



**EXECUTIVE SUMMARY**

**Study on Consumer Protection  
against Aviation Bankruptcy**

Prepared for:  
**Directorate-General Energy and Transport  
European Commission**

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London

07 January 2009

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the use and information of the client to whom it is addressed.*

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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

ERROR! BOOKMARK NOT DEFINED. 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:

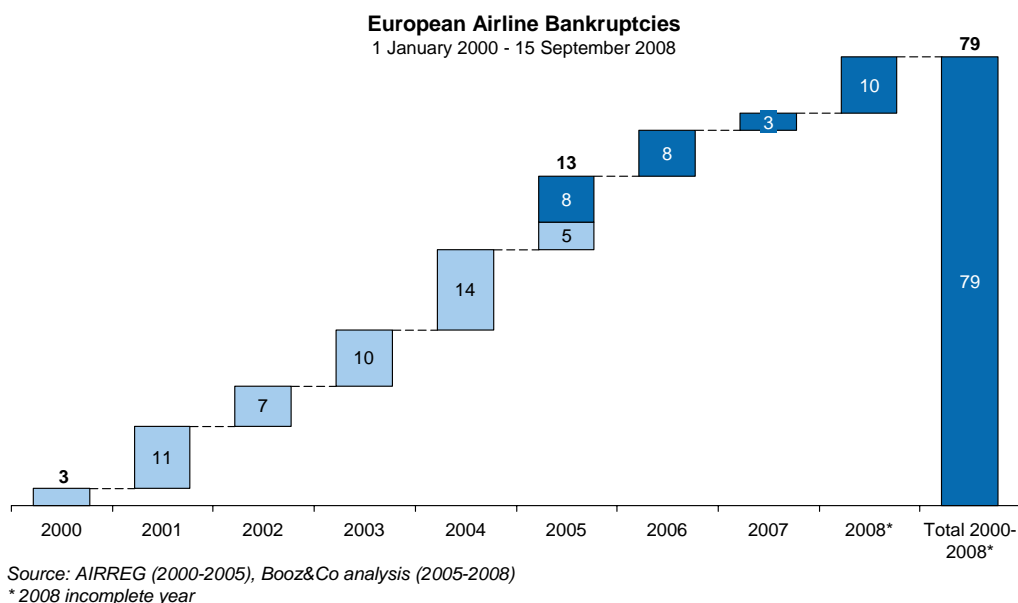
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- *Air Transport Industry Outlook.* We examine the current situation in the air transport market in the context of general economic conditions which, in 2008, have continued to put strong pressure on airlines.
  - *Existing Rules and Practices for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



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.

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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.

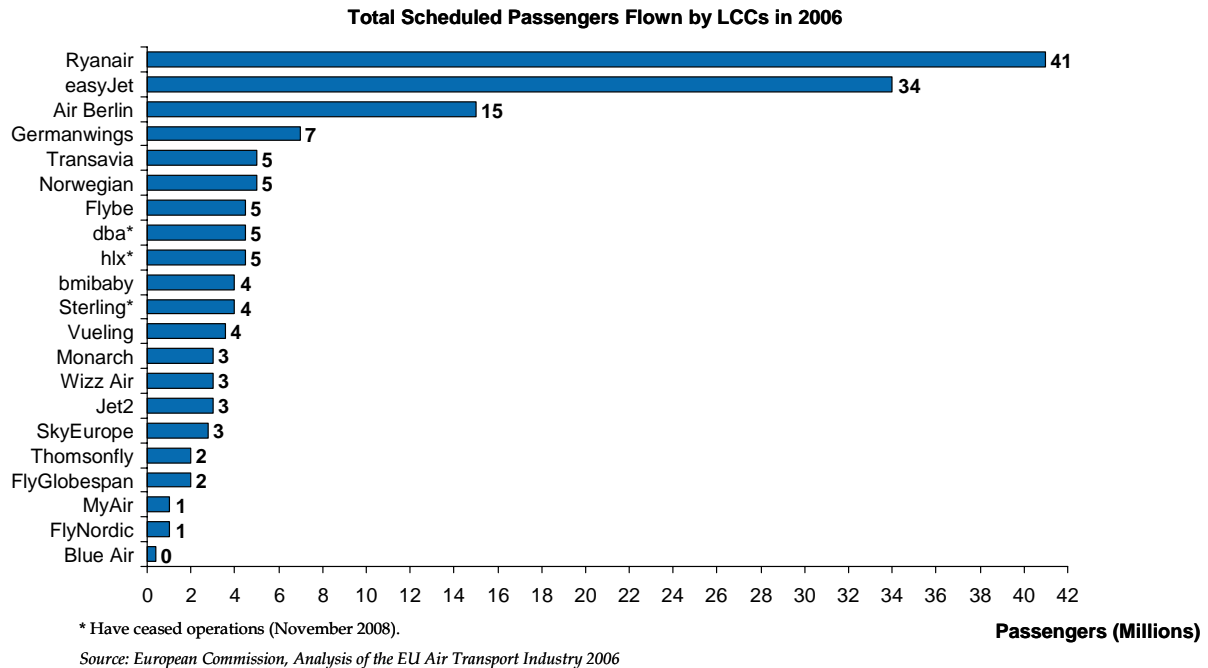
Denied boarding compensation rules (in defined cases) are embodied in Regulation 261/2004, although it excludes compensation in case of 'extra-ordinary circumstances'. This includes financial failures that lead to cessation of operations. Recourses might be available under general rules governing insolvency, 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:

