Airline Insolvency Review

A call for evidence

April 2018

Acknowledgements

The quotes on pages 4, 9, and 24 were reproduced from the "Our Favourite air lines" article in the Economist, 22.12.2011. All images in the document are reproduced with permission from the Civil Aviation Authority and Department for Transport, apart from the image on page 17, which was reproduced from Unsplash.

Contents

Chair's Foreword

Aviation has come a long way in the 114 years since the Wright Brothers first demonstrated the feasibility of powered flight. Along with advances in communications and information technology, and the new geopolitical order that emerged from the era of global conflict, it stands out as one of the major forces that have 'shrunk' our world. Just as railways in the nineteenth century transformed the lives of the majority by linking communities, facilitating commerce, and increasing mobility, so in the latter part of the 20th century aviation took that process much further, opening up the possibility of long-distance travel, both within and between continents, to the mass market.

In particular, the development of the European market in affordable all-inclusive package tours in the second half of the twentieth century laid the foundations for the rapid expansion in demand for air travel seen over the last 50 years. On average, one in two of us in the UK today is expected to take at least one flight in the next twelve months.

The growth in demand has also been stimulated by the competitive responses of both new entrant and incumbent carriers to the liberalisation of global aviation markets in more recent years. These have seen the addition of substantial new capacity and sharp downward pressure on prices. In the present century, the rapid development of internet-based distribution channels has also afforded consumers greater choice and flexibility in purchasing travel services.

These developments have brought large and widespread consumer benefits. But they have also led to growing financial pressures in the travel industry. For the most part, travel company margins are narrow, revenues exhibit a pronounced seasonality, and they face major external threats. These factors have led to a marked trend of consolidation, vertical integration and market exit. Airlines face many of the same risks and, in addition, are highly capital intensive and vulnerable to fluctuations in key input costs (especially fuel) and in consumer demand. Both sectors currently face continuing downward pressure on prices. In turn, these factors have heightened the likelihood of insolvency and so increased the risk faced by consumers.

Current consumer protections lag these more recent developments. At the centre is the ATOL scheme, which since 1973 has proved its worth in past cases of travel company failure, including those where the cause of failure has been the insolvency of an air carrier. But a growing proportion of leisure travel by air is now represented by purchases that are not covered by the ATOL scheme. Moreover, with the forecast long-run growth in demand for leisure travel by air and the degree of consolidation that may be expected in the European airline sector, the scale of any future failure may well be greater than anything the scheme has dealt with in the past. Future failures could thus overwhelm the resources currently available to the scheme and so potentially have major adverse implications for Government and the taxpayer.

So now is an opportune moment to review how best to ensure the consumer is protected against the consequences of airline insolvency. The challenges are considerable and require a fundamental re-think of the status quo. We need to consider both the practical measures needed to repatriate or reimburse affected consumers and how to fund the associated costs. That is the task of this review.

This document sets out the context for the review and the complexity of the problems to which solutions are sought, and briefly discusses the issues we shall need to consider. It is intended to serve as a call for evidence, to stimulate thinking and begin the process of proactive engagement with stakeholders that we intend to undertake to ensure we capture your thinking and fully understand the impacts of all the viable options for reform.

I look forward to working with you.

Peter Bucks
Chair of the Airline Insolvency Review

1. An introduction to airline insolvency

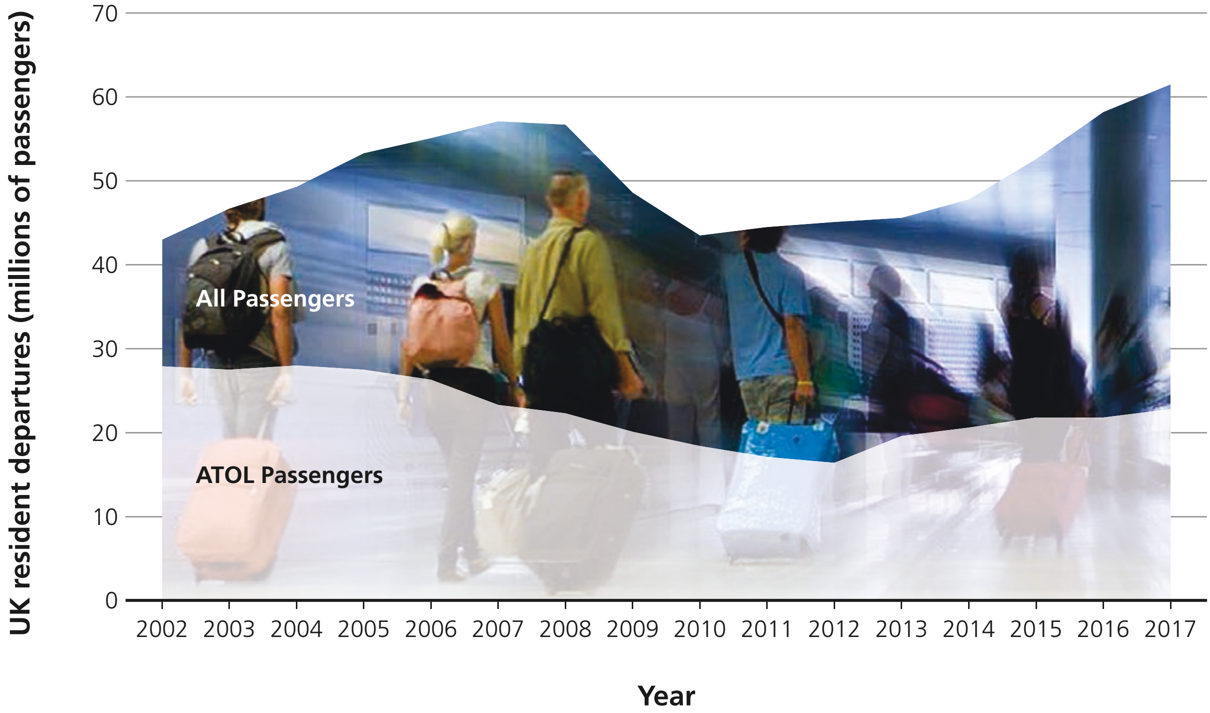
"If the Wright brothers were alive today Wilbur would have to fire Orville to reduce costs."

Herb Kelleher, founder of Southwest Airlines

1.1 Air transport brings considerable benefits to society, connecting people from all over the world. It is an industry that has seen considerable change over the last couple of decades as regulatory reform and liberalisation has increased competition and reduced prices. More and more people are flying than ever before, often paying considerable sums of money months in advance of their travel. Many do so without any knowledge of the underlying financial performance of their chosen airline, nor any appreciation of the risks to which their money may be exposed.

1.2 Recent history has demonstrated that the European market is still reacting to deregulation and the entry of low cost carriers. These factors have brought greater competition between new and existing airlines and seen several cease trading, often leaving passengers out of pocket. Many countries have protection

Figure 1. There are a growing number of passengers who are not protected by ATOL.



