¹²⁵ We note that the AIRREG/Booz bankruptcy data show that a number of airlines who obtained AOCs were not capable of even starting operations. Whether this suggests current financial fitness standards are too weak or whether it rather implies they have not been adequately monitored and enforced is a question beyond the scope of this study.

One immediate impact of shortening the term of licenses is that this can affect the marketing programme; that is, airlines so affected should not be able to sell tickets beyond a certain date thus preventing them from intensifying practices of borrowing ahead (though more advance sales) and instead requiring them to take actions to improve cash flow.

Such improvements can only come from two places: either by raising income or cutting costs. The latter aspect then raises the issue of strengthened oversight in technical and operational areas. Cost control must not come at the expense of meeting safety standards.

The terms of reference for this study have appropriately noted the importance of a coordinated approach to financial and technical oversight in the case of financially weak airlines. In the Air Madrid case Spanish authorities were challenged to intensify their monitoring of aircraft maintenance, for example, as the airline operated close to the edge in the months preceding its insolvency, which was also then accompanied by withdrawal of its AOC.

We believe it is important that all airlines and especially those who are in tight situations know that they will be monitored in such a way as to foreclose temptation to delay necessary maintenance or to certify aircraft as ready for flight in the presence of uncertain conditions.

Advantages of Strengthened Oversight

- *Safety is paramount.* Regulators have a duty to be extra alert and watchful with respect to airlines that are experiencing financial pressures and to monitor their operational and technical performance accordingly.
- *Raising minimum working capital requirements could therefore be wise.* Whether through a formal increase of the level of needed start up financing and/or through intensified monitoring of airline balance sheets regulators should work to ensure agreed minimum levels of financial soundness.
- *Timely intervention can minimise hardship.* The managed reorganisation or even liquidation of an endangered firm may be much less problematic than passively tolerating a slide into a bankruptcy that results in full and abrupt suspension of service. If serious concerns were identified early, limitations could be placed, e.g. on advanced bookings. This would reduce the number of people affected.
- *Reorganisation can benefit both employees and consumers.* The managed reorganisation of an endangered firm, if successful, has the benefit of maintaining at least some of an airline's business value and its jobs as well as keeping services going and avoiding the stranding of passengers.
- *Long term stronger and consequent financial oversight will benefit competition.* Clearly any new regulation or strengthened implementation of existing financial standards will affect sales and marketing strategies – for example pricing. Consumers could be deprived of low cost pricing models offered in desperation. On the other hand, airlines that price to obtain maximum income per aircraft mile (that is, including use of marginal pricing to fill otherwise empty seats) will still offer budget fares without the price dumping that can work to the long term detriment of competition.

Disadvantages of Strengthened Oversight

- *Intensified financial oversight can be counter-productive.* While the level of technical oversight demanded by the situation must always exist, *ad hoc* regulatory economic intervention, that is, issuing orders to individual airlines to take financial actions, is

likely to be counterproductive. It can deepen rather than mitigate dangerous conditions. Public awareness that the regulator believes or suspects that an airline's financial soundness is questionable will launch a vicious circle of responses: consumers will shy away; banks will not lend; suppliers will insist on immediate payment of bills; insurers will raise premiums or even stop writing policies. The consequence is that the ability of the airline to save itself or even reorganise under administrative protection will be compromised; jobs and economic activity will be lost. Ticket holders will be stranded and/or out-of-pocket when the curtain falls.

- *Implementation of ongoing financial oversight will place unreasonable demands on regulators.* Taking *ad hoc* actions in individual situations (in effect conducting an operational audit of current performance) will place enormous stress on regulators, who will of course be aware of the risks that could flow from acts of enforcement. Thus whatever financial standards are deemed necessary need to be set as simply as possible in the basic terms of the license and should only be reviewed on a scheduled periodic basis. Otherwise market forces will do a far better job if left alone in regulating survival chances.
- *Increasing working capital requirements will produce secondary consequences that will produce undesired effects.* Changing the financial conditions under which airlines must operate will affect their business plans in unforeseen and perhaps undesired ways. LCC services and pricing strategies have produced enormous benefits for European consumers resulting in new and more direct services and radically lower prices. Considering these benefits it is not worth the risk of any regulation that could change the marketing model. Better to rely on strategies to buffer the costs of the current system.

6.4.2.1 Summary Analysis of "Strengthened Oversight" with respect to the Seven Parameters

The study team summarises its own evaluation of "Strengthened Oversight" pursuant to the seven parameters defined in Section 6.3 (scale +5 to -5) as follows:

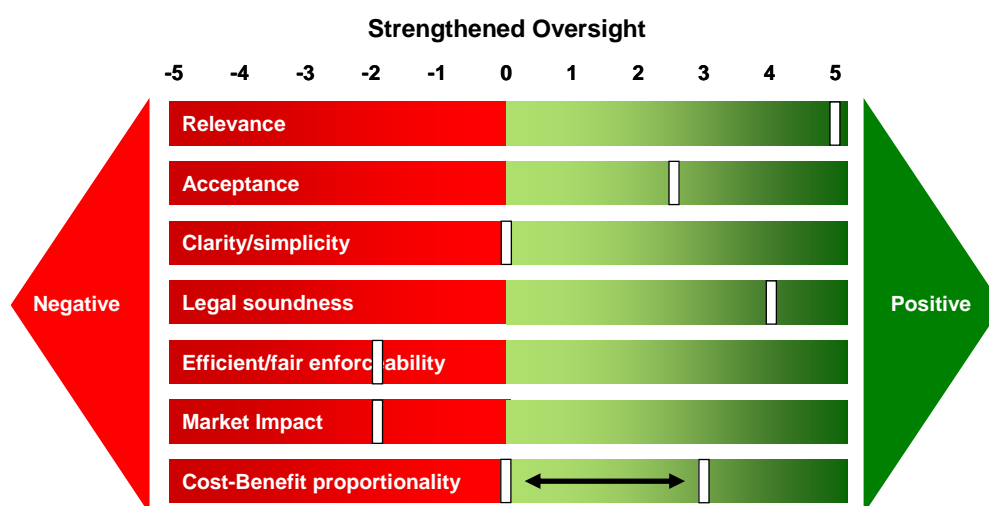


Figure 31: Study Team Evaluation of "Strengthened Oversight"

6.4.2.2 Discussion of Findings

The new licensing and market access rules and licensing rules embodied in Regulation 1008/2008 establish a clear context and a mandate for the implementation of this measure. Stakeholders will not seriously object to, and for the most part will welcome, stronger financial standards applied uniformly to the industry.

The goal of the measure is very clear, but oversight always demands judgement as well as expertise, and financial regulation – as has been amply demonstrated in recent months – is far from simple. Comparing treatments of individual cases might also produce variances across the Member States and indicate the need for monitoring at Community level as well.

Application and enforcement of this measure will add conditions to market entry and work to constrain it. Greater stability of performance will of course benefit consumers; however, fewer very low prices are likely to result. Costs of doing business will rise at the margin and for individual operators could be significant.

An overall estimate of cost/benefit from a Community perspective is extremely difficult. This measure depends significantly on the work of individual regulators in Member States in difficult individual cases.

6.4.3 Strengthened Information Standards

Description. The Commission and Member States have become increasingly watchful with respect to the rapidly rising tide of business being done on the Internet, which depends 100% on the presentation of information. Unlike a store where the buyer can form his/her impressions on the basis of a variety of physical parameters and sources of inspection, the virtual presentation of the Internet is one far more controlled by the seller.