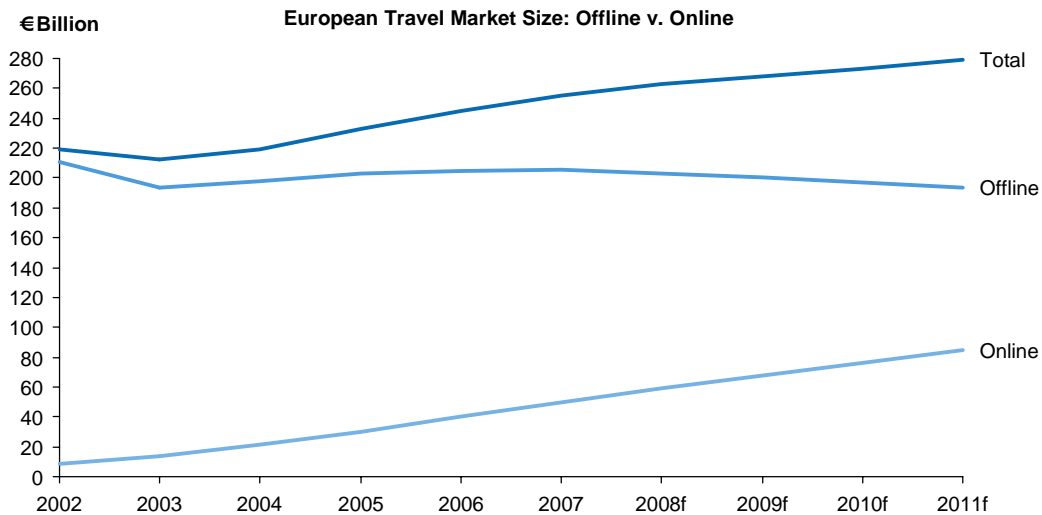


According to comparative data<sup>1</sup>, in 2007, Ryanair and easyJet were respectively first and fourth largest airlines in the world by number of scheduled passengers carried in border-crossing traffic, with Lufthansa, Air France and British Airways respectively second, third and fifth.

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.

<sup>1</sup> 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.



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## 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.

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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

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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*.

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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 4<sup>th</sup> and 5<sup>th</sup> 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 (6<sup>th</sup> measure) is fundamentally an instrument of ex post assistance.<sup>2</sup> Focus on ex post facto compensation or relief to creditors is also a basic function of the 7<sup>th</sup> 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?

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<sup>2</sup> *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.*

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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.<sup>3</sup> 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*

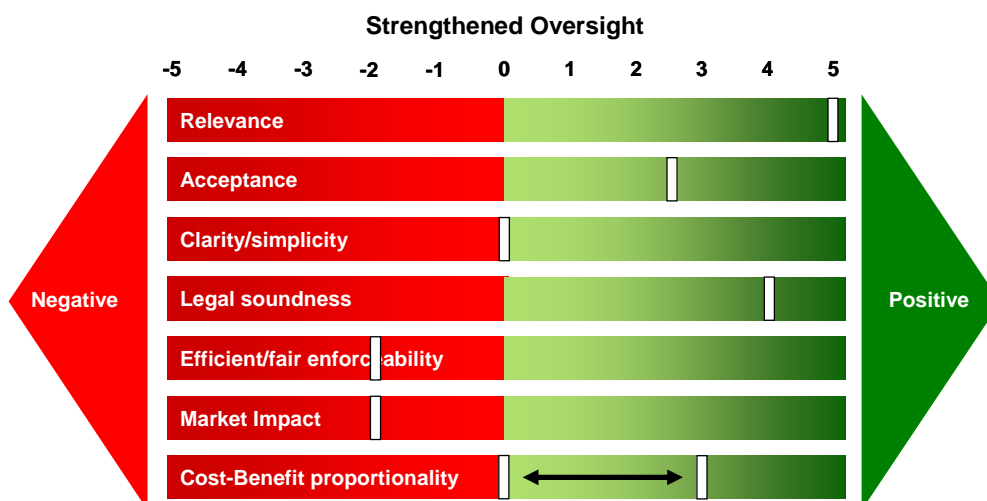
*Content and Scope:* Present Community regulations (Regulation 1008/2008) establish the principle that financial fitness is a condition of receiving an Air Operator Certificate (AOC) to operate and hold out flying services to the travelling public. The regulation also sets forth minimum standards of enterprise liquidity. One course of action might be to make such standards or at least their enforcement more rigorous.<sup>4</sup> 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:

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<sup>3</sup> 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.

