

ERA POSITION PAPER ON PASSENGER PROTECTION IN THE EVENT OF AIRLINE INSOLVENCY

Background

The ERA Directorate has consulted with members of the ERA Industry Affairs Work Group and the following is the considered view of ERA on passenger protection in the event of airline insolvency.

General ERA position

The instances of insolvency occurring are sufficiently low so as not to require regulatory intervention

- The problem of airline insolvency (terms of airlines and passenger affected) is not a large problem when put into context. In its impact assessment the EC states that 0.07% of total passengers with standalone tickets were affected between 2000-2010 by airline insolvencies. Of these, 12% were stranded away from homeⁱ which equates to 0.0084% of passengers who were carried during the period 2000-2010 were affected by an airline insolvency *and* were stranded away from home.
- Airline insolvency is media grabbing but any regulatory intervention should be driven by need rather than perception.
- Over-regulation will ultimately increase the cost of air travel.
- A simple non-regulatory solution would be the development of an industry code of practice on “rescue fares” that ensures stranded passengers are not commercially exploited.

Air passengers are no different to any other consumers

- Air passengers advance purchasing an air ticket should be treated no differently to any other consumer advance purchasing other goods and services.
- To do otherwise would be to single out airlines as being somehow different from other suppliers of goods and services and would be anti-competitive and discriminatory.

Passenger awareness of the risks of bankruptcy is important

- Air passengers (in common with any other consumer) should be made more aware of the risks associated with their journey when an airline becomes insolvent and be advised to take the necessary precautions to minimise any adverse effects.
- Air passengers should be left to make their own personal choice (accepting this is likely to have a cost implication) as to whether they wish to protect themselves from the potential risk of an airline becoming insolvent.

Airline insolvency does not just impact passengers but the whole supply chain including employees of airlines and their service providers

- The insolvency of any business is an extremely distressing experience for both users and suppliers of the products to the business as well as the employees of the business.
- When an airline (in common with any other business) becomes insolvent many different creditors are affected including passengers, suppliers to the airline and employees. Existing bankruptcy laws establish a process for **ALL** creditors to be reimbursed to the greatest extent possible. It would be discriminatory to the other creditors to create a regulatory tool that only protects passengers.

Financially “strong” airlines should not have to “pay” for financially “weak” airlines

- The use of reserve funds to provide financial solutions for dealing with the effects of airline insolvency (eg refunding tickets, recovery of stranded passengers etc) would mean that financially strong and healthy operators would be ultimately funding potentially weaker operators.
- This situation would be inequitable to those airlines that provide funds but never have cause to use the fund.



Specific ERA comments on options suggested by the EC

EC to encourage the industry to take action to protect passengers

This is a form of self-regulation by the industry who would be encouraged to protect passengers by improving the availability of Scheduled Airline Failure Insurance (SAFI) and by repatriating stranded passengers. SAFI is only available whilst an airline is not in administration. It is generally not offered to cover passengers of airlines who are in administration but still operating which is a critical weakness of the product. If it was compulsory then an operator would not be able to sell tickets whilst in administration and this would almost certainly force the termination of the operation. Some travel insurance policies allow a choice of SAFI within packages so passengers are able to make a choice.

Repatriation of stranded passengers by another airline is not an obligation due to the deregulated market. However there is an opportunity for airlines to step in if they see a market. Rescue fares should be set at a level sufficient to cover costs, but not maximise profit by taking advantage of the fact that passengers are stranded. An industry code of conduct could be drawn up to ensure that no commercial exploitation takes place.

Establishment of a general reserve fund to cover the insolvency risk of airlines

A general reserve fund established through a new charge collected on each air ticket sold, to cover the insolvency risk of airlines and to cover repatriation and assistance, is not a good use of capital. It would lead to the financially stronger airlines paying for the weaker airlines. There would be significant costs to administer the scheme whether it is on a national or EU level. If a fixed price per unit of travel is charged then there will be a greater impact on short haul services although the costs of long haul insolvencies will be greater. The cost of any charge should vary by type of travel with a higher rate for long haul. A compulsory general reserve fund to cover repatriation and assistance is essentially insurance by the state. ERA believes that the commercial market (eg insurance) is better placed and more efficient in dealing with this matter. A non-compulsory charge would most likely result in a small take up by passengers. Competition may be affected with respect to non-EU airlines who could not be obliged to pay into such a fund.