In the specific case of airline transportation, standards for information display have been a concern of regulators for some years (for example with respect to information management rules on computer reservations systems). National laws on truth-in-advertising in most states (whose specific examination is beyond the scope of this study) have penalised deceptive advertising. There are also positive rules on consumer information in a wide range of product areas – for example as to contents in products or product risks (e.g. with pharmaceuticals).

In the instant case, the high rate of airline bankruptcies as related to advance sales techniques described in this study make the issue of minimum standards with respect to the scope and content of consumer information highly relevant. Specific aspects that should be considered under this option include:

- Informing the consumer with respect to insurance options against bankruptcy risk as well as the conditions that might be offered by the individual airline (possible selling point) making clear whether guarantees are provided by which third parties
- Informing the consumer, in all cases where funds can be booked off following reservation by using means other than credit cards (such as debit cards or bank transfers) of any differences in rights of recovery for non-delivery of services.
- Informing the consumer, if he or she uses the website to inquire about other services such as rental cars or accommodation that in combination will qualify under the package directive, whether or not the provider will sell under the terms of the PTD (that is, the implementing national plan) and if not – explaining the resulting gap in protection.¹²⁶ Note: This would not exclude asking a fee for providing this protection.

¹²⁶ For example, in the case of the UK, the seller would state that the sale occurs under ATOL or does not or whether it is prepared to offer a comparable guarantee.

Advantages of Strengthened Information Standards

- Carefully implemented, such measures will add clarity and transparency as well as providing relevant information that, as indicated by the EUJet case, has not been consistently made available in the past.
- Such measures help create informed consumer behaviour. As such they strengthen the free market and enhance fair competition.
- Working with stakeholders in the formulation of exact rules it should be possible to implement useful reforms in an efficient way. Notwithstanding the new opt in rules on presentation of airline prices (see Chapter 3, Subsection 3.3.7), this could even include requiring purchasers of air transportation to make one or two acknowledgements (accept/reject clicks) recording their awareness of protections available (as is done routinely in the case of car rental insurance options, for example).
- There are ample precedents both in air transport marketing and in other fields for such rulemaking.
- These rules can also be formulated to mitigate concerns of important stakeholders (for example travel agents and tour operators) that current regulation in this area is unbalanced in that sellers of 'self-packaged' holidays (where the travel components are sold individually) are exempted from PTD consumer protection requirements. In this way possible or perceived distortions of competition can be mitigated or even eliminated as the buyer is made aware of services provided by the tour operator.

Disadvantages of Strengthened Information Standards

- Interfering with the seller's freedom to market is not without risk. While truth is a noble objective, perception is often in the eye of the beholder, and solutions can easily get designed that go in search of problems rather than vice versa.
- Unless the industry is carefully consulted in the process, there is even greater risk than requirements will onerous, bureaucratic, rigid and miss their objective if not formulated in simple and limited language, as buyers simply click past the warnings.
- Nothing prevents individual airlines who have arranged 3rd party protection for advance purchasers from using this as a selling point.
- One needs to think twice about all public requirements for information since there are dozens of potential areas that taken together can add significant cost burdens. For example, airlines could also be required to post things like their on-time performance statistics, their seat separations, their baggage loss statistics, their meal offers etc. any and all of which are potentially relevant for informed consumer choice.
- Finally, at the end of the day, bargain hunters will take risks no matter what the warnings are if they think they can save money. In the end, others will have to help pay for this, which means that information policies will not remove the problem and if removing it is important, other measures will be more relevant.

6.4.3.1 Summary Analysis of "Strengthened Information Standards" with respect to the Seven Parameters

The study team summarises its own evaluation of "Strengthened Information Standards" pursuant to the seven parameters defined in Section 6.3 as follows (scale +5 to -5) as follows:

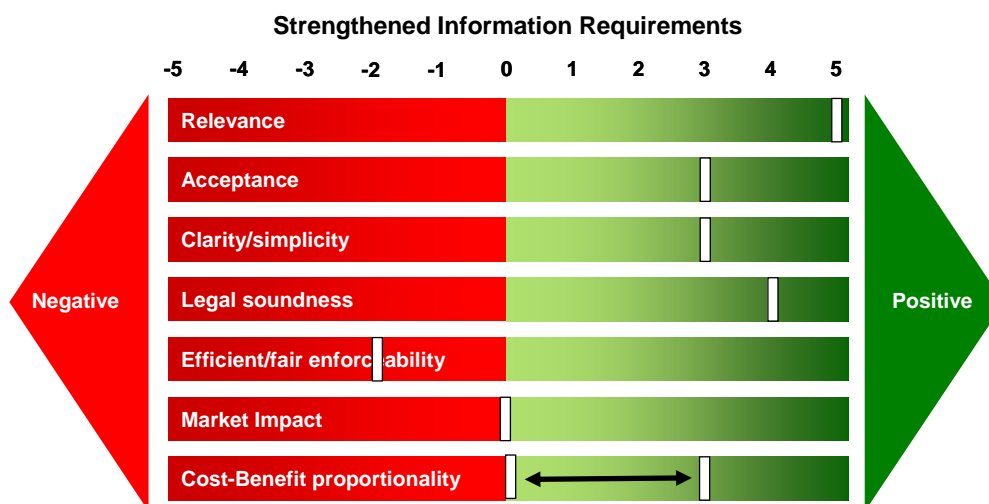


Figure 32: Study Team Evaluation of "Strengthened Information Standards"

6.4.3.2 Discussion of Findings

Current problems relate directly to marketing trends and sales modalities on the Internet. Regulatory standards and ongoing oversight in this area are highly relevant. The new marketing rules (also embodied in Regulation 1008/2008) provide fresh context for air transport sales regulation as do regulations with respect to information display and truth-in-advertising more generally.

Stakeholders will not seriously object and should welcome steps that add to transparency, completeness and timeliness of information. However, an informed, prudent and coordinated approach to the formulation and implementation of requirements will also be critical to assure acceptance of industry as well as consumers.

Clarity and simplicity are fundamental objectives of the measure itself (as is the development of uniform standards to assist consumers across the Community). Thus a positive impact may be reasonably expected.

The ingenuity and dynamism of the market will, however, provide an ongoing challenge, and the implementation of standards must be adaptable to changing and perhaps complex situations. As a dynamic, rapidly evolving medium, the Internet is very hard to regulate in an efficient, fair and timely manner. In addition, while regulation can ensure that the information is displayed, it may be more difficult to persuade time-conscious consumers to read it, particularly if it is not presented in an enticing fashion. Ongoing monitoring is indispensable and also a major challenge.

The likely market impact could be variable, depending on how this measure is applied. One effect could be some renewal of consumer interest in packaged travel. However, it may not be easy to design and enforce requirements that firmly alert or warn consumers without some impact on sales effectiveness and operating costs.

Overall we believe that a strengthening of information standards is likely to provide benefit; however, some costs may also result, and the strength of this measure is questionable, making an estimate of net benefit difficult.

6.4.4 Clarifying Sovereign Responsibility

Description. Agreed contingency procedures are a familiar tool to deal with problems created by suspension of flights. Arguably they should be part of the planning of all Aeronautical Authorities. They are relevant for dealing with the need to repatriate travellers for whatever cause. That is, they could arise in cases of political disturbances, for example.