Source: CAA and ONS

regimes such as the UK's Air Travel Organiser Licensing (ATOL) scheme or Section 75 of the Consumer Credit Act, which can provide some relief for consumers in the event of a travel company or airline failure. However, as the recent Monarch example demonstrated, protection is far from universal, often overlapping and many consumers are unaware or unsure of what protection if any, they benefit from.

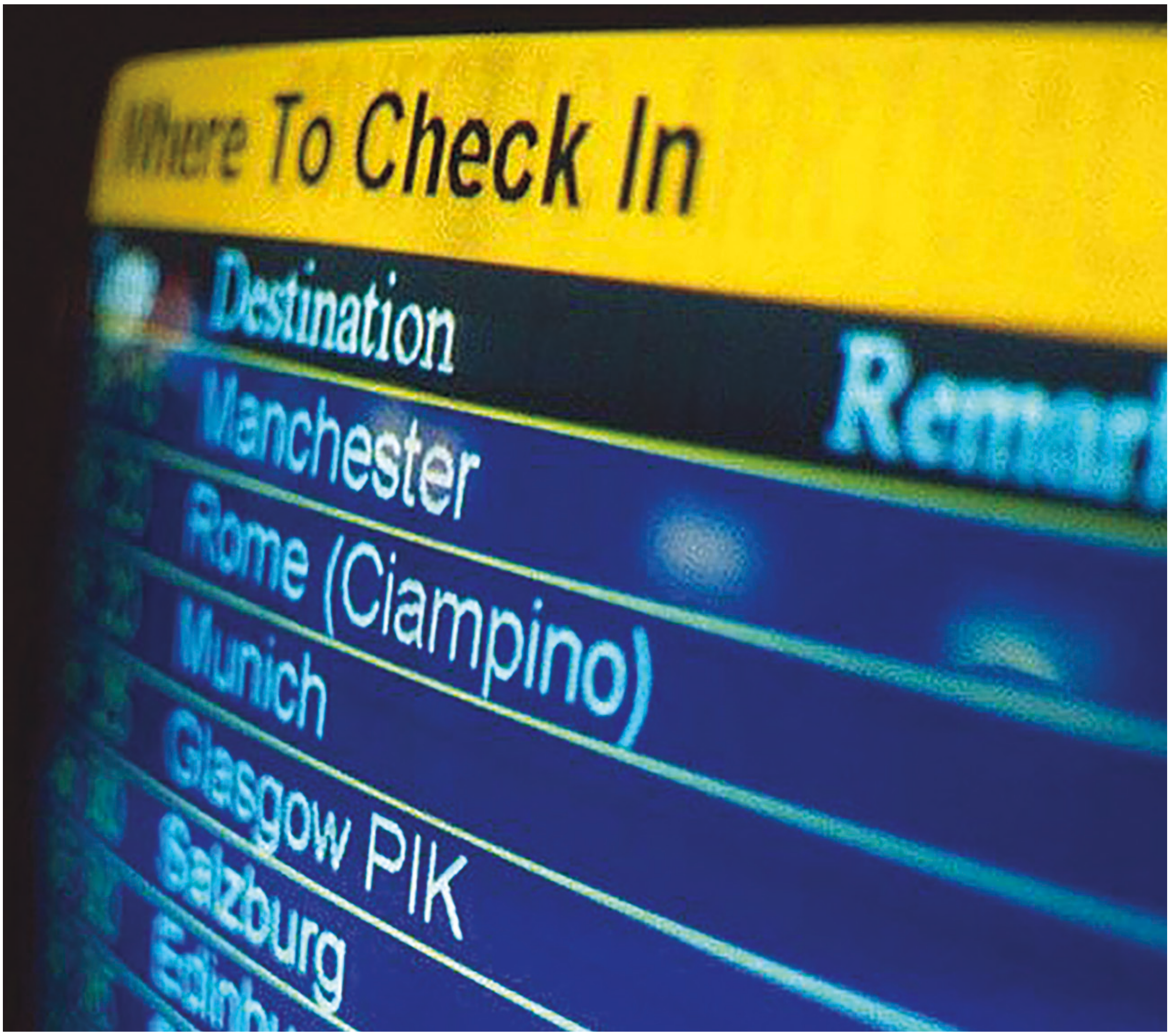
1.3 Changes in the industry have outpaced protection regimes, which remain focused on packages. Since the turn of the century there has been a modest decline in the number of ATOL passengers, against a background of strong growth in overall demand to fly (see Figure 1). As a result, there are a growing number of passengers who are not protected.

1.4 As a consequence of more cost conscious business models, airlines have sought ever more efficient ways to finance their assets, placing increasing reliance on upfront ticket payments, which are effectively a source of interest-free finance, and extended payment terms with key suppliers. Airlines tend to be capital intensive businesses whose revenues can be very high, but whose profit margins can be proportionately very low. All of which has led to complex financing, corporate governance and ownership structures that can reduce the flexibility of an airline to respond to events. Such complex structures further complicate the ability of regulators to offer simple solutions to protection and increase the risks of failure and passenger detriment.

1.5 Successive failures have demonstrated that where consumers fail to understand or manage the risks they expose themselves to, public policy and political factors can combine to mean the consequences of these risks are passed on to the taxpayer. There is therefore an argument for Government to step into the market place and correct some of these failings, either by improving consumer awareness and information and/or developing the protection regimes to ensure that passengers unwittingly do not take on risks they can ill afford.

1.6 In a sense the airline industry is similar to those offering financial services such as bank accounts or pensions where consumer money is taken by a company long in advance of service delivery. The protection regimes in these relatively older industries have been honed progressively over centuries, often in the aftermath of a significant failure and to keep up with industry developments. However, they too have seen recent fundamental changes with the various banking crises of the 1970s leading to deposit protection schemes. More recently, in the wake of the 2008 financial crisis, there have been moves to both strengthen consumer protection by ring-fencing retail banking activity, and also to mitigate the risk of taxpayer bailout.

1.7 Airlines are international businesses trading across borders and legal jurisdictions. Every airline is unique in terms of the routes it serves and the capacity it offers. Small airlines often represent the only provider to certain destinations, while larger airlines often offer a significant proportion of the capacity either in aggregate across a region or on specific routes. The failure therefore of any airline, large or small, and immediate cessation of its services could represent a catastrophic loss of capacity in certain areas or destinations.



Airline Insolvency Review Terms of Reference

The review will assess consumer protection in the event of an airline or travel company failure. It will consider both repatriation and refund protection and identify the market reforms necessary to ensure passengers are protected. This will include full consideration of options to allow airlines to wind down in an orderly fashion so that they are able to conduct and finance repatriation operations with minimal or no Government intervention. The review will also consider alternative models for the provision of refund protection, including through the travel insurance market.

The review will be led by an independent chair, appointed by the Secretary of State for Transport and supported by a secretariat comprising of Government officials and CAA staff, supported by professional advisers.