<sup>4</sup> 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.

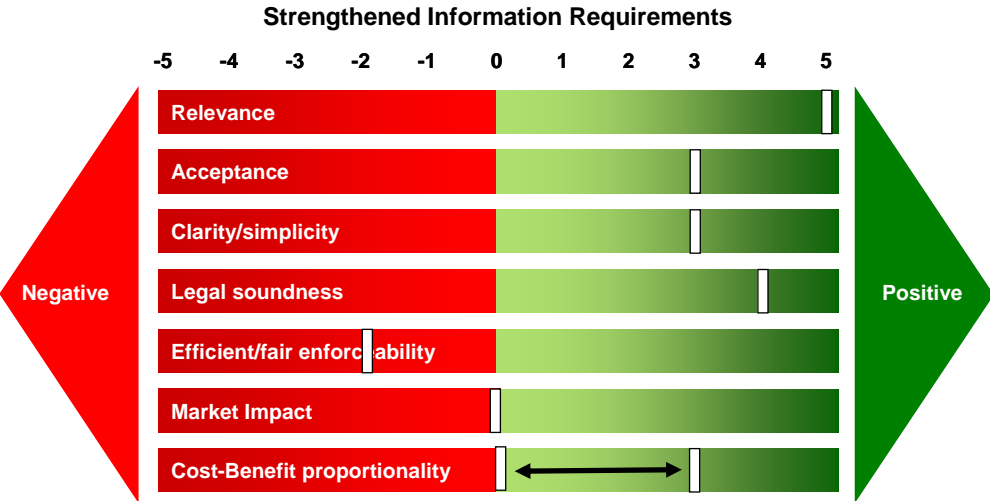
An overall estimate of cost/benefit from a Community perspective is extremely difficult. This measure depends significantly on the work of individual regulators in Member States in difficult individual cases.

## 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.

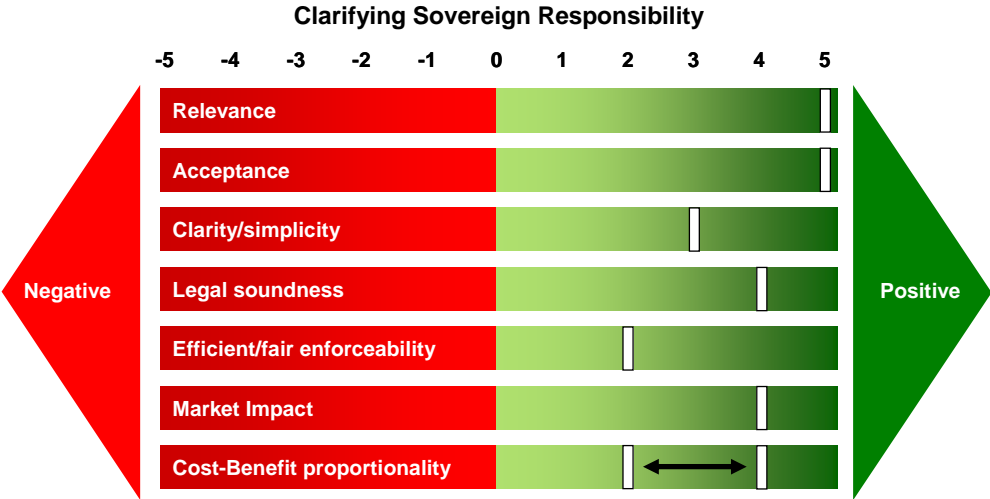
3. *Clarifying the Role of Sovereign Responsibility: It may be relevant to clarify the responsibilities of Member States to travellers on airlines operating under their aircraft operator certificates*