A common basis for such planning is the need to generate airlift capacity which will have to be provided from civil or military resources – preferably and most probably from the former. Considerable precedents both within and outside Europe for such planning exist. As described in Chapter 3, government-industry planning in the USA, following the 9/11 attacks led to the definition and acceptance of procedures for recovery of stranded passengers. Another long standing model for cooperative airlift relief in the US prior to 1978 (not dealt with in this study) lay in industry agreements (as then permitted by the CAB) to provide alternative airlift capacity in markets affected by industrial action.

The key in such airlift planning is the willingness and perhaps even preference of the airline industry to use voluntary self help measures to solve ad hoc problems such as repatriation of stranded passengers rather than creating formal instruments involving continuing and possibly universal obligations. Concretely, as described in Chapter 4, for example, UK licensed airlines are prepared (and prefer) to commit their resources to assist each other in emergencies, rather than be obliged to make payments on every passenger carried into an independent fund.

Such “bottom-up” willingness to assist ticket holders on bankrupt airlines, however, requires government approval and coordination, and especially in a major case during the peak travel season, the government may need to organise supplementary airlift.

Advantages of Clarifying Sovereign Responsibility

- Some form of national contingency planning is indispensable for being able to respond responsibly when a licensed airline abruptly stops service. It would be difficult for a government to just ignore 10,000 citizens stranded far away, on the basis that these consumers should have been aware of the risk and made private contingency plans.
- Evidence shows that airlifts can be generated cooperatively and cost-effectively working with industry
- Moreover, past experience suggests that supporting airlines will, in general, see it as being in their interest to assist (rather than exploit the situation of) stranded passengers, thus enhancing their reputation and protecting the reputation of the industry as a whole
- Thus, especially with thoughtful government leadership and coordination, such planning can produce affordable relief for most concerned.

Disadvantages of Clarifying Sovereign Responsibility

- Contingency planning is a necessary but not sufficient policy instrument. By definition it constitutes an *ad hoc* form of response and is not useful as a preventive tool; that is, it does not help avoid having the problem in the first place.

- While some contingency planning is desirable, general arrangements should not be based on it. Therefore it can negative side-effects if reliance on such plans results in watering down or rejecting other needed measures.
- In particular the state’s readiness to act as a saviour of last resort should not provide an excuse for not dealing with the increasing number of uninsured travellers who do not purchase packages and for whom airlines (unlike tour operators) are not obliged to provide financial contingency guarantees.

6.4.4.1 Summary Analysis of “Clarifying Sovereign Responsibility” with respect to the Seven Parameters

The study team summarises its own evaluation of “Contingency Planning” pursuant to the seven parameters defined in Section 6.3 (scale +5 to -5) as follows:

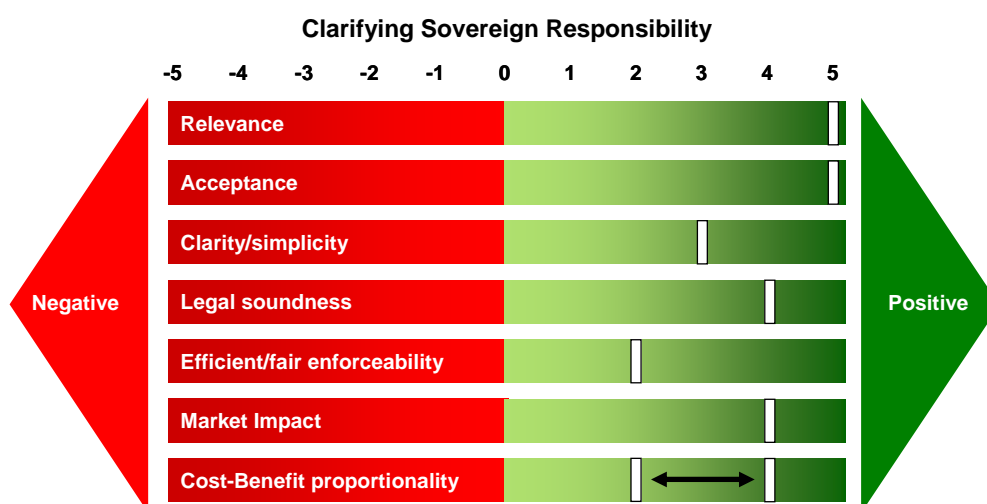


Figure 33: Study Team Evaluation of “Clarifying Sovereign Responsibility”

6.4.4.2 Discussion of Findings

The Team believes that appropriate planning and the identification of needed resources to act in a timely manner to ensure effective repatriation of larger numbers of stranded travellers is indispensable. The benefits of such planning far outweigh their costs, since insecurity and even short term chaos can result if the event strikes and the system is unprepared.

Not only the stakeholders but the general public accepts the need of public authority to act professionally and decisively in the face of emergency situations. Both airlines and airports will wish to cooperate in a solution of the problem. There is considerable tradition in the development and execution of airlift operations, though in the individual case of course political issues can arise.

From a social and economic perspective, the ability and willingness of the state to act in the case of a public emergency will also provide a measure of underlying assurance to markets, giving confidence to buyers and sellers.

What contingency planning does not do is create a relevant tool for averting the problem in the first place. At the level of the market as a whole it can inadvertently play the role of a safety valve encouraging airlines and consumers in the belief that help will come. Thus it may facilitate continuation of current marketing practices, whether for good or for ill.

6.4.5 Airline Self-Insurance against Liabilities to Travellers arising from Bankruptcy (or Broader Failure to Provide Services)

Description. This measure distinguishes itself from insurance measures in the following subsection (under which travellers insure themselves based on options which the airline may suggest) by requiring the airline itself to carry insurance to protect its passengers so that they would be provided alternate transportation and/or compensation for out of pocket expenses if the airline is unable to operate a scheduled service because of bankruptcy or for other reasons such as cancellation of its operating authority. Such a provision could be accomplished at Community level by amending Regulation 785/2004 on airline insurance.

Advantages of an Airline Self-Insurance Requirement

- Such a requirement will impose serious and needed financial discipline on airlines, since insurance companies will need to be persuaded that the risks of writing policies are acceptable and they will require more prudential behaviour
- Such an insurance requirement should therefore exercise a serious precautionary and preventive effect. While higher prices and reduced capacities in the market may be a consequence, consumers' risk of being stranded and/or out-of-pocket will be significantly reduced, since
- Such a requirement will require higher liquidity business models and most bankruptcies would only occur as a result of a downturn in the general business environment or because of catastrophic events depressing air travel and not through excessive risk taking by individual firms.

Disadvantages of an Airline Self-Insurance Requirement

- Requiring airlines to insure advance purchasers of their services would create an additional cost for all operators as it would not be correct to impose such a requirement selectively. Thus financially stable operators who have served the market for many years, providing the bulk of capacity in the EU, could be penalised to avert a (for them) non-problem. However, in a competitive insurance market the cost to financially stable carriers should be low. Perhaps more seriously, financially unstable carriers would face increasingly high insurance premiums which could hinder their ability to continue operating.
- More than most other measures being discussed, this requirement could create international law and policy problems as third country airlines would protest to their governments against the disproportional and precedential implications of such a measure.
- Providing such an added level of protection could add significantly to costs and will raise fares generally – thus imposing costs on all consumers in order to provide marginal benefits for a few consumers (for whom better alternatives may exist).
- Individual insurance or other forms of product delivery guarantees such as credit card conditions (see Chapter 3) are therefore a far fairer and less costly method.
- There is not much support for this option in the airline or in the insurance industry.