The review will provide an initial report to the Secretary of State on potential options to tackle the immediate repatriation of passengers of an insolvent airline by summer 2018. The review will produce a final report by the end of 2018 offering the Secretary of State recommendations on repatriation, refunds and on how the current financial protection arrangements for air-travel holidays can be put on a more commercial basis.

1.8 It is also important to reflect on the complexity of how an airline insolvency might be managed in respect of protecting consumers who are abroad at the time. The repatriation of Monarch Airline's passengers was an operational success largely due to the CAA's role as the airline's licensing authority, their access to information necessary to enable advance planning, and the availability of alternative aircraft capacity at the end of the peak season. Whether such plans could be applied and scaled up to larger airlines, airlines licensed by other authorities or at different times of the year is questionable and other solutions may need to be found to protect passengers.

1.9 For the reasons outlined above there is a strong case for government to consider further action in this area. This review has therefore been tasked with making recommendations on how to protect passengers from the effects of airline failure and to do so in a manner that reduces reliance on the taxpayer. The full terms of reference for the review can be seen in the text box.

1.10 We have broken this task down into three distinct elements:

- What practical arrangements are needed to get passengers home if sufficient capacity does not exist in the market?;
- How can passengers and the taxpayer be protected from the financial impacts of an airline failure?; and
- What changes need to be made to the current arrangements in the light of the answers to the above, and to put them on a more commercial basis?

1.11 We will conduct our work in an open and transparent manner, assessing options against the following principles:

- **The beneficiary pays for protection.** This will require a careful balancing of the level of risk covered and the affordability of protection. The corollary of this principle is that the taxpayer's exposure should be minimised or removed.
- **Efficient allocation of risk.** The risks for passengers should be allocated to those best placed to manage and control them, whilst avoiding duplication where possible.
- **Minimisation of market distortions.** Constraints on the competitiveness and size of the UK aviation market should be minimised and UK registered airlines should not be put at a competitive disadvantage vis-à-vis international competitors.
- **Simplicity for passengers.** Passengers should understand the protection available and be able to identify which risks are covered, and to what level. In addition, passengers should be compensated in a timely and efficient manner: being brought home and compensated quickly.

1.12 We would be interested in hearing views as to the suitability of these principles.

1.13 The review will issue an interim report to Ministers by mid-year and report its final recommendations by the end of the year, following a programme of stakeholder engagement and research. We will aim to consult widely with interested parties to ensure our findings are grounded in the reality of current commercial and financial practice but also cognisant of possible future developments and trends.

1.14 This document sets out how we propose to undertake our task, makes a call for evidence and sets out how stakeholders can engage and contribute to the work of the review. In particular we would be interested in hearing any initial views on our approach to the task, the suitability of the principles, and the possible solutions.

2. The context of the review

"The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favour by shooting Orville down."

Warren Buffett

The aviation market yesterday and today

2.1 Since the birth of commercial aviation in the first half of the 20th Century aviation has grown ever more important to the societies and economies it serves. Aviation is highly regulated with the greater part of its history written by governments and the publicly owned national flag carriers and airports that traditionally dominated the sector.

2.2 More recently commercial operators have been leading the sector, and are responsible now for an increasing share of the market. Progressive waves of reform, privatisation and liberalisation of the sector and its various markets, have resulted in dramatic change. Change that has heralded significant benefits for consumers in the UK, Europe and across the globe. Ever greater choice and connectivity has resulted in more competition and lower fares, which in turn has seen a general democratisation of air transport. Nowadays on average one in two people living in the UK will take a flight in any one year,[1] a marked difference from the early days of aviation where it was the preserve of the wealthy.

2.3 These dramatic changes in the industry, in particular the arrival of low cost carriers, have resulted in disruptive forces that not all companies have been able to adapt to. We have seen several airlines disappear from the skies as consolidation and competition has driven out the weaker and those unable to keep pace with change. Historically this has been most prominent in the United States where there were over 100 mainstream and regional airlines in the early 1970s, which has reduced to around 30 today.

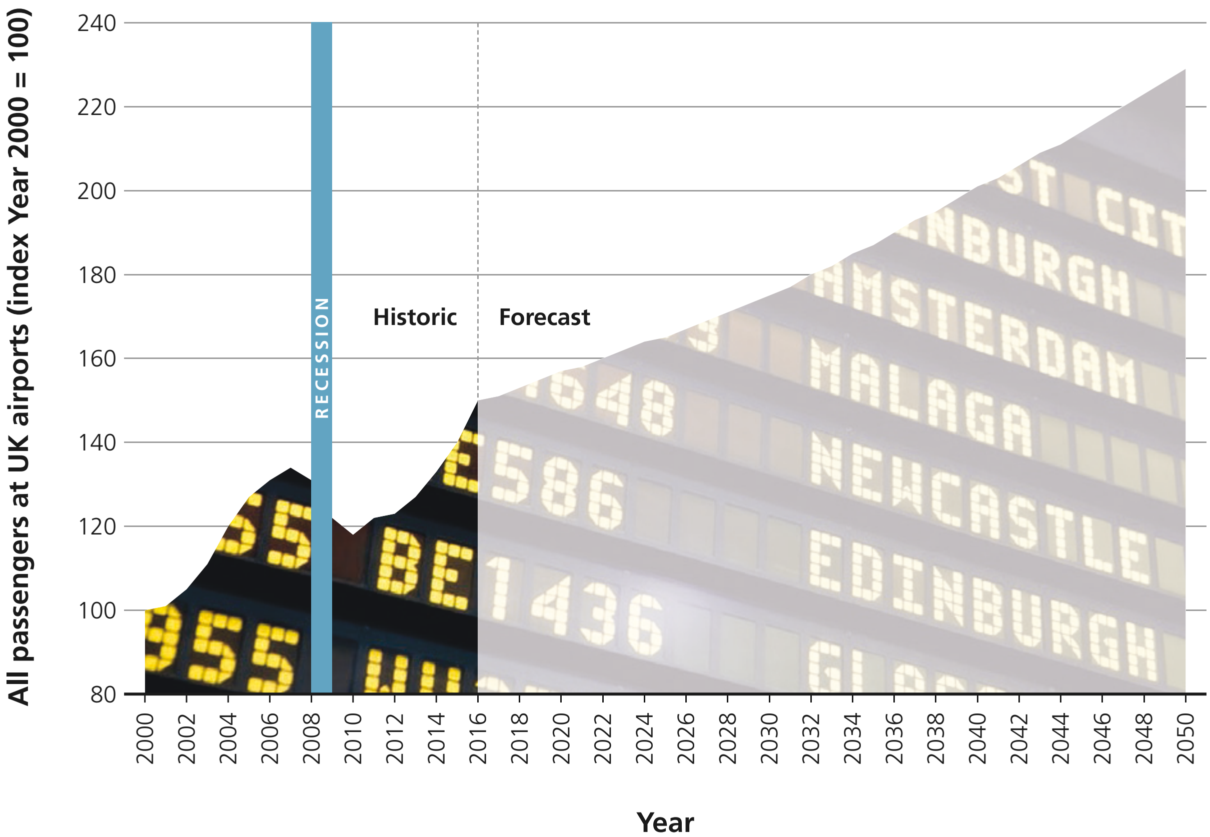
1 Civil Aviation Authority (2017): Consumer Tracker Survey (Wave 4).

