Airline Insolvency Review
Interim Report

July 2018
# Contents

Chair’s Foreword 2

1. **Introduction** 4

2. **Airline Insolvency** 6
   - How likely is airline insolvency? 6
   - Assessing insolvency risk 8
   - Developing our understanding of airline insolvency risk 13
   - Existing protection regimes take us only so far 14
   - EU Legislation governing air travel protection 16
   - Package Travel Directive & Air Travel Organiser’s Licensing 17
   - Card payments 18
   - Insurance 19
   - Other measures 20
   - Existing landscape succeeds in protecting some but not all 21

3. **Repatriation** 22
   - What is a successful repatriation? 22
   - Who leads the operation? 25
   - Self-Repatriation 27
   - Organised Charter 32
   - Keeping the fleet flying in an orderly wind-down 36

4. **Funding passenger protection** 46
   - Commercial based solution 47
   - Levy or tax based solution 48
   - Non-financial solutions 51

5. **Reforming the existing landscape** 53

6. **Next Steps** 55
Nine months ago, we witnessed the end of a well known British brand as Monarch Airlines ceased trading, leaving tens of thousands of passengers abroad.

In an effort to prevent significant detriment to those passengers’ welfare the Government launched an operation to replace the flying programme for two weeks, at a cost of some £60m.

At around the same time the German government was mounting its own programme to keep the fleet of Air Berlin flying to avoid similar impacts for its passengers. In this case the German government chose to provide immediate financial support to keep the airline temporarily running through administration. Two insolvencies with two different responses. Both managing to avoid thousands of passengers being left to fend for themselves, both costing the taxpayer significant amounts of money.

The Review has been established to answer the question to what extent it is appropriate to protect passengers from the impacts of such insolvencies in the future, how best to do so, and how to minimise the impact on the taxpayer.

In April we published our Call for Evidence where we set out our understanding of the current landscape for passenger protection and invited your thoughts and suggestions. I am very grateful to all of you who took the time to respond and share your thoughts and experience with us. Without your input and the benefit of your experience the Review will not be able to fully engage with this complex set of issues and deliver solutions.

Our Terms of Reference tasked us with producing “an initial report ...on potential options to tackle the immediate repatriation of passengers of an insolvent airline by summer 2018.” This Interim Report is intended to fulfil that requirement. In it, we set out our initial views on the potential options for meeting immediate repatriation needs, with minimal Government intervention, including options to allow the orderly wind-down of airlines facing insolvency. It also shares the extent of our thinking to date on the other questions we have been tasked to address. In particular it sets out alternative models for providing financial protections, including how these can be placed on a more commercial footing than the current arrangements.
We also set out the key questions the Review will be seeking to resolve in the second phase of our work. In addition to further refinement of our thinking on the options for immediate repatriation presented in this Report, we will also be working towards recommendations on how passenger protections can be financed in the future and how the current arrangements would need to be reformed to implement our recommendations in relation to both repatriation and refund protections.

Peter Bucks
Chair of the Airline Insolvency Review
1. Introduction

1.1 In the 2017 Autumn Budget the Chancellor of the Exchequer announced the establishment of this review into airline insolvency. The Terms of Reference for this Review were published and a Call for Evidence was opened in April 2018. In it the task of the Review was broken down into three key questions: how to repatriate passengers in the immediate aftermath of an insolvency, how to finance a system of passenger protection and what reforms were necessary to the existing protection framework.

1.2 We received 33 responses from a wide variety of individuals and organisations. At the same time the Chair and the Review team have been meeting with interested parties to better understand the drivers and constraints, to which those working in and around the sector operate. In addition, the Review organised two public evidence sessions in London and Manchester. The purpose of these sessions was to hear at first hand peoples’ views of how the questions could be answered, engage in discussion on issues raised in the responses to the Call for Evidence and also to offer anyone with an interest the opportunity to speak directly to the Chair and Review team.

1.3 The experience and knowledge shared through the processes described above has helped shape our thinking. The responses to our Call for Evidence are summarised in a separate document published alongside this Interim Report, as are the individual responses themselves. Notes of the two public evidence sessions are also available on the website and we would encourage anyone with further thoughts to share to continue to do so and engage with the Review in the manner set out at the end of this Report.

1.4 In late May the Review invited expressions of interest from people with relevant experience to join an expert advisory panel and we are currently assessing the responses we have received. Our intention is to appoint members over the course of the summer. At the same time the Review will shortly be inviting bids from professional advisers to help analyse and assess the different options in preparation for the final report.

1.5 This Interim Report answers the call in our Terms of Reference to provide an initial report on potential options for the immediate repatriation of stranded passengers and as such it represents a progress update on our deliberations to date. It focuses heavily on the first of the three questions we set ourselves in the Call for Evidence: what practical arrangements are needed to get passengers home if sufficient capacity does not exist in the market? But it also sets out our thinking to date on the other two questions and offers an insight into how the Review intends to develop its analysis.
1.6 After this introduction the Interim Report is organised into five further sections covering: our assessment of the risk of airline insolvency; practical measures to get passengers home; measures to protect passengers and the taxpayer from the financial impacts; reform of current protection arrangements; and the process going forwards and how to get further involved.
2. Airline Insolvency

How likely is airline insolvency?

2.1 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. This was the view of the sector set out in the Call for Evidence and one that many respondents recognised. Also recognised was the view that despite expected growth in passenger numbers over the coming decades, commercial pressures resulting from increased liberalisation and greater competition are likely to drive consolidation in the European market. Whilst we can expect to see new airlines joining the market we should also expect to see a greater number leave it, such that the overall trend over the coming decade is likely to be one of fewer airlines serving a growing number of passengers.

2.2 Liberalisation and a trend towards more cost-conscious business models has also meant that more than at any other time in the sector’s history, airlines increasingly exhibit complex financial structures. This can reduce their flexibility to respond to market developments and, in the extreme case, threaten their continued viability. However, airlines will not exclusively exit the market through insolvency and, as many respondents have pointed out, many airlines exit the market through merger and acquisition activity that has relatively little or no immediate detrimental impact on the passenger.