6.4.5.1 Summary Analysis of “Airline Self-Insurance Requirements” with respect to the Seven Parameters

The study team summarises its own evaluation of “Airline Self-Insurance Requirements” pursuant to the seven parameters defined in Section 6.3 (scale +5 to -5) as follows:

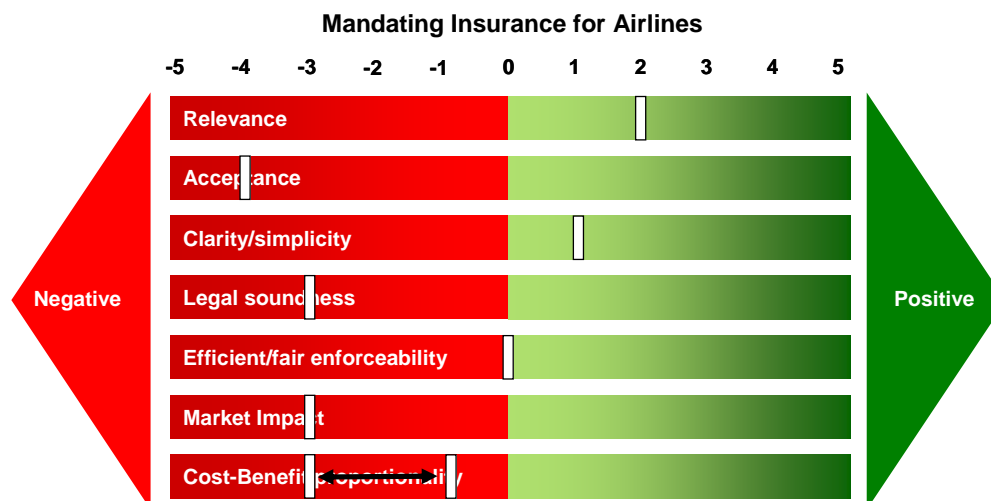


Figure 34: Study Team Evaluation of “Mandating Insurance for Airlines”

6.4.5.2 Discussion of Findings

This measure would eliminate lack of coverage against the risk of airline bankruptcy. However, it would impose a requirement that is arguably not relevant for many Community airlines carrying the bulk of EU traffic. Airlines strongly object to such a requirement,

The recent public comment review conducted by the Commission regarding revision of Regulation 785/2004 (see also Chapter 3) - except for the concerns of tour operators and travel agents that they suffer marketing discrimination (which could be addressed by other means as in 6.4.7 below) - showed little stakeholder interest for adding such a general requirement.

As a single explicit requirement this measure is relatively simple to formulate. Execution in the marketplace could however be another matter. Insurance companies set and adjust premiums based on perception of risk and individual airlines might even be deemed uninsurable.

Legal and policy issues would be significant. Insurance requirements in relation to airline liability for damage caused to passengers and shippers of cargo during air carriage have been extensively addressed at the multilateral level (e.g. the Montreal Convention of 1999). A unilateral decision to impose new forms of insurance requirements on all carriers operating to the EU would result in international protests. A decision to impose the requirement only on Community carriers could lead to distortions of competition.

All airlines would have to pay a new set of costs. While the insurance premiums could be negligible or low, they will also vary in accordance with risk perception. Overall we believe that the economic costs and the political complications outweigh the possible benefits.

6.4.6 Providing Optional Self-Insurance to Ticket Holders

Description. In this section we describe the concept of mandating availability of individual traveller insurance on the basis of the following assumptions:

- *Ticket holder responsibility.* While the airline's obligation (see further below) is to provide options and all relevant information about them, the ticket holder decides which if any options he or she will choose and pay for.
- *Acceptance of dynamic commercial risk factors.* Unlike trust fund-type arrangements (below) this requirement accepts (perhaps even welcomes) the fact that commercial risk factors can play a dynamic role; that is, that premiums will be higher for airlines whose financial position is shaky and lower for those with strong cash positions. Credit card companies, who insure consumers against non-delivery of goods and services purchased, may require escrowing of funds being billed until flights have actually taken place. Insurance companies may also stop offering coverage if they consider the level of risk of a weakening company unacceptable.
- *Regulatory focus on information requirements (with certain forceful elements).* In this measure, the central task of both rule making and oversight is to define, publish, monitor and enforce information requirements and perhaps certain procedural aspects of the booking process (recording awareness and acceptance/decline of protection options). This option *distinguishes itself from pure information requirements* (see 6.4.3 above) in that it would *require* the airline to maintain eligibility for at least some forms of third party protection or face the need of informing purchasers that it is no longer capable of complying with consumer protection standards.

Advantages of Mandating Availability of Self-Insurance to Ticket Holders

- While this measure is not as systematic as those that precede and follow it, the problem of bankruptcy while serious and real is *not general* in the EU. Therefore, the point of departure should be to aim for targeted and market-responsive solutions which this measure represents.
- By creating a framework for the development and offering of products such as SAFI, this option would strongly encourage though not formally require the closing of the coverage gap between travellers covered under the Package Directive and those purchasing individual products.
- This measure avoids penalising airlines that maintain working capital reserves. Moreover, it will identify risks to consumers.
- This measure also has the benefit of being objectives-focused; that is, it leaves open the type of plan which the purchaser can choose -- creating bottom-up flexibility as opposed to top-down rigidity.

Disadvantages of Mandating Availability of Self-Insurance to Ticket Holders

- Just as much as an airline purchasing its own insurance against insolvency, this option will complicate the problems of an airline facing financial difficulties; its potential creditors in a future bankruptcy proceeding (insurance and credit card companies) will demand rising risk premiums or impose cash control measures in order to protect their obligations and risk exposure to the travelling public. Thus, to the extent to which price conscious consumers alter their demand as a result of this, rather than working to reduce the number of bankruptcies this measure could increase them.

- Moreover, the fact that insurance companies may simply stop writing insurance on a troubled company implies that, from a public policy perspective the “uninsurable carrier” problem pertains here as much as it does for airline self-insurance.
- Another practical problem with regard to the SAFI concept in particular is that it does not appear to be generally or uniformly available in the Community air transport/tourism market. For example, as noted in Chapter 3, the product is not generally known in the EU’s largest travel origin market, namely Germany.
- This option will only protect people who choose to buy the insurance. It therefore cannot remove the possibility of having a substantial number of uninsured, stranded passengers in the extent of a sudden bankruptcy.
- Finally, this measure is far more discriminatory in its application than the trust fund concept (that follows in 6.4.7). Those who reject an insurance option may in many cases require and obtain public assistance anyway, so it would be more equitable to charge all a modest and flat fee.