2.4 Europe too has seen some consolidation of its airlines as the market reacts to liberalisation and new competition regimes, with national airlines having to compete more effectively amongst each other and with new entrants' disruptive business models. However, liberalisation and a plurality of nation states within the EU's single aviation market means this broadly comparable market in terms of geographical and demographic size looks very different from that of the United States. We might therefore expect to see further consolidation as Europe's market continues to react to similar drivers to those in the US market.

2.5 Current geopolitical conditions, such as the sluggish performance of the global economy and consumer reactions to recent terrorism and perceived political instability, mean that airlines will continue to operate in an extremely challenging marketplace in the short term. This is despite forecasts of significant longer term passenger growth (see Figure 2), which offer those that can stay the course more positive future prospects. In Europe, the large number of airlines and excess capacity will continue to put pressure on profits and are likely to lead to further consolidation and future failures.

2.6 Against this background, the capital-intensive nature and increasingly leveraged financing arrangements of airlines add further risk. Passengers also add to this by booking tickets often several months in advance of the flight. This is encouraged by air carriers, tour operators or travel agents through lower or discounted fares the earlier a booking is made. Consumers are therefore exposed during this period to a real risk that the businesses involved could become insolvent between payment and the delivery of the service.

Figure 2. UK Passenger demand was impacted by recent world events but is staging a recovery and is expected to grow into the long term



Source: ONS: Table AVI0101, and DfT aviation forecasts 2017

Impact of an insolvency

2.7 The impact of an insolvency can be significant. Consumers may experience both distress and inconvenience from a cancelled holiday or from being left abroad without immediate means of getting home. Consumers are also exposed to potential financial losses arising from:

- **Cancellation of forward bookings (refunds).** An airline insolvency may affect several hundreds of thousands of consumers who may face the prospect of losing the money paid for the original ticket and choosing between rearranging or cancelling their trip. If they rearrange, they will need to meet the additional cost of booking alternative travel. If they decide not to travel, then they may incur further losses from any non-refundable components of the trip (such as accommodation or car hire).
- **Travelling home by other means (repatriation).** In addition, some of those affected will be mid-way through their trip. Where an airline becomes insolvent and its operations cease with immediate effect, it may leave tens or hundreds of thousands of passengers overseas without the immediate means of returning. In the absence of any specific protection, these passengers will have to arrange and pay for alternative travel. Assuming these are available, they will need to be made at short notice, when alternative capacity might be limited and prices at a premium. This may also lead to delays, with affected passengers having to arrange and pay for extra accommodation and other subsistence costs.

Recent airline insolvencies

Two recent failures demonstrate very different airline operating scenarios and the equally diverse approaches made to handle their insolvency and enable a temporary continuation of services.

Air Berlin

Air Berlin entered administration on 15th August 2017, when it had a fleet of over 140 aircraft operating a range of short, medium and long-haul services, including to the US. Upon entering administration, Air Berlin was provided a €150m bridging loan, backed by the German Government, which enabled it to continue operating aircraft until 27th October 2017.

Monarch Airlines

Monarch Airlines had a fleet of 33 aircraft operating within Europe and entered administration on 2nd October 2017. Upon entering administration all operations ceased with immediate effect: all aircraft were grounded leaving over 100,000 passengers abroad without their intended flight home. Given the limited capacity of alternative airlines, the UK Government mounted an operation, organised by the CAA, to repatriate UK residents at a cost of approximately £60m.

2.8 While the scale and impact of airline insolvency in recent years is in relative terms small when compared with the benefits consumers have gained, the risk of further perhaps more significant insolvencies remains, and it is therefore important to look at all possible options that will mitigate the risk of consumer detriment. Recent examples have shown current arrangements are not sufficient to protect passengers without significant government intervention.

Current landscape of financial protection

2.9 In undertaking this review it is important to understand the landscape of current statutory and voluntary arrangements that actually provide protection already. Figure 3 summarises current statutory arrangements that will protect consumers in the event of airline insolvency, as well as non-statutory arrangements that if relevant and taken up by consumers may offer complete or partial cover. The statutory protection available is largely determined by the choices the consumer makes in booking and purchasing their flight, as illustrated in Figure 4 and explained below.

ATOL and package travel protection

2.10 The Air Travel Organisers Licence (ATOL) scheme was created in 1973 to provide statutory protection to package holiday customers in the case of a tour operator entering insolvency. Since its creation ATOL has undergone a number of reforms, in part to reflect changes in the market for holiday travel.

2.11 ATOL protection is dependent on the type of service and from whom it is purchased. Broadly speaking all package holidays that contain a flight are protected regardless of the provider. Some flight-only bookings bought from ATOL holders will also be protected. However, flights booked on their own directly with the airline or an authorised airline ticketing agent are not ATOL protected.