2.3 As can be seen from the selective history set out in the box below, airline insolvencies are a relatively rare event and so data sets are small making it difficult to develop a meaningful analysis of which particular developments in aviation may be driving insolvency risk amongst airlines. However, some common themes can be identified and include failure to adapt to changing market conditions, geo-political events such as terrorism and fiercer competition driving out the less efficient. Given many of these factors are expected to be present into the future and are well outside governments’ abilities to fully control, it is appropriate that the Review considers how to deal with the aftermath of any such failure.

2.4 Our approach is one of allowing market forces to determine which airlines will fail and focus on mitigating impacts on passengers and the taxpayer when that happens. Some respondents expressed concern that adding charges or pricing risk into the cost of flying will force weaker airlines out of the market, precipitating the risk that we are trying to mitigate.
Disappearing aviation brands
Several UK and European airlines have exited the market over the past decade through liquidation, or take-over. The table below identifies some of the notable ones, and we have provided a summary of two examples, which resulted in markedly different outcomes.

Monarch Airlines Insolvency – On 2 October 2017 one of the UK’s oldest airlines filed for administration, leaving 110,000 passengers overseas and over 750,000 customers with forward bookings out of pocket. The airline’s failure was exacerbated by geo-political events in the eastern Mediterranean and North Africa, which led to increased competition in the Western Mediterranean, a core market for Monarch. This coupled with a falling pound and increasing costs meant the airline was hit by unsustainable trading losses, which pushed the airline into administration. The Civil Aviation Authority (CAA) and UK Government stepped in to provide charter services to repatriate passengers.

The sale of British Midland International (BMI) – The BMI Group comprised the “no-frills” carrier bmibaby, the commuter carrier BMI Regional and the domestic and long-haul carrier BMI International. CAA monitoring identified growing financial issues within the BMI group in 2011. The Group acknowledged the problem and with the support of their parent company, Lufthansa, sought to sell the businesses. BMI International operated a number of routes, for example to central Asia, where they were the only UK airline operating. While the possible sale of the business was being worked through, the CAA agreed a contingency plan with the Group in the event of closure. This included arrangements in relation to BMI International for a phased wind-down of operations, for example with flights only bringing passengers back to the UK, and agreement with Lufthansa to make seats available on other services in their Group and Alliance, and the setting up of an escrow structure to protect funds of passengers who had yet to travel. The successful sale of the business to International Airlines Group (IAG) meant that these contingency plans did not need to be used.

<table>
<thead>
<tr>
<th>Airline</th>
<th>Started Ops</th>
<th>Ceased Ops</th>
<th>Reason for Cessation</th>
</tr>
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<tbody>
<tr>
<td>Monarch Airlines</td>
<td>1968</td>
<td>2017</td>
<td>Filed for Administration in October 2017</td>
</tr>
<tr>
<td>Air Berlin (Niki 2003)</td>
<td>1979</td>
<td>2017</td>
<td>Filed for Administration in August 2017</td>
</tr>
<tr>
<td>British Midland International (Including bmibaby)</td>
<td>1938</td>
<td>2012</td>
<td>Acquired by IAG and integrated into British Airways</td>
</tr>
<tr>
<td>Flyglobespan</td>
<td>2002</td>
<td>2009</td>
<td>Administration into liquidation</td>
</tr>
<tr>
<td>Zoom Airlines</td>
<td>2002</td>
<td>2008</td>
<td>Administration into liquidation</td>
</tr>
<tr>
<td>XL Airways UK</td>
<td>1994</td>
<td>2008</td>
<td>Administration into liquidation</td>
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<tr>
<td>Silverjet</td>
<td>2006</td>
<td>2008</td>
<td>Administration into liquidation</td>
</tr>
<tr>
<td>GB Airways</td>
<td>1931</td>
<td>2008</td>
<td>Acquired by easyJet</td>
</tr>
</tbody>
</table>
2.5 It could be argued that strengthening the price signal for insolvency risk would help improve the functioning of the market, correcting a current distortion rather than creating a new one. With risk better priced into tickets consumers would make choices taking more account of insolvency risk. With such an approach there are commercial rewards for operators who take less risk on their balance sheet and thereby reduce passenger exposure. However, the extent to which passengers would react to price signals of this nature, the degree to which it is possible to price risk into tickets and the likely impacts on competitiveness are all factors that we will need to assess and consider further. Such assessment will be critical to ensuring we address another concern expressed by respondents: that the recommendations of the Review should be proportionate to the risk being tackled.

2.6 Ensuring that the Review’s outputs are proportionate and assessing the factors outlined above requires an analysis of the likely risk and exposure that passengers will face. The UK has the third largest aviation market in the world,\(^1\) with approximately 284 million passengers passing through UK airports in 2017.\(^2\) Of the 375 airlines serving the UK, the top 17 as shown in Figure 1 accounted for just over 80 per cent of all trips and these form the basis of our risk analysis.

**Assessing insolvency risk**

2.7 We asked the Government Actuaries Department (GAD) to analyse the probability of airline insolvency over the next 15 years. GAD based its analysis on airline credit rating data and published rating agency transition probability tables. It should be noted that the transition tables do not account for airline specific factors which may vary from broader industrial averages. As we noted in the Call for Evidence, there may be reasons why some airlines are less likely to fail than other companies given the regulatory regime; however, there are also reasons to believe trading conditions for European airlines are getting more difficult as competition reacts to liberalisation. As Figure 2 demonstrates we estimate the probability of an airline with a publicly available credit rating becoming insolvent to vary from six per cent next year to 13 per cent over the next 15 years.

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**Investigating consumer appetite for insolvency protection**

We received responses in the Call for Evidence that consumer awareness of existing protection should be improved, as this could significantly reduce the problem of airline insolvency. However, currently we know very little about either consumer awareness of existing protection or the level of protection they want and the price they would be prepared to pay.

Insolvency protection can take many forms and be delivered by a range of people. One of our tasks will be to understand consumer awareness of these issues, their preferences and to investigate how to align the policy proposals with these and raise awareness at the same time.