6.4.6.1 Summary Analysis of “Mandating Availability of Self-Insurance to Ticket Holders” with respect to the Seven Parameters

The study team summarises its own evaluation of “Providing self-insurance choice options to ticket holders” pursuant to the seven parameters defined in Section 6.3 (scale +5 to -5) as follows:

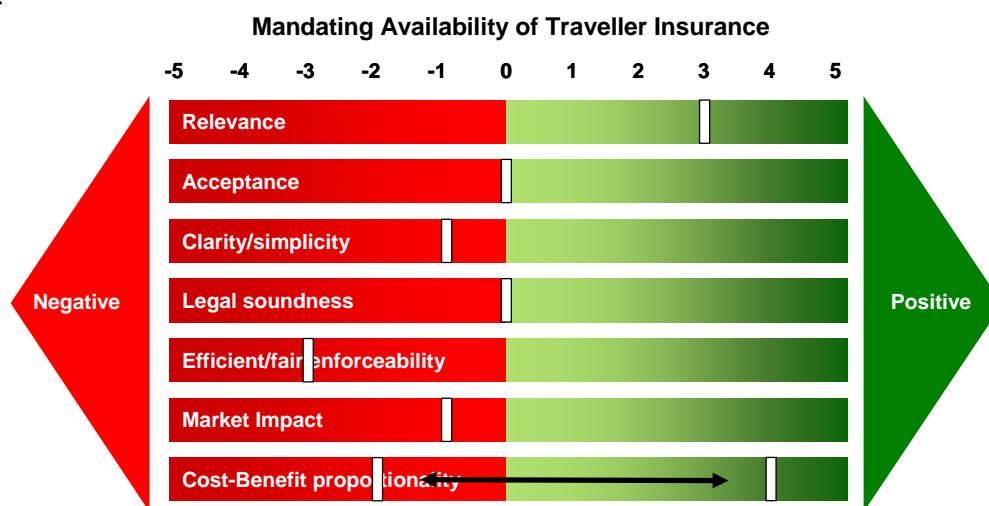


Figure 35: Study Team Evaluation of “Mandating Availability of Traveller Insurance”

6.4.6.2 Discussion of Findings

This measure creates a procedure that could go far to reduce consumer risks while at the same time placing the costs of coverage on the consumer who would benefit from it.

Acceptance by stakeholders, however, appears to be mixed. Airlines, while they might prefer this measure to the ones that precede and follow it, will resist new regulation that applies mandates not only to their marketing and sales procedures but which also sets forth new conditions for their financial relationships. Tour operators, for their part would prefer a stronger regulation to govern insurance of non-packaged travel services. Consumer groups may also find this proposal as not going far enough in the right direction.

While its core idea is relatively simple, this measure creates room for dispute over what constitutes protection. Would the guaranteed availability of credit card refund guarantees

suffice, at least with respect to non-commenced travel? What exact scope should insurance policies provide; that is, would they also need to offer compensation for losses such as pre-paid hotel services that could not be used after flights fell through?

This measure could require comprehensive monitoring of websites and other selling procedures (to ensure that each airline or travel agency provided acceptable access to voluntary coverage options) as well as periodic examination of the scope and terms of the insurance coverage itself to ensure that standards (as might be formulated in the regulation) were being met.

While the direct costs for coverage would shift to consumers, airline revenues and costs would be affected indirectly as they would be made subject to stronger monitoring procedures by insurance and credit card companies if the latter find their financial risk exposure increasing.

On this measure, there was considerable difference of view within the study team. Some members questioned the ability of this measure to produce significant benefits and felt it might produce more costs. Others believed that it could provide a cost-effective tool to direct consumer attention to products and procedures in order to give buyers every reasonable chance to protect themselves or consciously choose to assume risks.

6.4.7 Requiring General Contingency Funds or Trust Fund Arrangements

Description. As discussed in preceding chapters, the concept of a general public insurance fund established by a standard charging formula such as a flat fee per ticket, which would cover all scheduled services flights, has been proposed by various industry stakeholders and government bodies. Such a system would, by regulation, close the coverage gap between individual travel purchase and package sales covered by bonding arrangements as required by the PTD.

Such funds might on the one hand most logically be established at national level with oversight by aeronautical authorities who issue AOCs. On the other hand, Community airlines increasingly operate in multiple markets and this would raise issues as to whether fees should not go to funds maintained in the country of travel origin? In any event, given the level of air travel in the EU, even a fee of 1 Euro (or 1 Pound) per ticket would build up considerable funds rapidly.

While simple and clear in basic outline and seemingly equitable in structure, a general contingency fund will throw up complex issues such as:

- Whether a single flat fee is really fair and whether claims for compensation are then limited to set amounts, or whether there should not be some variability in premiums (e.g. percentage relationship to the prices paid) or based on the amount of coverage being needed or desired in the individual case?
- Whether the scope of coverage of such a general fund should be limited to cases of service stoppage for financial reasons or whether it should not broadly cover dealing with emergency situations?
- What to do with funds if (as would be hoped) few or no bankruptcies occur and fund balances swell? Should ongoing contributions then be suspended or past contributions paid back, and if so to whom, the airlines or the travellers?

- Should the funds simply be administered by financial institutions or should they acquire an own institutional form and perhaps competences to go with that (example: the Federal Deposit Insurance Corporation in the USA¹²⁷)?
- Would the goal be to displace the role of private insurers entirely?

6.4.7.1 Advantages of Requiring General Contingency Funds or Trust Fund Arrangements

- The flat fee-based fund is simple to understand, deals with a growing problem, is affordable (because of the widely spread risk) and socially equitable.
- As a publicly controlled mechanism or body, the fund will be more reliable in helping travellers and also give troubled companies better chances to recover than if these parties need to rely on the uncertain support of private insurance or credit card companies, who may raise premiums, sequester cash flow or even suspend coverage just when it is most needed.
- The general fund concept as defined cannot be seriously opposed by foreign airlines selling transportation from the EU. There is an international law based precedent for such a fund, namely, the Supplemental Compensation Fund.¹²⁸

6.4.7.2 Disadvantages of Requiring General Contingency Funds or Trust Fund Arrangements

- A general fund requirement, even if the charge is small, adds yet another user fee to the growing mountain of such fees that in aggregate contribute to rising costs in a soft market. Thereby it enhances the risk of the event it is designed to avoid.
- However, unlike other user fees, this charge would not, in the case of most airlines (who also provide the overwhelming bulk of services in the Community) provide them with needed services. While perhaps growing, the insolvency problem is not general.
- This option removes a level of discipline from the market by shifting risk from private actors to a public fund. Administrators of a not-for-profit institution will have little incentive and may lack scope to put pressure on airlines to remain liquid. Arguably a general fund is a support measure for less financially robust or adventurous firms as much as it is a protection device for consumers.
- Over time, administrative and institutional problems will arise with near certainty as decisions have to be made with fund administration, refund as well as charging policies, and it will be necessary to develop procedures to respond to perhaps many thousands of persons individually in need of assistance. If established as a general Community requirement, this could lead to high overheads in aggregate as up to 27 national funds get established and administered.

¹²⁷ The FDIC insures all personal accounts at registered banks in the USA up to a maximum level. If a bank becomes insolvent, the FDIC – which is a permanent institution with expert staff – obtains claims against the bank in exchange for its protection of depositors – and then may takeover the bank with the goal of reorganizing it and then subsequently selling the assets back to the private sector.