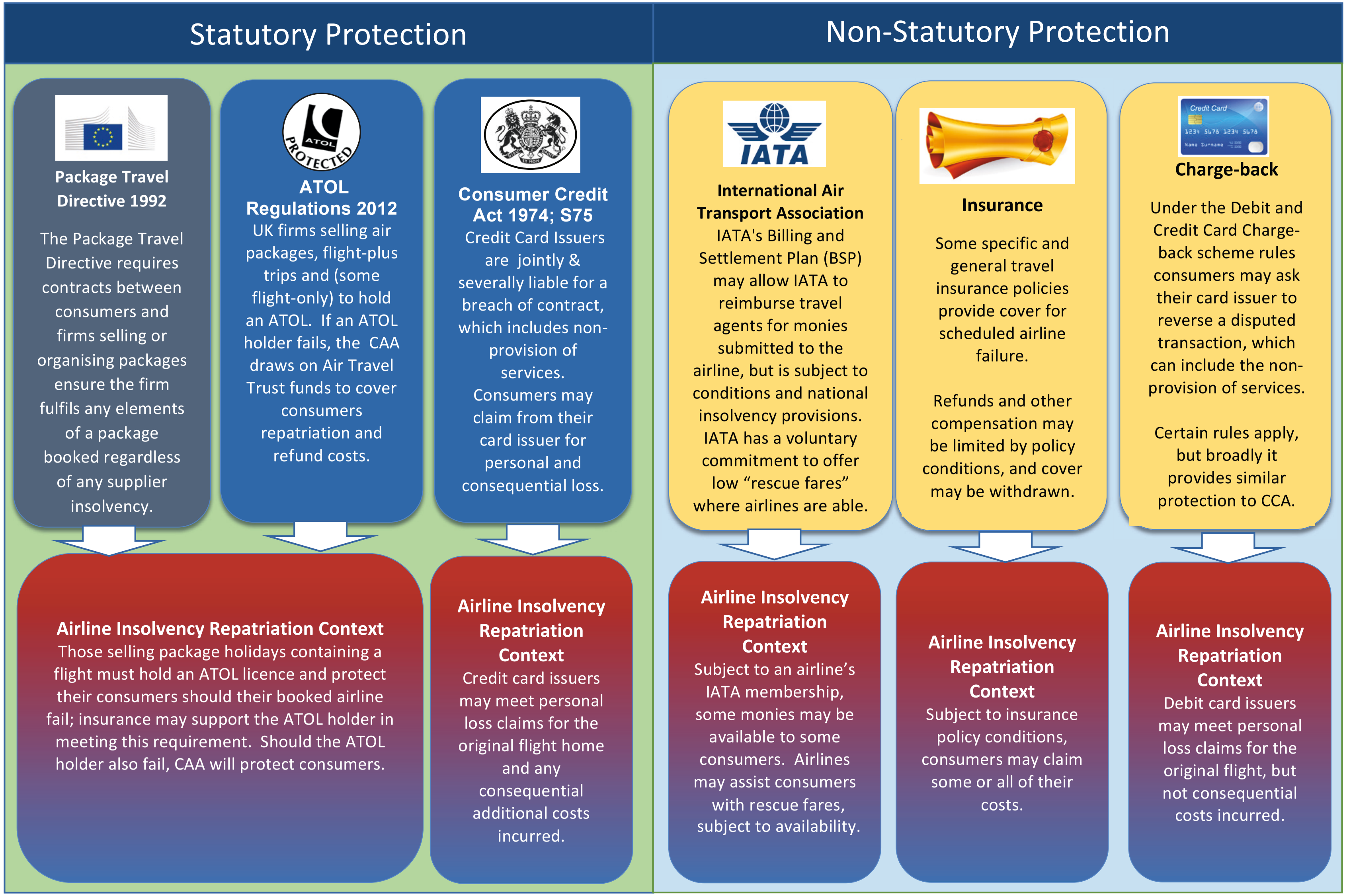
2.12 In the case of package holidays, ATOL protection is mandatory; consumers do not have the right to opt out. ATOL protection is currently charged to the ATOL holder at £2.50 per passenger. This then contributes to the Air Travel Trust (ATT) fund, which ensures that protected passengers can finish their holiday or receive a full refund in the event of an ATOL holder's insolvency.

2.13 Contracts between consumers and ATOL holding firms ensure that should a supplier of an element of the holiday become insolvent (e.g. the airline) the ATOL holder will ensure fulfilment of the contract. Should the ATOL holder be unable to fulfill the contract and fail as a consequence then the CAA will ensure consumers are protected.

Insurance

2.14 Insurance to protect against the failure of airlines is a product that is currently available to both consumers and businesses. Consumers have the opportunity to include supplier failure insurance in their travel insurance policy, although this tends to be for higher end travel insurance policies. Travel agents and other businesses that rely on airlines to deliver products they sell to consumers can also purchase Scheduled Airline Failure Insurance (often referred to as SAFI) as part of their risk management processes. Costs vary, depending on the risks involved and the insurance products chosen.

Figure 3. There are a range of statutory and non-statutory arrangements that seek to provide passenger financial protection from airline insolvency



Card payments

2.15 Under Section 75 of the Consumer Credit Act 1974, credit card issuers are jointly and severally liable with the merchant for breaches of contract, which in this context would include the failure of an airline to honour a contract of carriage, and allows a card-holder to claim a refund of all personal losses and any applicable consequential losses. There are limitations: cover is limited to purchases with a value of £100 or more; it only covers personal loss to the card holder, thereby potentially excluding the losses to others within a booking; and protection may depend on the nature of the contract and whether it is with the airline or a third party such as a travel agent. For these reasons protection may not extend to all payments.

2.16 There is an additional non-statutory scheme called Charge-Back, which forms part of a card issuer's agreement with Visa and Mastercard. Consumers who pay an airline direct with a participating debit or credit card may request their card issuer to reverse a disputed transaction, although claims will be subject to time limits: in some cases claims must be made within 120 days of the original date of the transaction. This would include the failure of an airline to honour a contract of carriage due to insolvency, provided the consumer claims within the timescales. Other card schemes like PayPal and American Express provide similar arrangements.

Rescue fares

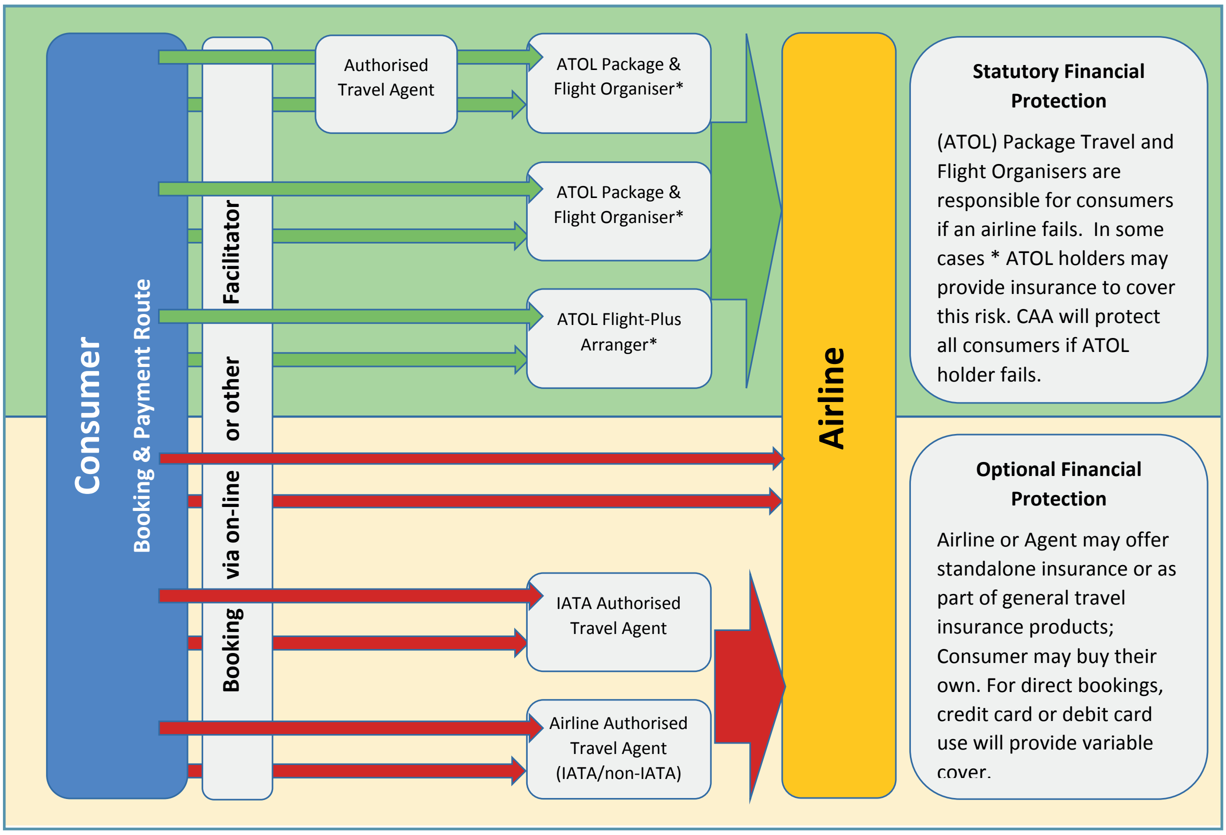
2.17 Airline groupings, including the International Air Transport Association (IATA), have entered into voluntary arrangements on behalf of their members (UK and non-UK) to offer lower (repatriation) fares to UK consumers who would otherwise be stranded. While this offer is welcome, passengers are often unclear about how to access rescue fares. In addition, because the rescue fares are subject to availability the amount of protection is subject to variation and therefore uncertain. Annex A sets out the published terms of the IATA agreement.