Amendment to national insolvency/bankruptcy laws to improve the ability of passengers affected by insolvency to make claims against an insolvent airline

Insolvency laws vary significantly across states. Amending laws on a common basis will prove to be very difficult. It must be remembered that an air passenger is just one creditor in a long line of creditors which includes employees. Is it fair and equitable to put passengers first? Consumers in other sectors are not treated any better than other unsecured creditors, so why should airline consumers be treated differently?

Improve the monitoring of the financial status of airlines

There is already an obligation for on-going monitoring of the financial status of airlines. Regulation 1008/2008 addresses this issue. Airlines report financial data on an on-going basis and the licensing agency can intervene and take action against insolvent airlines. However there may be issues as to exactly when a licensing agency should intervene as any intervention could create a problem that might not actually have occurred had it not been for the intervention. Additional cost burdens could also be placed on airlines by increased monitoring requirements.

Introduction of an obligation for states to plan and coordinate the repatriation of stranded air passengers

This option has benefits as the state is responsible, but how will the state pay for it? Denmark provides such a service through a levy on tickets. This solution still raises the problem of the "strong" paying for the "weak" which is also a problem with a number of the other options. It would not be practical to define this policy on the basis of where the passenger is stranded; as this would not cover passengers stranded outside the EU and would also create problems for states which receive a large number of visitors, e.g. Spain. The state in which the airline is licensed or the state from which the passenger has departed would need to be responsible. The Danish system only covers Danish registered airlines. There may be issues with extending the scheme to cover non-EU airlines as it could not be for both ends of a route.



Insurance against Insolvency

Obliging airlines to offer optional insurance to their passengers, on booking, against the risk of insolvency is an attractive option. However extra charges must be transparent and passengers must be fully aware of the risks if they are opting out and hence what they are and are not covered for. There could be difficulties when booking for passengers particularly if the passenger has not booked directly with an airline. A key weakness of compulsory insurance is that existing products are not available when an airline is in administration so this is likely to be the case for compulsory insurance. For example SAFI is available on all airlines not in administration so if this was compulsory and an airline is uninsurable then there will still be a problem. SAFI is only available from a small number of providers so these would need to be regulated at the same time ensuring they are able to meet the risk.

The costs for requiring airlines to have insurance against the risk of insolvency could be potentially high for airlines, especially if the insurance market exploits airlines by imposing high premiums. If the insurance is bundled in the price of an airfare then airfares will increase without giving the consumer the choice to choose if they want cover. The cost could potentially be a few euros per ticket, however the relative cost, were the insurance to be a flat fee, would be proportionally higher compared to ticket prices for short haul operators. Extending cover to non-EU airlines could also cause legal issues regarding extra-territoriality eg EU ETS.

Requirement for member states to provide information to passengers when an airline becomes insolvent or on the risk of an airline's insolvency

States disseminating information on airline insolvency could inadvertently risk speeding up the process of an airline becoming insolvent. It also might cause political difficulties, for example, if the UK government designated a major UK airline to be a low insolvency risk but ranked a major US airline as a high insolvency risk there may be political repercussions. Many airlines are private companies without credit ratings therefore this could not be used as a basis for determining insolvency. Many member states already give information to passengers about what to do if an airline becomes insolvent.

Requirement for airlines to provide information to passengers on their websites of the risks they are undertaking and available options for protection

Adding to the amount of information that airlines already have to supply makes it less likely that anyone will read it. This is easier to achieve through online means but would be problematic over the phone. Passenger awareness is important, but it is difficult to achieve.

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ⁱ European Commission impact assessment of passenger protection in the event of airline insolvency February 2011 prepared by Steer Davies Gleave