¹²⁸ Created by Article 22 of the Guatemala City Protocol which is part of the so called Warsaw regime or system governing airline liability

6.4.7.3 Summary Analysis of “Requiring General Contingency Funds or Trust Fund Arrangements” with respect to the Seven Parameters

The study team summarises its own evaluation of “Requiring General Contingency Funds or Trust Fund Arrangements” pursuant to the seven parameters defined in Section 6.3 (scale +5 to -5) as follows:

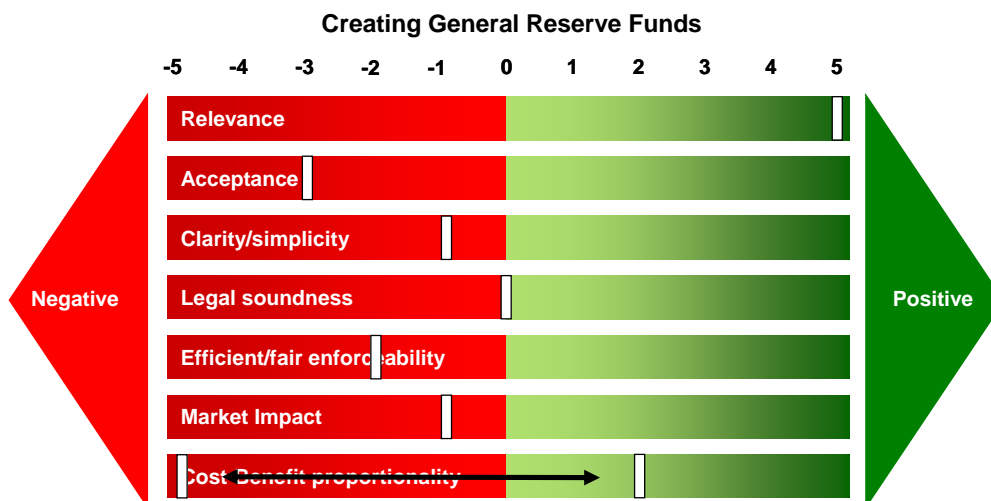


Figure 36: Study Team Evaluation of “Creating General Reserve Funds”

6.4.7.1 Discussion of Findings

This measure focuses in a very direct way on the problem. It provides universal coverage to the consumer at an affordable price that is likely to be much lower than private insurance. However, airlines strongly object to this measure. Other groups may also have difficulties with various aspects of this measure.

While its core idea is very simple, this measure will create new administrative and institutional machinery whose remit over time is not clear. The test of such a fund is not just how it collects money but how it manages and disburses it. Will it need to establish a permanent staff for claims administration that can act rapidly in emergencies that are only very occasional events for most Member States?

This measure would extend some of the protections of the PTD to individual travellers in exchange for paying a small mandatory fee. Such regulation, however, would work to displace private sector enterprises. If mandated by Community Directive the measure would have to address the issue of scope of responsibility of which national fund is to assist which travellers? Since most EU air travel is on carriers that offer network or point to point services in multiple markets, the traveller may have paid his or her fee into the Fund of one country but embarked on a carrier whose services were suspended in another.

As a relief measure the test of enforceability is how well such a Fund will actually work after the fact of a service suspension (not how easily it collects modest fees).

Though the fees would be small for individual travellers they are still part of the final price paid and as such, if the cost is borne by the airlines, constitute foregone revenues that over

time aggregate to considerable sums, or, if borne by the consumer, would create a negative consumer surplus which may, at the margin, dampen demand for travel.

On this measure, there was also difference of view within the study team. Some members believed this measure would produce net benefits for consumers originating travel in certain Member States at least. The more general view was that General Funds would risk producing unintended consequences such as either piling up money, creating high and redundant administrative overheads or otherwise not being cost-effective in their operational use.

Most fundamentally policy makers need to ask how general the problem has become and whether the creation of large general funds to relieve problem cases are essential and whether they will support and compensate or interfere with the natural disciplines of the market.

6.4.8 Steps under the Bankruptcy Laws

This subsection will not follow the full format of the preceding ones. While the application of bankruptcy law is obviously relevant, defined proposals for reform of general bankruptcy law are not under discussion in the current debate. Changes cannot be proposed realistically on an individual economic sector basis. It seems unlikely that the discrete problems of the airline industry can *per se* influence formal changes in this very sensitive legal and economic policy area.

However, it may be relevant to consider the role of two particular general policy issues whose handling could be quite important in managing future cases of airline industry bankruptcies, since consideration of these points also connects to the management and use of the more specific industry measures described and analysed above. These issues are:

- A. A consideration of the procedural issues involved in managing the interests of ticket holders as a creditor class in an insolvency proceeding (see the Air Madrid case), and
- B. To reflect on the benefits of using reorganisation (as opposed to liquidation) procedures whenever realistically feasible, especially when larger operators are involved.

6.4.8.1 Representation of Ticket Holders in Liquidation Proceedings

Concretely, ticket holders are creditors if they have not received the transportation they paid for or refund of the monies paid. That is, they have paid for a physical service that they have not received. Should they recover their money by a reversal of credit card charges (as is legally required within term limits under US law for example) when the airline fails to deliver service, then they effectively subrogate their creditor claim to the credit card company.

As a general matter credit card companies and insurance companies are in a far better position than individual claimants of smaller sums to bundle claims and to seek partial recovery in the bankruptcy proceeding from the available asset mass based on the legal standing of such claims under the applicable national law. As a practical matter, 20% of something is better than 100% of nothing. By the same token other airlines who honour tickets of the bankrupt carrier can at least consider whether pursuing partial recovery

(possibly in line with IATA framework procedures) is a cost-effective form of action in the individual case. In general it would be helpful if states ensure fair or equal treatment of such creditors consistent with protection of other interested parties, which of course notably include the employees.

It could also be extremely helpful to airline travellers if states take note of and reflect on the procedures in the Air Madrid case to deal with the ticket holders as a creditor class and implications that might be drawn. That is, in an electronic age that provides universal networking capacities, it ought to be possible to identify most potential claimants from the carrier's booking inventory and then formulate and disseminate (in many cases via e-mail) a simple and clear claims form that could be individually registered in the proceeding and then go forward with a timely adjudication of such claims. By contrast the apparent diffusion of responsibility (English claimants, mixed set of Irish/English bankruptcy administrators) led to a confused situation and apparent fragmentation of claims in the EUJet case and tangible losses suffered by affected travellers notwithstanding public and Parliamentary interest in the case.

6.4.8.2 Encouraging Efforts to Reorganise Illiquid Companies

As noted in previous chapters, bankruptcy proceedings can essentially follow two courses of action: liquidation, in which remaining assets are simply divided up among the creditors; and reorganisation, in which efforts are made to save at least parts of the company.

Reorganisation proceedings based, for example in the German case on the development of a so-called *Insolvenzplan*, have not been as widely used in the EU as they have in the US, where US carriers have frequently sought temporary protection against creditors as a tool to reorganise and then re-emerge in a modified form.

From an operational standpoint, and in the interest of travellers as well as employees, a reorganisation strategy is far more attractive than liquidation. Without getting into a debate on the change of laws, it may be useful to explore the scope of policy to encourage greater pursuit of reorganisation strategies (as in the case of the Swissair/Swiss and Sabena/Brussels Air transactions). These are obviously most important in the case of larger airline failures where meaningful service demand has existed and perhaps can be revitalised than with very recent and small start ups which have less market to work with.