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1 IATA (2016), ‘IATA forecasts passenger demand to double over 20 years’  
http://www.iata.org/pressroom/pr/Pages/2016-10-18-02.aspx
2 Department for Transport analysis of CAA data
Figure 1: The UK aviation market is concentrated among the top 3 airlines with a large number of smaller airlines.

![Bar chart showing passengers flown to/from the UK by airline in 2017. Source: CAA data.]

Figure 2: The risk of airline insolvency in the UK market remains around 25% in any of the next 15 years.

![Bar chart showing the probability of airline insolvency over the next 15 years. Source: GAD.]

Probability of insolvency of the airlines in Figure 1 over the next 15 years.
2.8 For six of the 17 airlines there are no publicly available credit ratings. In these cases GAD assigned a notional credit rating guided by the airlines’ financial characteristics. It should be noted that many of the airlines with no credit rating are financially weaker, with higher levels of debt and are often loss-making. This acts to raise the overall annual probability of one or more insolvencies in this group of airlines to around 25 per cent throughout the period. Not all these insolvencies would lead to another Monarch style repatriation operation and the next chapter of the report explores the possible options for responses.

2.9 In light of this probability analysis GAD forecast the number of passengers affected by an insolvency to rise over the forecast period from approximately 500,000 to nearly 900,000 as shown in Figure 3: on average this amounts to 0.5 per cent of all passengers over the 15 year period. This increase in affected passengers is driven by passenger demand growth and increasing insolvency risk. Of the total number of affected passengers GAD estimate only about 7 per cent would need repatriating: the cancellation of advance bookings would account for the vast majority of affected passengers. Survey evidence from the Office for National Statistics (ONS) suggests approximately two thirds of passengers on UK registered airlines are UK residents, which would likely mean a lower number of passengers would need protection according to the definition we set out in the Call for Evidence. However, as is discussed later in the document this would depend entirely on the type of airline concerned, its route network and the type of traffic it was carrying.

2.10 When interpreting the forecast number of affected passengers, it is important to bear in mind that these are annual averages. This has two key effects. Firstly, it masks in year variation. As Figure 3: With the size of the UK aviation market, a large number of passengers could be affected by airline insolvency.

![Figure 3](source: GAD)
4 shows, over the course of a year the passenger exposure varies significantly, due to the seasonality of passenger demand such that we could expect many more passengers to be affected in summer than winter. Secondly, insolvency impacts are dependent on the airline in question and are ‘lumpy’: the impacts for passengers are immediate and not spread over a number of years. For example, the collapse of Monarch left 110,000 passengers overseas with around a further 750,000 losing their advanced bookings. Thus, at any single point in time the number of potentially affected passengers could be much greater than the averages estimated in the risk analysis.

2.11 In addition, insolvency events give rise to political risk. Government may feel compelled to act for public policy reasons, despite the moral hazard of protecting passengers who failed to protect themselves. Over the course of the last 20 years we have seen an insolvency event each decade that has obliged the UK Government to intervene in such a manner and mitigate the impacts to unprotected passengers. The UK is not alone in feeling the effects of such political risk: 2017 saw both the German and Italian governments also act as a result of such political risk and difficult public policy pressures. In developing our policy recommendations, we will investigate how the financial impacts to the taxpayer of such political risk can be minimised or removed and the extent to which Government should retain a role in coordinating any response.

2.12 The Call for Evidence sets out that the Review would be organised into three tasks, which received broad support from responses:

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3 Consultancy.UK (2017), ‘KPMG to administrate ailing UK airline Monarch’
● 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?

● What changes need to be made to the current protection arrangements in light of the answers to the first two questions, and to put them on a more commercial basis?

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### Estimating passengers affected by airline insolvency

As part of the European Commission’s impact assessment to its 2013 Communication on Passenger Protection in the Event of Airline Insolvency, Steer Davies Gleave (SDG) undertook a similar exercise to estimate the number of affected passengers. SDG focused on the European aviation market and estimated the average number of affected passengers would increase from 325,000 in 2011 to 480,000 by 2020; representing 0.07 passengers per year.

Whilst SDG and Government Actuaries Department (GAD) have sought to estimate the number of passengers who would potentially be affected by an airline insolvency, there are important differences in the approaches adopted which account for the variation in estimates.

SDG forecast the number of affected passengers who were not protected under the Package Travel Directive, which is assumed to be 85 per cent of all passengers, across Europe. They examined airline insolvency data for the period 2000 to 2010 and extrapolated this for period 2011 to 2020, such that demand growth is the only factor accounting for an increase in the number of affected passengers. This implicitly assumes that the market conditions for airlines for the period 2011 to 2020 will be identical to those in the preceding decade.

In contrast to this, GAD adopted a risk-based approach to forecast the number of all affected passengers for the British market, which accounts for approximately 25 per cent of the European market. GAD based its analysis on credit ratings data and assumed ratings where data was not available, for the top 17 airlines serving the British market using transition probabilities to forecast insolvencies over the next 15 years. The transition probabilities are average across all industries and not specific to airlines.

Both approaches have merit, both have drawbacks. The UK analysis is more akin to how financial organisations would determine the cost of insolvency protection, and as such more useful when considering how to develop options to fund insolvency protection. The EU-wide analysis gives a better picture of how insolvency has manifested itself in the past and what the future risk profile of those airlines would look like should similar conditions prevail. Furthermore, if we were to adopt the SDG approach, we may find the results are overly skewed by a few large insolvencies, due to the relatively small UK dataset. Nevertheless, we will look to sensitivity test the GAD approach using the SDG approach.

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2.13 The answers to the first two questions will dictate what reforms are necessary. As a result, our efforts in this Report are primarily focused on answering the first two questions: we will outline the options for reform of the current protection arrangements in the final report.