*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

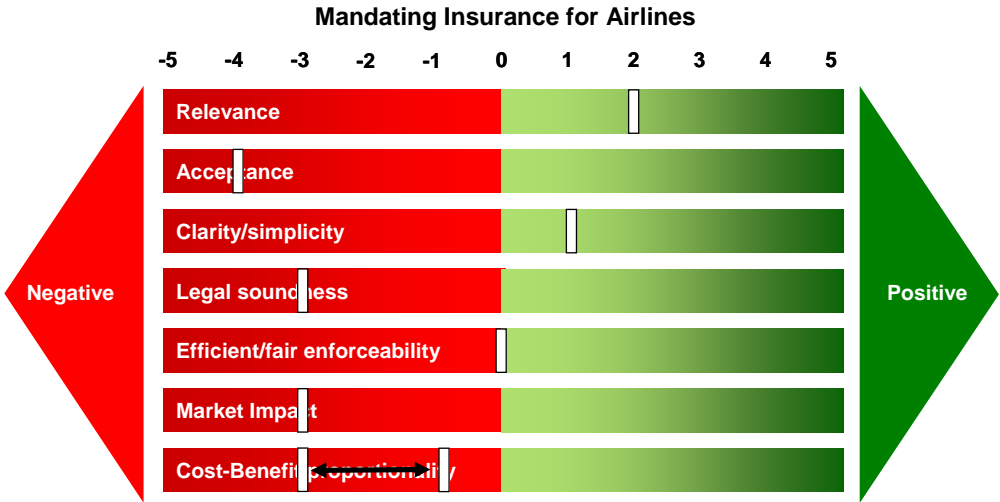


safety valve encouraging airlines and consumers in the belief that help will come. Thus it may facilitate continuation of current marketing practices, whether for good or for ill.

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.

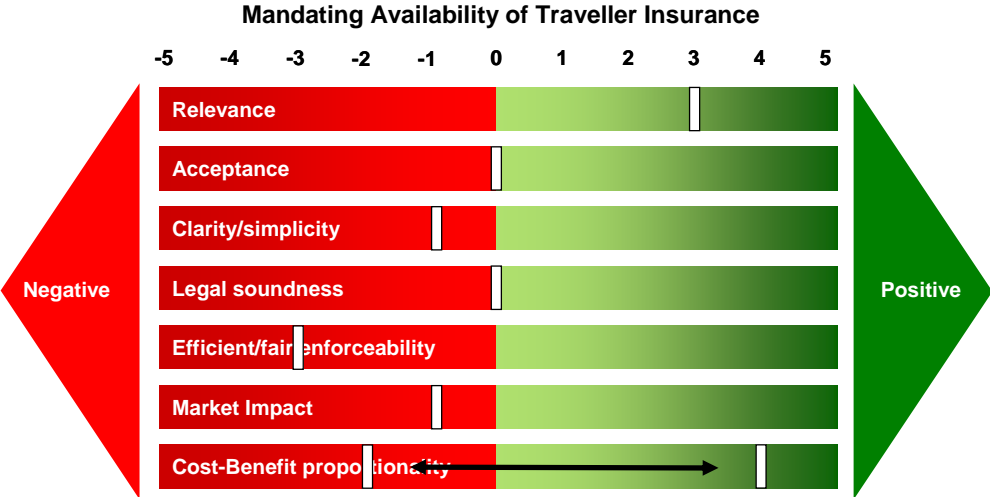
All airlines would have to pay a new set of costs. While the insurance premiums could be negligible or low, they will also vary in accordance with risk perception. Overall, we believe there is a strong probability that the economic costs and the political complications would outweigh the potential benefits.

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:



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*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*

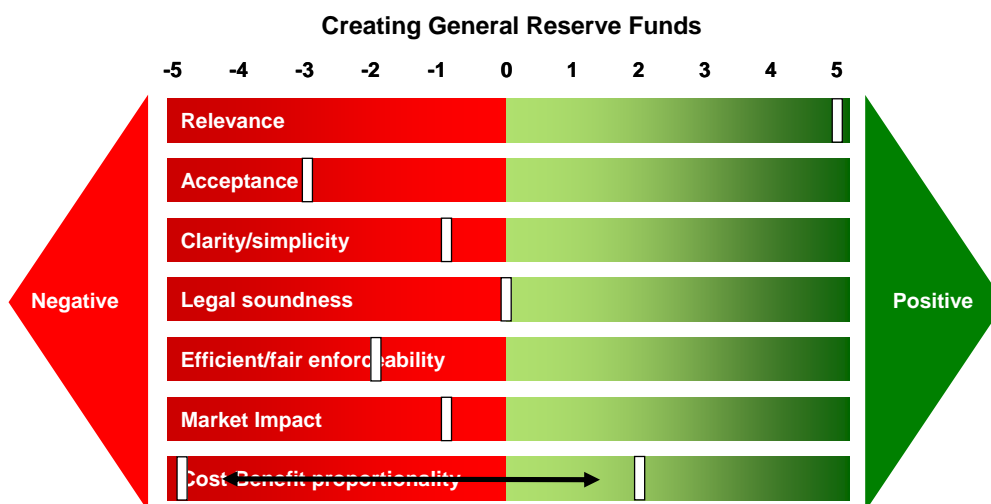
*Content and Scope.* The concept of a general public insurance fund established by a standard charging formula such as a flat fee per ticket, which would cover all scheduled services flights, has been proposed by various industry stakeholders and government bodies. Such a system would, by regulation, 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

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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.

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*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.

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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.