7 OVERALL CONCLUSIONS

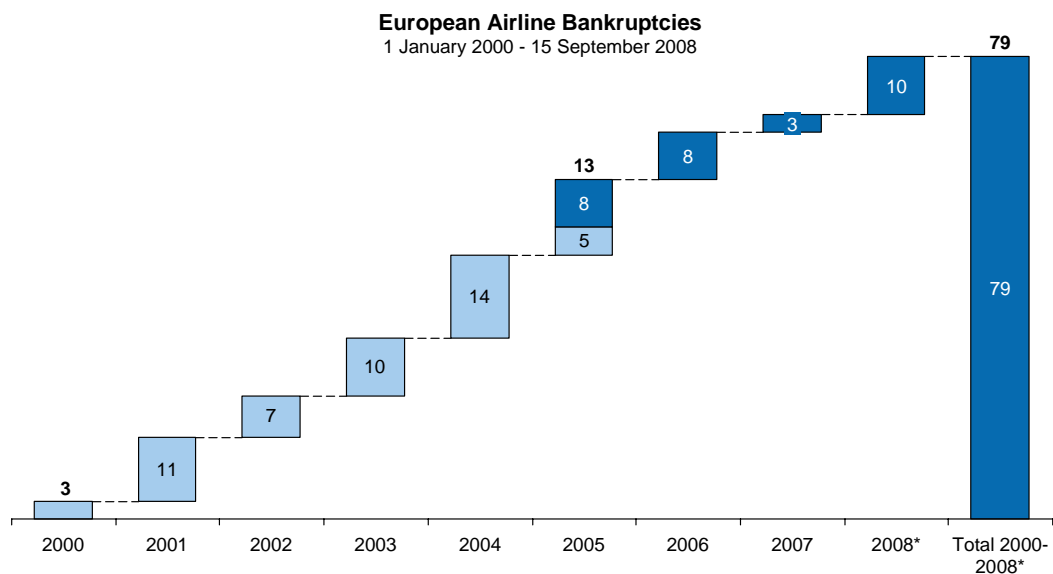
This study has considered the adequacy of protection of consumers in the European Union against financial and personal risks that may arise when airlines go bankrupt. These risks broadly take two forms: first, the consumer is almost certain to suffer inconvenience and some level of financial loss if planned arrangements are abruptly cancelled (even with insurance or other refund guarantees); second, if the trip has already commenced, he or she may be stranded at the outbound destination and exposed to personal and family hardship in the absence of prompt assistance with repatriation.

In this final chapter we summarise fact finding and analysis from the following perspectives:

- *Likely trends in the scope and depth of the problem:* Is there a strong risk that the number of out-of-pocket and stranded travellers caused by abrupt cessations of airline service will increase?
- *Causes of the problem:* What developments in: business planning and service structure; marketing strategies; consumer behaviour and the current regulatory as well as legal practice can be said to have led to or influenced the nature and extent of the problem in recent years?
- *Precautionary role of public authority in implementation of policy and legislation:* Where and how does or should the state intervene to protect consumers? That is, what consideration should be given to intensified monitoring and oversight procedures and to contingency planning (for emergencies such as large scale repatriation of stranded passengers) under current law as well as to adoption of new regulations - in contrast to relying in whole or in part on self-regulating forces in the market?
- *Ex post facto measures to provide compensation and relief:* What other steps might be taken to protect the interests of consumers?

7.1 TRENDS IN THE SCOPE AND DEPTH OF THE PROBLEM

Liberalisation of Community air transport markets in the 1990s has led to an explosion of new services operated by new operators that have provided consumers an enormous increase in service alternatives with less rigid conditions often offered at much lower prices. Competition between legacy carriers and new entrant low cost carriers has sharply intensified and multiplied the number of market exits as well as market entries as uncompetitive airlines were liquidated or reorganised. As documented in Chapter 2 of this Study, the number of bankruptcies since January 2000 is at least 79, and a higher rate than that reported in the 1990s.



Source: AIRREG (2000-2005), Booz&Co analysis (2005-2008)
* 2008 incomplete year

In most cases, the number of affected passengers has been relatively small, but the potential for significant disruption should a large carrier become bankrupt is high.

As the European and the global economy confront rising uncertainty and the risk of serious downturn in 2009, some if not a considerable number of the total scheduled service Air Operator Certificate (AOC) holders in the EU will face the risk of insolvency. Even if fuel prices continue to moderate, consumers have become insecure and cautious, and the volatility of fuel prices introduces a large element of uncertainty in business planning. We seem poised for an era of retrenchment. Demand has already softened and seems likely to fall further especially if deflationary tendencies continue to develop. The prospect for further financial failures in the near term of existing operators seems to be high. On the other hand, the current atmosphere is not conducive to dynamic entry and the rate of start up will almost certainly slow down.

Longer term, moreover, continuation of the level of the ambitious new entry of the 1997-2007 period seems unlikely for several reasons. First, lenders will remain more cautious, probably far more cautious, for some time in supporting new business enterprises (as well as financing existing ones) than in the recent past. Second, the historically weak levels of profitability of the airline sector compared to other sectors will also make financing here of even strong business plans more difficult.

Finally, regulators operating under the newly strengthened guidelines for financial oversight under Regulation 1008/2008 are likely to be more careful and rigorous in the granting of new AOCs than has been customary in the past. Thus a certain risk of over-correcting, say in the post 2009 period, with respect to lenders and regulators requiring strengthened financial fitness should not be excluded. Trends in regulatory implementation as well as market performance should therefore be carefully monitored.

7.2 CAUSES OF THE CURRENT SITUATION

7.2.1 Historical Background

In Chapters 2 and 4 of this Study we examine in some detail the emergence of a business planning approach, especially but not only on the part of low cost carriers, that relies on advanced (at times far advanced) sales of non-refundable transportation on scheduled airline services to generate cash flow for current operations. The earlier you buy a ticket the cheaper it is likely to be. The later you buy, the more expensive. This sales practice, in the historic form of APEX (advance purchase) fares, has of course been an element of scheduled airlines' marketing for many years, just as it has been a bedrock element of travel packages sold by tour operators involving carriage by charter operators.

Tour operators and travel agencies have long practiced a business model in which they buy in hotel and airline capacity (as well as related supporting services) at wholesale rates and then construct individual or group packages which they retail to the travelling public. Since the public concerned has consisted substantially of low budget vacationers, national regulators, as discussed on Chapter 3, historically established consumer protection rules for such package travellers, which have been reflected, extended and formalised in Community legislation.

Thus, as long as they purchased agreed packages from package providers (who were subject to mandatory bonding or insurance requirements), European consumers were likely to enjoy financial protection against cancellations resulting from failure of individual providers, such as airlines, to perform.

7.2.2 Recent Trends toward Dynamic Packaging and Loss of Automatic Risk Coverage

Recent years have seen a strong trend away from the sale of classic tour packages as the role of travel intermediaries such as tour operators and travel agents has diminished. The availability of cost-effective direct marketing tools such as websites as well as powerful pressures to reduce costs wherever possible have revolutionised the retailing of air transportation services and travel services generally.

Procedures have developed and flourished under which consumers visit websites, select and contract for travel services using e-ticketing procedures for payment and documentation. While such websites may also offer service combinations that qualify for (and therefore may require) financial protection of consumers under the terms of the package directive, the marketing generally starts with the air transport service. Ancillary services such as hotels, rental cars, etc. may also be offered on or via the website (links to other websites). A tendency is very discernible for the traveller to self package and to build a combination of the products he or she needs dynamically.

Individually contracted services (unless the website offers an explicit option to buy them as a package) are likely to be sold as unbundled parts – just as today's airline ticketing has often been presented to consumers as a modular process in which even basic elements such as seat reservations and baggage carriage as well as standard user fees and fuel charges can be displayed as independent cost factors.

Travel insurance, including protection against airline failure to fly (which is variously but unevenly available in most Member State markets), is therefore also an independent product and will remain so – unless new procedures are permitted or required that will either cover

purchasers of unpackaged services automatically or encourage them to obtain such coverage voluntarily as a supplement.

A key question is whether the risks to consumers are so general as to require a systematic, mandatory safety net to cover all of them or whether public authority and the general public interest would be adequately if not better served by focussing on strengthening the consumer as an intelligent buyer who is better positioned to be aware of areas of risk and make choices as to whether to accept them?