2.14 In addition to the three tasks, the Call for Evidence suggested four principles against which to test any proposed solutions. These principles were generally supported by respondents, although several additional or alternative principles were suggested and many different commentaries were offered with regards to the relative hierarchy or merit of the principles. Given the difficulty of putting numbers to intangible concepts such as consumer confidence and political certainty, we believe that it would not be appropriate to use a form of weighted scoring system to select between options. Rather the Review will aim to ensure consistent comparison of impacts whether qualitatively or quantitatively expressed and not seek to rank or otherwise weight the principles.

Principles of the Review

- **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.

Developing our understanding of airline insolvency risk

2.15 Understanding the scope and scale of any airline insolvency risk will be critical to constructing a proportionate system that protects passengers appropriately. Building on the Interim Report, the Review will undertake more detailed risk analysis of the repatriation and financing options.

2.16 Risk modelling will be used to estimate capital requirements and hence cost to the passenger of the different options. Key elements of the modelling will include the assumed profile of insolvency risk, the cost per passenger of refunds and repatriation under different scenarios, and forecasts of demand growth. The costs of refunds and repatriation will, to a large extent, be determined by the type of repatriation proposed (discussed in further detail later on). We will use these risk-derived costs to assess the likely impacts on levels of competition in the market.
2.17 The risk modelling is based on average exposure. However, as noted above, insolvency events are ‘lumpy’ with the impacts concentrated in a short period of time. Thus, to have confidence in the risk analysis, we will need to know whether the financing and repatriation options remain viable, both in terms of affordability and practicability, under a set of realistic stress tests.

2.18 The scenarios for the stress tests will be based on existing market characteristics, such as fleet size, destination and route density. Our analysis will take these ‘worst case scenarios’ and estimate the extent to which different financial options can absorb the associated financial losses. It should be noted that the objective of this exercise is to inform the decision around the preferred option: it is not intended to be used to construct a financial option which captures all risks no matter how improbable.

2.19 We have adopted a risk based approach as we believe this is the best way to understand the scale of potential impact and identify the most proportionate repatriation and financial options. As we set out in the next section, the feasibility of each repatriation option depends upon the scale of impact. Thus, a risk based approach will be a key determinant of the circumstances in which they could be used in a proportionate manner.

Existing protection regimes take us only so far

2.20 As set out in the Call for Evidence, a passenger’s current insolvency protection is often determined by the manner in which they book their ticket. Protection can be based in law (statutory protection) or offered by companies involved in organising or selling the ticket (non-statutory), or from sales direct to consumers of protection products such as travel insurance (also non-statutory). These protections often overlap and none are universal, such that on any one flight several of the passengers may have unwittingly paid twice or more for the same protection. Others whether intentionally or otherwise may not have paid for any protection at all and may be carrying the risk of insolvency themselves.

2.21 Whether a passenger benefits from protection or not depends mainly on what and how they have booked their travel. It is far from a simple landscape to navigate, but in general terms purchases of other travel services such as accommodation made at the same time as the purchase of a flight, will normally result in the creation of a package holiday and be subject to the protections set out in the Package Travel Directive and, in the UK, the Air Travel Organiser Licensing scheme. Other protections include those available through whatever payment system is used. In the case of credit cards in the UK this will usually mean the card company is jointly liable for the provision of the service by virtue of Section 75 of the Consumer Credit Act. Finally, passengers may benefit from travel insurance policies which include supplier failure cover although not all such policies do. Figure 5 below summarises these protections as they are currently available to those booking air tickets and the section below explains in more detail how they operate.
### Airline Insolvency Repatriation Context

**Package Travel Directive 1992**

The Package Travel Directive requires contracts between consumers and firms selling or organising packages ensure the firm fulfils any elements of a package booked regardless of any supplier insolvency.

**ATOL Regulations 2012**

UK firms selling air packages, flight-plus trips and (some flight-only) to hold an ATOL. If an ATOL holder fails, the CAA draws on Air Travel Trust funds to cover consumers repatriation and refund costs.

**Consumer Credit Act 1974; S75**

Credit Card Issuers are jointly & severally liable for a breach of contract, which includes non-provision of services. Consumers may claim from their card issuer for personal and consequential loss.

**International Air Transport Association**

IATA’s Billing and Settlement Plan (BSP) may allow IATA to reimburse travel agents for monies submitted to the airline, but is subject to conditions and national insolvency provisions. IATA has a voluntary commitment to offer low “rescue fares” where airlines are able.

**Insurance**

Some specific and general travel insurance policies provide cover for scheduled airline failure.

**Charge-back**

Under the Debit and Credit Card Charge-back scheme rules consumers may ask their card issuer to reverse a disputed transaction, which can include the non-provision of services. Certain rules apply, but broadly it provides similar protection to CCA.

### Statutory Protection

- **Package Travel Directive 1992**
- **ATOL Regulations 2012**
- **Consumer Credit Act 1974; S75**
- **International Air Transport Association**
- **Insurance**
- **Charge-back**

### Non-Statutory Protection

- **Airline Insolvency Repatriation Context**
- **Airline Insolvency Repatriation Context**
- **Airline Insolvency Repatriation Context**
- **Airline Insolvency Repatriation Context**
- **Airline Insolvency Repatriation Context**

**Figure 5: Protection Landscape Chart (from CfE)**
EU Legislation governing air travel protection

2.22 A significant body of legislation governing the aviation sector in the UK is set at a European level. The most relevant to this review include Regulation (EC) No 261/2004 which established common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights; and Regulation (EC) No 1008/2008 which established common rules for the operation of air services.

2.23 On 18 March 2013, the European Commission adopted a Communication on passenger protection in the event of airline insolvency. In it the European Commission assessed the extent of passenger protection available from the interplay between these two pieces of legislation and whether it was effective at protecting passengers from airline insolvency. One of the principal conclusions was that while the overall proportion of passengers affected by airline insolvency in the EU is low, the impact on passengers could be significant, citing the difficulties passengers face in having to arrange their own repatriation and the related financial losses. Importantly, they also noted that seasonal capacity constraints could lead to delayed returns, with affected passengers having to meet additional consequential costs.

The Commission also noted the lack of consumer awareness of both the risk and the protection available to them. This is a picture that respondents to the Call for Evidence would recognise.