2.18 What is clear from the current protection landscape in the UK is that the nature and extent of protection is heavily dependent on the route by which a consumer makes an air ticket purchase. Figure 4 sets out a summary of the different levels of protection and how they relate to the route used to purchase an airline ticket in the UK

Other approaches to consumer protection

2.19 In accordance with the EU Package Travel Directive (PTD), all EU member states have protection in place to protect package holiday customers from airline insolvency. However, the approach to the delivery of the protection varies. Some have funds, akin to ATOL, while others use certification schemes, in which travel operators must demonstrate protection in the form of bonding or insurance.

Figure 4. Routes to booking & payment – financial protection



2.20 For example, in Germany PTD insolvency protection is largely provided by insurers that make their own assessments of package organiser businesses; they may require bank guarantees to mitigate risk or indeed refuse to insure a business, in which case they may not be able to enter the market. Funding for refunds and (self-arranged) repatriation comes from the insurance policy, but the amounts protected are limited by an annual aggregate liability cap of 110 million Euros per insurer which is set by the German government.

2.21 The Kingdom of Denmark has gone beyond the Package Travel Directive in order to protect consumers against airline insolvency by creating a sub-section of their Travel Guarantee Fund, which includes flight-only bookings. All airline passengers departing from Denmark are required to pay a levy of DKK 2 per passenger (approx. £0.20) towards the fund.

Whose protection should be the focus of the review?

2.22 Liberalisation of the European market has brought many changes to the way airlines operate. The freedom for airlines to operate without restriction within the single European aviation market has broken the link between where an airline is regulated and the predominant flows of its business. Europe's largest airline by volume of passengers – Ryanair – is regulated by the Irish equivalent of the UK's CAA. However, a large proportion of its passengers do not travel to or from Ireland. Indeed the largest flows of passengers for the airline are on its routes to and from the UK.

2.23 In light of this it would seem appropriate for this review to start from a position of trying to protect all passengers whose journeys begin in the UK. In part this is because any protection measures limited to UK airlines may lead to competitive distortion. It also does not seem plausible that the UK government would gain confidence that its citizens' interests were being protected by a regime that only applied to passengers of UK registered airlines and not others.

2.24 Nevertheless, it may be possible to identify solutions through the licensing arrangements of UK registered airlines, if our principle of limiting competitive distortion can be assured. We would be interested in hearing views on our proposed approach of starting from a position of protecting passengers whose journey begins in the UK, and also considering options that could be predicated on changes to the UK licensing regime.

Handling uncertainty

2.25 The debate over the UK's exit from the European Union has seen commentators on all sides offer opinions on what will happen to flights and the airlines that operate them between the UK and the rest of the EU. The structure of international agreements and legislation that together underpin the single European aviation market will clearly be an important part of the Brexit negotiations and have the potential to radically alter the context that this review's recommendations will need to be implemented in.

2.26 However, the possible permutations are myriad and likely to remain to some degree uncertain beyond the timescale of this review. While keeping in mind the desirability of minimising the need for change under future scenarios, we shall therefore seek to make recommendations that can work in the current legislative and regulatory framework with a view to ensuring consumer protections that are fit for purpose in the world we know today.

3. The challenge of responding to an airline insolvency

The problem

3.1 The recent history of aviation contains many examples of airlines that are no longer trading. Many have been bought piecemeal or wholesale by bigger rivals, others have simply entered into administration or liquidation with immediate effect. Either possibility gives rise to potential detriment to passengers where they are unable to travel as expected and need to make new arrangements, usually at their own expense despite having already paid for the service. Airline insolvencies therefore give rise to two key problems: large numbers of passengers experiencing a financial loss (refunds) and for many a very immediate need to find alternative travel arrangements to return home (repatriation).

3.2 Governments have felt compelled to act to protect the interests of their citizens during an airline failure. This is in no small part because the current systems of protection do not deliver confidence that the welfare of citizens will be protected. The task of this review is to identify improvements that can be implemented to provide confidence and minimise the need for Government intervention. In particular, we will look for solutions that minimise or remove the burden on the taxpayer and place the current protection arrangements onto a more commercial footing.

3.3 This lack of confidence stems from a series of systems evolved over time that overlap and address similar risks, such that many passengers have no or only partial protection, whilst others may have several layers of protection. Whilst

many passengers will have financial protection of some form, they may not be aware of how to access it or they may not have the resources required to access it. For example many credit card issuers and insurance companies will require customers to purchase replacement services and then claim back the costs at a later date, something some consumers will not have the ability to do. There is also the question in cases where a passenger has multiple layers of protection, which should offer protection first.

Possible solutions

3.4 It would appear that risk and the correct management of risk is at the very heart of this issue. For passengers, an airline failure crystallises the financial risks inherent in handing over money well in advance of service delivery. For some passengers failure will also create the additional problems of being away from home without any immediate means of getting back and the associated personal risks for example relating to accommodation and welfare.

3.5 In a well-functioning market passengers would consciously weigh and manage these risks before making their purchasing decisions. However, previous airline failures have demonstrated that a large number do not. They may not have access to the necessary information nor have the ability to properly assess the risk, or they may incorrectly believe that the regulator is fully protecting them from loss.

3.6 When Governments have intervened to protect passengers' interests in situations such as Air Berlin and Monarch, they do so to correct this flawed risk management. Ultimately such action usually makes the taxpayer carry some of the burden and thereby creates moral hazard, as passengers who have chosen not to protect themselves (whether consciously or not) rely upon society to act when things go wrong. The travel industry and its customers thus benefit from a form of subsidy from the taxpayer.

3.7 Good risk management generally requires that those exposed to risks ensure that they either manage it themselves or transfer it to someone else better able to handle the risk. Successful approaches to risk management also usually ensure that those who benefit from the risk being managed, pay for this to ensure that interests are aligned. Finally financial orthodoxy indicates that the cheapest way to manage risk is to spread liabilities as much as possible such that the burden of liability caused by any large impactful event is shared amongst many.