7.3 ROLE OF PUBLIC AUTHORITY IN IMPLEMENTING EXISTING LEGISLATION

Governments make rules that establish framework conditions for private economic activity. For example, laws may regulate misleading advertising or otherwise establish standards for marketing and consumer protection as well as information. Monitoring, oversight and enforcement are at least as important in this process as the formulation of the rules themselves. In this section of the conclusions, we shall therefore primarily consider ways in which existing rules can be implemented.

In dealing with instant problems of consumer protection against airline failure, a central finding of this study is that the aeronautical authorities who grant and oversee aircraft operator certificates (AOCs) to commercial operators can play a crucial role from a precautionary standpoint as well as operationally in cases where travellers are stranded.

Precautionary action can have operational as well as formal aspects. In addition to granting licences to operators based on their initial demonstration of financial and technical fitness, regulators must monitor performance and be watchful to ensure that legal standards are being met. Safety is of course a paramount concern from a public interest standpoint, but, as experience demonstrates, a collapse of financial fitness can create operational as well as economic risks – if operators are tempted to cut corners in vital areas such as maintenance. Vigilant oversight is needed to close the door to this form of temptation.

7.3.1 Areas of Precautionary Regulation and Oversight

7.3.1.1 Oversight of Licensing

The new, consolidated Community market access regulation 1008/2008 has, as discussed in Chapter 3, both confirmed the ability of national authorities to condition the term validity of AOCs and placed greater weight on the control of financial fitness. The new regulation also establishes standards for the disclosure of prices.

How the law will be implemented in practice will depend on the skill and judgement of the regulators who implement it. Over time it seems reasonable to expect, especially in the currently developing financial environment, that it will lead to more conservative financial policies on the part of operators. In the short term, however, regulators may face very delicate situations as they try to give operators and their employees who provide valuable services to the travelling public the best chance for survival in a tough economic climate as long as they maintain requisite levels of safety as well as overall service.

7.3.1.2 Emergency Response Planning and Organisation

Public authority can, and in our judgement should, play a critical precautionary role in establishing contingency plans to deal operationally with the problems of stranded passengers. Passengers could be stranded not only because of operator financial problems

but also as a consequence of loss of license for other causes, work stoppages, closures of airports or airspace or because of a range of international relations problems. In such cases, governments must be prepared to act as providers or organisers of assistance of last resort to provide repatriation and to ensure availability of basic services.

Contingency planning, ideally undertaken in cooperation with airlines and airports, should therefore identify the physical and financial resources that could be drawn upon and how they might be drawn upon.

When a cessation of service occurs, the most immediate problem is to protect stranded travellers against the direct and indirect (e.g. cascading) costs of physical delays that could prevent them from returning to home, work, school, etc. on time as well as incurring unforeseen expenses for lodging and meals as well as substituted forms of transportation.

After they have been repatriated stranded travellers may, therefore, still have substantial claims for costs caused by airline failure. The same is obviously also true for those who have not commenced travel at all but who will have paid for airline transportation and perhaps other products such as lodging in advance. Both categories of travellers therefore will be seeking compensation, either through insurance claims (see below) or through direct efforts to obtain ex post facto reimbursement for their losses as creditors of the bankrupt airline.

7.4 POSSIBLE ACTIONS TO ENSURE FAIR AND EFFICIENT EX POST FACTO PROTECTION OF CONSUMER RIGHTS

Bankruptcy is an age-old problem that is solved by formal arrangements to allocate or mitigate losses of creditors. As discussed in Chapters 3 and 5, states apply their general laws on bankruptcy when airlines become insolvent, declare bankruptcy and seek protection from their creditors. Two forms of general outcome can result:

1. The enterprise can be *reorganised*; that is, under supervision of a court and/or an appointed administrator, the company can re-emerge, usually under new ownership and resume services in a similar or modified form. During this period, the company may also be able to maintain at least a certain level of business activity while enjoying a moratorium on at least some of its debt obligations.
2. The enterprise will be *liquidated*; that is, it will cease operations entirely, and its remaining assets will be allocated to its creditors, which could include a range of claimant categories such as unpaid suppliers of goods and services, grantors of financial credits, lessors of equipment and persons or companies who have paid in advance for services not yet received. Certain debts may be “secured” through underlying ownership of property. Other creditors are “unsecured.” In some states, unsecured creditors may enjoy a certain priority or ranking; in others, laws may provide for equal standing for all such claims.

In either case, a volatile as well as uncertain situation can result calling upon bankruptcy administrators to exercise skill, imagination and judgment in seeking the best possible outcome for all interested parties that will notably include employees as well as creditors.

For the passenger, it is clear that the reorganisation scenario is the preferred situation, as the airline may continue to fly. Thus, as we have discussed in Chapter 5, in the case of larger

operators particularly, it is also far less disruptive for the economy at large if a key airline is put into reorganisation rather than into an abrupt liquidation in which all activity ceases.

Therefore, an element in emergency planning response as broadly seen (see above), could also include a more pro-active monitoring by competent authorities of deteriorating situations under which enterprises caught in dangerous, and especially vicious circle, situations are given latitude if not encouragement to seek protection earlier rather than later - when there still may be constructive prospects to reorganise successfully.

7.4.1 The Position and Recourse of Individual Airline Passengers

When the airline ceases service altogether (as will happen under liquidation) consumers will suffer financial losses -- except to the extent recoverable as a pro-rata share of claims or because the traveller is covered by third party insurance or other financial guarantees.

If travellers get money back because they are insured under either private policies or through public bonding arrangements (as is provided for if they have purchased packages) then third parties who provide such coverage will assume their demands as creditors against the bankrupt airline. If travellers are not covered in such ways, they will retain their position as direct claimants.

Individual direct claimants for comparatively small sums cannot be efficiently represented in bankruptcy proceedings. However, the same technologies that have led to paperless e-tickets could arguably be of relevant help in creating adequate procedures for registering such claims as a consolidated group. That is, airline booking inventories should be able to generate reservations data that identify travellers and their addresses as well as amounts paid.

Courts and bankruptcy administrators therefore should consider procedures to simplify claims making by use of electronic notification to claimants and efficient, direct claims procedures.

7.4.2 Consideration of Compensation Policies - an Overall View

Public authorities are challenged to rethink the traditional tools of consumer protection. This need not and probably should not include protecting bargain hunters against risks they are prepared to accept; however, reasonable and cost-effective rules that ensure they have been made aware of such risks may not only help individual travellers; they may also reduce the need for public efforts to assist them in distress.

Although this study shows clearly that an increasing number of passengers are purchasing flight-only options or self-packaging their holidays, this fact alone does not entail the need for increased protection. Many consumers are travelling to relatively near destinations, for example in the EU or its immediate neighbourhood, where the consequences of being stranded are unlikely to be as severe as if stranded at an intercontinental destination. Furthermore, many more are travelling for purposes of visiting friends and relatives (VFR) and are thus more likely to be well-supported in the case of disruption to travel. In the case of nearby markets, alternative transport options (including other modes) exist for repatriation at reasonable cost. Even these travellers can, of course, suffer significant material cost, not to mention considerable stress, when their vacations are disrupted; however, repatriation and returning home or to the workplace will be a lesser problem.

Thus, rather than looking for a single solution, we believe, consistent with AIRREG's earlier findings, that experience shows that it may be more valuable to think of a combination of measures in the framework of a general responsibility of governments, industry and the courts to create and provide rapid ad hoc responses if and when emergency conditions arise as well as ensuring fairness in the treatment of all damaged persons and bodies. This situation implies a key role for individuals such as bankruptcy administrators but also for governments in their oversight and response-coordination capacities.