2.24 The Commission concluded that the existing regimes should be explored further to improve their functioning given the low level of risk. In addition, national authorities should ensure the interplay between the two pieces of legislation was more apparent, such that the licensing regime more actively ensured passengers’ rights under Regulation 261 were better protected, even in the event of insolvency.

2.25 It seems likely that following recent events, the Commission will be returning to this issue. Given an increasing number of airlines are licensed in more than one jurisdiction and that many carry large volumes of passengers to and from jurisdictions in which they are not licensed. Further legislation or guidance at the European level may help ensure a consistency of approach within the internal market for air transport services. The Review will seek to ensure any recommendations are based on the current regimes but where relevant indicate the potential for changes to legislation to further improve them.

European Regulation on Air Passenger Rights

Air passenger rights in situations of denied boarding, cancellation and long delay are dealt with under EC Regulation 261/2004. The Regulation applies to all services operated within the boundaries of the EU and on services from the EU to a third country and in some cases it also applies where an EU carrier is operating a flight from a third country into the EU. Under the terms of the Regulation, a passenger who is subjected to disruption to his or her journey is entitled to a range of assistance, including if appropriate, rerouting, refunds and/or defined financial compensation.
Package Travel Directive & Air Travel Organiser’s Licensing

2.26 Another key piece of relevant European legislation is the Package Travel Directive. Amongst other protections this requires the providers of package holidays and related products to ensure the protection of their customers in the event of their or their suppliers’ failure. For holidays including a flight sold by UK companies this is implemented via the Air Travel Organiser’s Licensing scheme (ATOL). For other types of package holiday sold by companies established in the UK the Package Travel Regulations apply. The ATOL scheme acts to ensure a clear regime is in place to both license sellers and provide protection to passengers affected by holiday company insolvency.

2.27 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 normally ATOL protected.

2.28 For package holidays, ATOL protection is mandatory; consumers and holiday companies do not have the right to opt out and the ATOL holder will be charged £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.

2.29 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 fulfil the contract and fail as a consequence then the CAA acting for the Trustees of the Air Travel Trust will ensure consumers are protected. About 20 per cent of Monarch’s passengers were ATOL protected and received either support to continue their holiday and a replacement flight home if they were abroad at the time of the failure, or a refund of their tickets if they were yet to fly.

2.30 One of the key benefits of the ATOL scheme is its simplicity for passengers. Passengers can book a protected holiday from a licence holder safe in the knowledge that should the organiser or any of the suppliers become insolvent, someone will ensure they can complete their holiday or if they are yet to travel they will receive a full refund. Perhaps one of the greatest drawbacks to the scheme is its lack of universal coverage and the difficulty passengers appear to have in understanding whether or not their flights and holidays are protected. Although certificates are issued detailing protection, it is unclear whether passengers fully understand the arrangement and the extent to which they are protected or not.

2.31 Another criticism often levelled at the ATOL scheme by some industry participants and one that was repeated in responses to the Call for Evidence, is its unsophisticated approach to pricing risk. The CAA undertakes several measures to ensure a risk-based approach, such as more onerous licensing conditions for new entrants and those at greater risk of insolvency. However, although discounts have historically existed for those operating through an accredited body, for most holidays all risks are charged at the same rate. This blunting of price signals where weaker companies with greater likelihood of failure are priced at the same rate as stronger companies with lesser risk, is regarded by some to distort the market.
and by others to be a virtuous simplification of an otherwise potentially complex system. Further discussion of these points is taken up in more detail later on.

Card payments

2.32 Payments made by cards are underpinned by a complex series of relationships that enable cardholders to make payments to retailers. This chain of relationships means that the bank or other institution that issues the card to the consumer does not have a direct relationship with the merchant or retailer from whom the consumer purchases goods or services. Merchants/retailers have service agreements with acquirers to process payments on their behalf and provide the infrastructure to do so (terminals etc). The acquirer passes details of transactions to the card issuer via a card scheme (e.g. Visa, Mastercard, American Express) who organises and controls the operation and clearing of transactions according to their scheme rules. Importantly it is the acquirer who has the relationship with the merchant retailer and not the card issuer.

2.33 Under Section 75 of the Consumer Credit Act 1974, credit card issuers are jointly 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. Cardholders are thereby able to claim a refund of all personal losses and any applicable consequential losses from their card issuer. There are limitations: cover is limited to personal loss by the card-holder, potentially excluding losses of others within a booking; and protection depends 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 payments consumers make to agents as the contract is not with the airline directly.

2.34 There is an additional non-statutory scheme called Charge-Back, which forms part of the rules of the card scheme, to which the issuer and acquirer as members of that scheme are bound. This mechanism allows the card issuer to reclaim a refund of the purchase amount in a number of circumstances, including if the goods or services are not received, if the company has gone into liquidation or if the goods or services turn out to be faulty, counterfeit or defective.
2.35 Consumers who pay an airline direct with a participating debit or credit card, may request their card issuer to reimburse them for a disputed transaction. This would include the failure of an airline to honour a contract of carriage due to insolvency, provided the consumer meets certain timescales. Other payment services such as PayPal provide similar arrangements.

2.36 In normal circumstances, the issuer would re-charge the transaction to the acquirer which would seek to recover this cost from the retailer, but in the case of insolvency that loss would reside with the acquirer.

2.37 Responses to the Call for Evidence recognised the role and importance of these protections, but many noted the inconsistency with the Review’s principle of efficient risk allocation. The card issuers claim they are generally ill-equipped to manage the risk of airlines as they do not have the individual relationships or access to information that would allow them to do so. Acquirers have a cautious view of the airline industry and some refuse to operate in the market given the risks of insolvency, whilst others set their charges and collateral requirements to reflect this. Often acquirers will not release some or all customer monies to an airline until very near the date of a flight to reduce their exposure to the risk the airline becomes insolvent and the consumer requests a refund. In this context it has been suggested that removing the risk to card issuers and acquirers will likely result in more competition to provide an acquirer service to airlines. This in turn would likely lead to a reduction in fees and charges to airlines and their customers. Were this in contemplation, it would also be necessary to consider whether alternative sources of protection were adequate.