3.8 An approach based on applying these principles to airline insolvency in a comprehensive manner is likely to deliver a more enduring solution than current practice. The remainder of this section identifies the ways in which we think this might be possible as a result of our initial analysis. This is not a definitive list of solutions from which we will draw our final recommendations, rather a suggested departure point for discussions over the coming months and we are interested in hearing views on alternatives or on the detail of how these may be made to work and the relative merits and impacts of each.

How to pay for failure

3.9 How you ensure that passengers are not unwittingly exposed to risk and that the taxpayer is protected from subsidising the use of riskier airlines by bailing out their customers when they fail, will in our view require better or more consistent risk transfer than is presently the case. Existing protections do exist such as the ATOL scheme and Consumer Credit Act. Unfortunately these do not provide universal coverage.

3.10 In the case of larger scale failures it is also far from clear that these measures would ensure all passenger detriment could be adequately managed. For example where the failure is of a significant scale such as Monarch or Air Berlin, the immediate insolvency and cessation of flying would have a systemic impact on European aviation connectivity. This could take weeks or months to recover from as other market operators reacted to the unsatisfied demand and rearranged their networks to take advantage.

3.11 We are therefore interested in views on the extent to which the current measures, suitably promoted and encouraged, could offer a robust solution to larger failures and overcome the political imperative to act by offering Government confidence that the welfare of citizens are suitably protected.

3.12 In addition, the review will also look to understand the potential of other options to ensure all risk is actively managed. Options here could include a variety of methods that effectively take away passengers choice of whether or not to manage the risk and also potentially how to manage it. An argument for Government action here would be similar to that for third party motor insurance (see text box). Government intervention could aim to ensure that wider society and the taxpayer are protected from foolhardy or ill-informed decision making by passengers and from moral hazard by ensuring the cost of protection is factored into upfront flight costs.

Car insurance

Fully comprehensive car insurance is designed to protect the purchaser against the loss of an asset they would find difficult to immediately replace. Buying an insurance policy offers immediate protection against an event such as a fire or a serious accident that could happen at any moment.

Ensuring the motorist pays a risk-based premium for the insurance aligns their interests with that of the insurance company such that they are rewarded for reducing risk e.g. parking the car overnight in a garage results in a lower premium as the risks are reduced. The insurer is better placed to manage the risk, given their experience and expertise, greater access to financial products, and their ability to mutualise the risk with that of other car owners and achieve economies of scale. The car owner does not risk a period of under protection whilst they build up the capital to be able to buy a new car of the same quality should they have an accident.

Driving a car on public roads also creates risks to other road users and wider society that the owner has little financial incentive to manage. For this reason the Government has intervened to protect others from the financial consequences of motorists’ actions. All drivers on the UK’s public roads are required to be covered by third party insurance. This intervention better aligns the interests of motorists, insurers and other road users such that the financial consequences of an accident are managed by the insurance company and not the motorist. Such companies are better able to reimburse third parties their losses and charge the motorist a premium commensurate with the risk they undertake.

3.13 Several methods are possible. One group of solutions would seek to price in risk to air travel in general, for example through mandatory personal travel insurance paid for when purchasing an airline ticket (whether as part of a package or by itself), or a legal requirement on airlines to protect their passengers from their own insolvency through insurance, bonding or other methods.

3.14 An alternative group of options would replicate for all airline ticket sales the state sponsored and or administered mutual insurance undertakings that many countries use to protect package holidays. The UK's ATOL scheme and the Danish Rejsegarantifonden are examples here, where companies pay a levy on travel products which feeds a fund used to pay refunds and ensure repatriation.

3.15 We would be interested in hearing views on who would be best placed to administer such schemes, and the extent to which capacity exists in current insurance and financial markets to provide equivalent protection on a commercial basis. We would also like to hear from those with views on how to create such capacity should none exist.

How to bring people home

3.16 As discussed above, all passengers of a failed airline will be faced with the financial problems of replacing the service they will no longer receive. However, some will also have the urgent problems associated with the loss of an immediate return leg of a journey they are only halfway through. For many therefore this is understandably the most pressing problem, often needing resolution in hours or days as booked accommodation expires or other urgent medical, financial, or emotional requirements to be somewhere else press (e.g. an operation, employment or a funeral).

3.17 No two airlines are the same as each operates its own mix of fleet across its individual network, meaning no two failures will have the exact same requirement for repatriation. There is therefore a range of possible options in response and a host of practical problems to overcome.

3.18 At one extreme, during peak holiday season or where a large airline or an airline with a large proportion of capacity on certain routes fails, the immediate transport needs of passengers might be such that the only way to fulfil them without significant detriment would be to keep the fleet of the insolvent airline operating through administration. This would usually be for a temporary period only to allow passengers and industry to adjust and for any sale or asset realisation to take place.

3.19 This might be done by the airline itself, through the agency of a court-appointed-administrator or by the directors under a debtor-in-possession regime (such as Chapter 11 of the United States Bankruptcy Code), or by a receiver or other agent of the creditors. An example of this was Air Berlin. The large numbers of bookings, the large fleet of aircraft and the reasonable prospect of value realisation meant that the German government intervened to provide working capital and ensure the airline could continue its operations in the short term.

3.20 Adoption of such an approach in the UK would almost certainly require legislation, to overcome a number of obstacles presented by the insolvency laws as they stand today. In particular, it would be necessary to ensure that neither the duties owed to creditors nor the actions they may take to enforce their claims, prevent continued trading even where the associated costs exceed marginal revenues (as would be likely in many, if not all cases).

3.21 Even if these obstacles were overcome there would remain challenges associated with enforcement in multiple jurisdictions. At the least, those imply the potential for (possibly protracted) delay that would drastically detract from the efficacy of the intended consumer protections.

3.22 To address these issues satisfactorily would in all probability require the availability of sufficient financial resources to meet, or at least assure, the outstanding claims of suppliers (including lessors) and to underwrite the expenses and liabilities arising from continued trading. It must be recognised that the scale of resources required could be very large. In other Special Administration regimes adopted by the UK, provision is made for the Government to provide loans, guarantees and or indemnities for this purpose. If we are to minimise the extent to which the taxpayer is exposed it will be necessary to identify alternative sources of capital that can be pooled to provide equivalent backing. We will be especially interested in hearing views on how private sector markets could do this.

3.23 Given the high level of cost and risks that could arise from this approach, other options may provide a more practical solution. For example, where the numbers of passengers are such that sufficient capacity could be procured from the wet-lease market without recourse to the insolvent airline's own airframes, this could provide a cheaper and less risky option for a very short term repatriation. This would allow additional capacity to be available until such time as other airlines could satisfy passenger demand in the normal course of business. The UK Government's response to the failure of Monarch is an example of such an approach.

3.24 Finally at the other end of the scale, some airline failures will not require any large scale intervention to ensure that capacity exists to meet demand, be it air

or credible surface transport alternatives. This is likely to be the case where the failing airline is small, operates short regional routes, or the failure takes place outside peak season when load factors on alternative scheduled capacity are likely to be lower. In this space the political and public policy imperative for Government intervention during a repatriation starts to dissipate and therefore measures to improve passenger awareness may offer more appropriate solutions. These may be expected to help passengers protect themselves, for example through the discretionary purchase of travel insurance products.