2.38 Moving the management of airline insolvency risk to actors better able to actively manage it, or alternatively more clearly identify the order in which the various existing overlapping protections are to be called upon, may result in savings to the passenger as financial services companies react to the new risk profile of this area of their business. Equally the inertia in these markets may mean that such efficiencies are not realised. In addition the development of new business models and payment systems may mean the significance of credit card protection is diminished as ever greater market share is captured by new alternative electronic payment methods such as PayPal. We will be especially interested in hearing more about this issue.

Insurance

2.39 Insurance products to protect against the failure of airlines are currently available to both consumers and businesses. Consumers have the opportunity to include supplier failure insurance in their travel insurance policy. 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.

2.40 Responses to the Call for Evidence were mixed in their views on the quality and effectiveness of insurance. Many in the travel industry, the main user of Scheduled Airline Failure Insurance products, expressed concern that the market was not resilient and that most policies enabled the withdrawal of cover at short-notice.

2.41 Personal travel insurance that travellers can purchase either for a single trip or as part of an annual multi-trip
policy can also offer supplier failure insurance, which could offer protection in the event of an airline insolvency. However, these products are designed primarily to protect passengers against medical costs encountered when travelling. Although this element has been broadly standardised across the industry, the terms of supplier failure cover vary from policy to policy, often with specific exclusions that make it difficult for consumers to understand whether or not they are covered.

2.42 Finally, some respondents to the Call for Evidence also set out the current limited numbers of consumers choosing to take out these policies and the small proportion thereof that actually include supplier failure cover. In combination, these factors mean only a minor proportion of the flying public has personal insurance cover against airline insolvency. Such a position even with renewed efforts at publicity and awareness raising may make it difficult to place reliance solely on such measures to provide adequate consumer protection against airline insolvency.

Other measures

2.43 There are other schemes and measures in place that may help passengers of insolvent airlines, including International Air Travel Association (IATA) rescue fares and its Billing and Settlement Plan (BSP). The BSP is a system designed to facilitate and simplify the selling, reporting and remitting procedures of International Air Transport Association (IATA) Accredited Passenger Sales Agents, and may allow IATA to reimburse travel agents for moneys submitted to an insolvent airline under certain conditions.

2.44 Rescue fares are a voluntary offering from the airline industry via groupings, such as IATA, whereby members offer lower repatriation or ‘rescue’ fares to passengers of a failed airline. The terms of such arrangements are by their nature voluntary and leave a lot of understandable uncertainty as to what will actually be provided in any given case. Such fares are typically subject to availability in any event. Many respondents to the Call for Evidence noted the efficacy and cost-effectiveness of such systems citing failures in the past where passengers were almost exclusively
catered for by such a system. However, other respondents cite the lack of clarity in how passengers are supposed to access such fares and the uncertainty of their availability as factors which militate against placing reliance on them to ensure passengers are adequately catered for.

**Existing landscape succeeds in protecting some but not all**

2.45 From the discussion above it is clear that the current protection landscape is uneven, does not apply to all passengers and can often be duplicated for individual passengers. The nature and extent of protection is heavily dependent upon the route by which a consumer purchases an air ticket and as a result is probably not understood by many passengers.

2.46 The cost of protection is sometimes not borne by the passenger but by the card holder (not always the same person) and with flat rate levies the costs of protection are often not risk based and lead to cross subsidisation. In effect, as many respondents have remarked, weaker companies are able to compete against stronger ones due to the failure of passengers or protection regimes to distinguish between the different levels of risk.

2.47 As such, and assessed against the Review’s four principles, it would appear that there is a prima facie case for simplifying and broadening the current regime. Many have recognised the need to simplify arrangements, at least as far as passengers are concerned; others have commented on the need to ensure any changes are risk-based and do not distort the market for air transport, not only in terms of distortion between UK and non-UK airlines but also in terms of distortion between airlines and travel agents selling the same product. It is also clear that not enough passengers are protected with sufficient certainty to remove the risk to taxpayers that historically has caused governments to spend millions on tackling the impacts of particular airline insolvencies. The next section of this report attempts to define what the Review considers should be the aim of any repatriation exercise.
3. Repatriation

What is a successful repatriation?

3.1 Generally when an airline becomes insolvent, without external intervention, the process is rapid and often without warning. The typical financial model of modern airlines is such that the majority have received a large amount of money from passengers expecting to fly in the future. This ‘unflown revenue’ can be substantial and may be several times readily realisable assets the company has available at any time.

3.2 Management teams can often be fighting a constant battle with financial backers to provide working capital, such that the coup de grace of a failing airline may be delivered suddenly when a backer withdraws support or management come to the conclusion that further sources are not likely to be forthcoming, or a significant creditor whose claims have been inadequately managed starts proceedings to recover what is owed. At this point the move from business as usual to insolvent is often measured in hours and days rather than weeks. Both Monarch and Air Berlin failed when they still had the financial resources to continue flying for several weeks more. However, they had both reached the point where the directors’ legal duties rather than a lack of cash meant they saw no reasonable prospect of continuing.

3.3 In these circumstances aircraft lessors’ desire to ensure their multi-million-dollar assets are secure, combined with administrators’ duties to protect creditors’ interests by (amongst other things) securing the aircraft lessors’ assets, mean the flying programme is curtailed immediately. Often the entry into administration is timed to coincide with the point in the schedule where the majority of an airline’s aircraft are either at or heading to their home bases.

3.4 All passengers of a failed airline will be faced with the financial problem of replacing the service they will no longer receive and the potential of other consequential losses if this cannot be achieved. Those who are aboard at the time will additionally have the problem and distress associated with the loss of an immediate return leg of a journey they are only part way through.

3.5 For the purposes of this report ‘repatriation’ refers to flying these passengers back to where their outbound leg started. As set out in the Call for Evidence, the Review’s focus will be on passengers whose journey starts in the UK and so require repatriation to the UK.

3.6 Without trying to calculate the emotional and welfare toll of such a predicament, calculating the financial impact alone of replacing a flight in such circumstances is difficult and depends on
a range of factors, including the time of year, the size and schedule of the failed airline and the levels of alternative capacity in the market.

3.7 In many circumstances, for example on well supplied routes, passengers will be able to book alternative flights with other airlines operating at or around the same time as their original flight. However, as is set out in further detail below, many airlines are of such scale that the immediate removal of their capacity from the market would make such an approach impractical within reasonable timescales acceptable to consumers. Even in a
situation where there are enough spare seats on some routes, there may still be some destination’s where this would not be the case as the airline was the predominant or only carrier. In such cases financial impacts let alone wider considerations may be considerable. They will be driven by expensive replacement flights during a period of scarce supply and high demand, as well as the potential consequential costs of needing additional accommodation and subsistence.

3.8 Historically in these circumstances Governments have chosen to act. Usually they judge that the impacts on their citizens’ welfare coupled with wider considerations such as transport connectivity and employment, are more effectively tackled by taking measures in advance of failure rather than reacting after the event. Both the British and German governments came to this conclusion last autumn, though they employed different methods.

3.9 For these reasons the Review is of the opinion that no one-size-fits-all solution is suitable for every airline insolvency. Rather regulators, passengers and industry should avail themselves of a toolkit of options, deploying each response as the situation requires. We consider such a toolkit is made of three elements that can be used to repatriate passengers when an airline fails, individually or in combination. Figure 6 illustrates the elements that make up this toolkit but in summary they are:

- **Self-Organised repatriation**, where the passenger makes arrangements to book his or her own replacement travel.
- **Organised Charter**, where the airline’s flight services would be replicated with chartered aircraft for a short period until the market can provide sufficient capacity to cope with the demand for services.
- **Keeping the fleet flying**, in an orderly wind-down, where the airline’s flight schedule would continue using its existing fleet and resources for a short period until the market can cope with demand.

3.10 Responses to the Call for Evidence and discussions at the public evidence sessions broadly agreed that these are the three elements of a repatriation toolkit:

- **Keep the Fleet Flying**
  - All sizes of fleet
  - Low but uncertain cost
  - High risk of creditor action

- **Organised Charter**
  - Fleet availability variable
  - Potentially up to 60 Aircraft
  - High but certain costs

- **Self-Repatriation**
  - Small fleets with low market share
  - Rescue fares could keep costs low where available

Figure 6: Elements of a Repatriation Toolkit
options available and that each is only suitable in certain circumstances. There was a general recognition that the ideal solution for passengers was to keep the fleet of the insolvent airline flying as it would ensure the least amount of disruption to passengers’ journeys. However, given the costs and risks associated with this it was also recognised that alternatives are useful depending on the circumstances.

**Who leads the operation?**

3.11 One of the key questions arising from stakeholder responses to the Call for Evidence is who should play any central organising role. Many respondents cited the critical function the CAA plays in both licensing and managing organisational aspects ahead of a situation crystallising, including negotiating (in confidence) with third party airlines, as well as ensuring safety, which led them to believe the authority is uniquely placed to run a repatriation operation for a UK registered airline, this may be the case also for non-UK airlines from an operational perspective, while accepting that it will not have the same insights and access to information. The CAA could leverage its relationships and use its central role to act as a convening authority.

3.12 Many respondents noted how the CAA’s proximity with Government, means that many actors would be more willing to engage with the CAA than another commercial operator e.g. an insurance company. In particular when keeping the fleet flying, many creditors and service providers may take greater confidence that they will be paid if the whole operation has the implicit backing of the UK Regulator. This government support is also cited as a key factor in resolving diplomatic tensions with other countries, especially where the aviation industry is more heavily state influenced than in the UK.

3.13 However, CAA or Government ownership of any repatriation operation is not the only possible model. Private operators can act in the same capacity to coordinate and organise a repatriation operation if suitably funded as was the case with Paramount Airways in 1990. A number of tour operators sought
collaboratively to run the airline through a period of its administration to continue services during the summer peak period that would have been otherwise impossible to source.

3.14 Airlines themselves are also possible actors, in particular groupings like International Air Transport Association (IATA) have stressed the services they maybe able to offer under their Billing and Settlement Plan and Rescue Fares concept that could be fundamental elements in any self-repatriation exercise. Given the industry’s unparalleled understanding and control of alternative services, any self-repatriation exercise is arguably as well led by the airline industry itself as by Government or the CAA.

3.15 However, responses from airlines have made clear that many do not believe that they are well-placed to co-ordinate, make preparations for, or lead any such repatriation exercise, though they are able to offer adhoc resource reactively and advice to assist someone else. Partly this is due to the competitive tension between airlines making cooperation in advance of a failure difficult as the degree of preparation required may be considerable and airlines may have competing interests in securing their positions vis-à-vis the resources or routes of the failing competitor.

3.16 An industry led response would also be difficult due to the fact that no individual airline typically has the ability to replicate a failing airline’s fleet, necessary skill set and other resources, without compromising their ongoing ‘business as usual’ operations. However, across the industry pooled resources supplemented where necessary and led by a non-partisan figure or group may make industry participation possible and operationally viable.

3.17 Airlines and their associations have argued that they are able to respond to external events such as the failure of a competitor by providing spare seats and offering special lower fares in recognition of the distressed situation. They will be best placed to be able to add extra capacity from within their own operational fleet, such as upgrading aircraft size or...
increasing frequency, or by bringing in external capacity. They may also have useful existing established channels of communications to which passengers can be directed, for example websites, call centres, ticket desks and social media accounts. We therefore believe there may be scope for airlines to share responsibility through collaborative working with or without government leadership.

3.18 The following sections of this report explore each of these options, when they might be deployed, limits to their use and their advantages and disadvantages, as well as considering who would be best placed to organise and run them. The analysis that follows is without prejudice to funding any such arrangements which is handled in a later section.