3.25 There are a range of challenges and problems associated with all of the options outlined above and any hybrid approaches that fall between them. It is for consideration how far these problems could be addressed by Government action in advance of a failure, to make the approaches easier, less risky or cheaper. Examples could include amendments to the airline licensing regime, which might enable regulators to intervene earlier or which ensure passenger funds are handled differently when an airline is at greater risk of insolvency. Such changes could thereby limit the total financial exposure of passengers by making replacement flights easier to secure or allowing for easier and fuller refunds of monies paid in advance of any flights.

3.26 Changes could also be made to the legal framework surrounding the insolvency of airlines to ensure there is access to the data and airline systems needed to run these operations effectively and efficiently in administration. Changes could also be made to place the emphasis on those administering an insolvent airline to ensure passengers' welfare. Again these could act to both improve the ability of passengers to find replacement flights and to lessen the financial impact of the failure.

3.27 In outlining the options above we have cited two examples where Governments intervened to ensure passengers were not excessively impacted by an airline failure. In both examples the main role of Government was to provide capital to underpin the operation, leaving other more qualified agents to carry out the operations. In the case of Monarch the UK's aviation regulator the CAA, and in the case of Air Berlin the insolvent airline's management working with the administrator. We would be interested in views as to who such agents should be and whether or not this is something that private agents could undertake without state sponsorship.

3.28 Clearly one of the biggest problems to overcome with the repatriation of passengers in the immediate aftermath is one of finance. Indeed whatever the scale of failure, most of the detriment to passengers (with a few notable exceptions) is resolved if they have confidence that their financial costs will be paid by someone else. Would the majority of passengers in a large scale failure be happy simply to wait until alternative scheduled capacity was available, particularly if their accommodation and marginal additional living expenses were paid for. This example illustrates how solving the financial component of airline insolvency has the potential to be a solution or at least part of the solution for the practical problems of short term under-supply of aviation capacity in the immediate aftermath of an airline failure.

4. Next steps and how to get involved

"Running an airline is like having a baby: fun to conceive, but hell to deliver."

CE Woolman, founder of Delta Air Lines

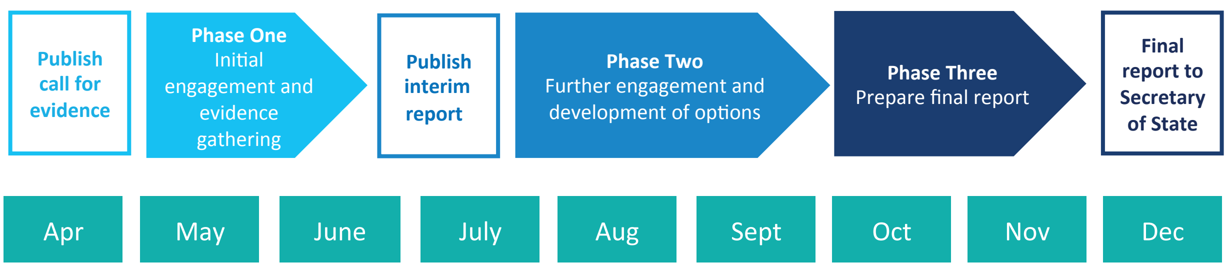
Next steps

4.1 We have not yet finalised the programme of work that will lead to our final report. However, it is certain that successful solutions to the issues surrounding the provision of adequate passenger protection will only be developed with a great deal of input from the industries affected. It is therefore our intention to consult and offer all with relevant experience and evidence to share, the opportunity to be involved. Our intention is to achieve this through a combination of evidence gathering, consultation, public evidence sessions and stakeholder working groups.

4.2 This document represents the first step in that process as we set out our interpretations of the issues, and invite views on that and possible solutions for us to investigate. We will follow this with public evidence sessions open to all, before publishing an interim report in the summer with our views on possible solutions. The interim report will invite thoughts and comments on these possible solutions and will be followed by a series of working groups to help us further develop our proposals and understand the impacts they are likely to have. Finally we are aiming to publish a final set of recommendations to meet the questions posed in the terms of reference by the end of the year. Figure 5 summarises this timetable.

4.3 In order to help us meet this challenging timeline we are therefore inviting any initial thoughts and evidence on all the questions set out above by 11 May 2018.

Figure 5. Airline Insolvency Review – 2018/19 Timeline



4.4 In due course we will also be setting out the details of our public evidence sessions and working groups. To help us organise and prepare these sessions we would like to hear from those interested in participating and would request expressions of interest by the end of April 2018. We will make further details publicly available on the website in due course, however, we will also contact those that have expressed an interest directly with details of how to participate.

4.5 The deadlines set out above are those that we believe will enable us to meet our timetable and we will consider any views submitted to us by these dates. The process will be an iterative one and anyone with views to share is more than welcome to do so at any time, however, given the nature of the challenge we can only commit to making our best endeavours to consider any views or evidence submitted after the timescales set out above.

How to get involved

4.6 The review and its recommendations will only be as good as the evidence and thinking upon which they are based. We really do encourage any and all with a view or evidence pertinent to the questions surrounding airline insolvency to share them with us. You can share your thoughts with the Chair and the Review team by sending them to airlineinsolvency@dft.gsi.gov.uk.

4.7 Further information on the review can be found at https://www.gov.uk/government/collections/airline-insolvency.

Freedom of information

4.8 Please note that we may publish any views or evidence shared with us. Respondents wishing information that they provide to be treated as confidential should be aware that, while the Review is not a body designated under the Freedom of Information Act 2000 ('the Act') as subject to the terms of the Act, we will seek to broadly follow the terms of the Act. Information provided may therefore be made public where we consider that no exemption from disclosure applies. In view of this it would be helpful if respondents could explain why the information provided should remain confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. A confidentiality disclaimer generated by an IT system will not, of itself, be regarded as binding.

4.9 We will process personal data in accordance with the relevant data protection legislation and in the majority of circumstances this will mean that personal data will not be disclosed to third parties.

Annex A: IATA rescue fare offer

In October 2014, IATA published their voluntary repatriation assistance notice to passengers stranded as a result of financial failure by another airline. This included the following offer:

IATA member airlines flying to and from the European Union will make their best efforts to offer repatriation to passengers stranded away from home as a result of a financial failure of another airline. These passengers will be returned, subject to available capacity, to their point of origin, or to the nearest airport served by an IATA member airline, at a discounted rate (also known as a "rescue fare"). Such assistance, restricted to air transport and subject to the above conditions, may be made available up to a maximum of two weeks after the date of failure of the original airline.

To ensure maximum awareness, the State responsible for the licencing of the insolvent airline should communicate to stranded passengers the possibility of this rescue service, e.g. via national Government websites. This rescue service should only be available for passengers who do not have insurance covering such.