Self-Repatriation

3.19 This option relies on passengers booking themselves onto available alternative scheduled air services or other means of transport and organising any necessary additional accommodation. This is the default position for many passengers currently who travel without the protection offered by a tour operator or the ATOL scheme.

Rationale for Self-Repatriation

3.20 The rationale behind Self-Repatriation is one of efficiency and putting the emphasis for organising the response to an airline insolvency on the very person that stands to gain most from the repatriation effort – the passenger.

3.21 It is ideally suited to situations where passengers are spread between many destinations abroad in small numbers or where inbound load factors are such that wet-leasing capacity or running the insolvent airline’s fleet in administration is not financially efficient. This option has been used successfully in many smaller insolvencies in the past, either with the CAA or tour operators helping their passengers to find alternative flights, or passengers themselves booking replacements. In the modern digital age large numbers of travellers will have access to the internet and a wide selection of booking sites in their pockets. This option has therefore become very much easier to use and consequently applicable to a wider range of cases.

3.22 However, in certain situations the scale of an insolvent airline’s operations may mean that, regardless of how easy it is to book alternatives, there may be none available within acceptable time scales. Larger airlines may represent such a high proportion of flying over certain routes that the loss of their capacity will, initially at least, result in more passengers seeking flights than are available.

Delivering Self-Repatriation

3.23 It is possible to see a correlation between an airline’s market share and the feasibility of self-repatriation. It would probably be safe to assume that on one of the world’s busiest routes such as New York to London there would be the most scope to find alternative capacity. Figure 7 shows that even for airlines flying between New York and London the higher an airline’s market share, the less likely it is that spare capacity will be available for all its passengers in the event of its demise.

3.24 For example, assuming every passenger still wished to fly, it is possible to see from the data that should British Airways’ capacity on the New York – London route be withdrawn, in the immediate aftermath there would be nearly four passengers chasing each available seat on other airlines. In fact for any airline on that route representing 13 per cent or more of the market there
would be more passengers than seats available. Clearly not all passengers would need repatriation. While some may be looking for a return flight back to the UK others may be based in the US with the lost journey being the outbound leg of their trip and therefore not a repatriation in our definition. Whilst we have yet to analyse data on this factor, a plausible assumption could be that the majority of passengers on UK registered aircraft would require repatriation to the UK. However, even if the number of passengers needing repatriation was only 50 per cent of the total, effectively halving the number of passengers requiring a seat, it can be seen that self-repatriation would not be possible for all passengers if an airline the size and profile of British Airways were to fail.

3.25 Another possibility for passengers in the extreme scenario outlined above is that self repatriating passengers are not constrained to fly the original chosen route; they could conceivably travel to and from alternative airports, or via connecting services. Figure 8 shows the impact of adding the additional capacity available within a 200-mile radius of New York to any airport within the UK. Though the position is improved such that the passengers of most airlines could be accommodated on alternative capacity, passengers of an airline the size and shape of British Airways, even if we assume only 50 per cent were self-repatriating, would still not be fully catered for.

3.26 This picture does not radically change if we add the USA’s other main hub airports and assume the availability of connecting flights (Atlanta, Dallas/Fort Worth, Los Angeles or Chicago). We have not tested the myriad of options available through other European hubs and consider that ultimately for the world’s most heavily trafficked route between the US and Europe it would be possible to find enough capacity on existing services to fly people...
home. However, what is clear is that doing so after the failure of some airlines with large amounts of market share would be more difficult, costlier and potentially involve several surface and air connections as well as additional accommodation. This would make it a very unattractive prospect for consumers who may not have the financial and technical capability to put together such a complex replacement itinerary at such short notice, or for whom the delay entailed would be costly.

3.27 The analysis above demonstrates that the feasibility of Self-Repatriation even on one of the most generously catered for routes in the world, depends entirely on the market share of the insolvent airline. To demonstrate how much more difficult it could be we have also analysed a perhaps more common scenario for UK passengers – a short haul flight to a summer sun destination in Europe, the Greek island of Kefalonia.

3.28 In this scenario the feasibility of self-repatriation will not only depend upon the market share of the airline concerned but also the period of the year in which the insolvency event occurs. Figure 9 below shows the relationship between time of year and the feasibility of self-repatriation for airlines flying between the UK and Kefalonia. During the low season, many of the major operators will not fly at all to the summer holiday destinations, such that repatriation would not be necessary in the event of insolvency. However, for most of the year their market share and high load factors mean that self-repatriation would not be feasible for the majority of passengers, without significant additional surface or air connections and accommodation.
3.29 Although this example is at the more extreme end of the spectrum of destinations, being an island resort with only three main providers of air transport to the UK, it shares key characteristics with most holiday destinations in Europe. Other popular holiday destinations on mainland Europe will have a greater variety of provider or alternative airports within feasible surface connection distance or some alternative rail and ferry routes. However, the scale of impact is likely to be of the same order of magnitude with over six and up to ten passengers chasing each available seat for large periods of the peak season.

3.30 It is worth noting that there is a finite ferry and rail capacity across the channel such that, in the case of Monarch with a medium size fleet of 30 aircraft, the Government felt that even assuming passengers could get to the channel ports there would not be enough capacity to accommodate all and prevent additional accommodation and costs. Also unlike the New York example above, for these holiday routes nearly all passengers will be based in the UK and require repatriation. Finally, there are also geo-political factors to consider, with the nearest alternative airport for some holiday destinations requiring land transport through regions where the Foreign Office advises against unnecessary travel.

3.31 From this analysis it is therefore possible to draw the conclusion that self-repatriation is a viable option for airline failures of a certain size, operating particular routes and at specific points in the year. Existing practice and experience has demonstrated successful application of this approach in the past and current voluntary schemes such as IATA’s rescue fare offering are welcome features that, when available, help enable this option.
3.32 However, there are limits to its applicability if considerable amounts of passenger detriment, both financial and welfare, are to be avoided. In addition, it will almost always be difficult to predict with any certainty the exact numbers of passengers that can be repatriated and at what cost in terms of time, money and welfare. This uncertainty would weigh heavily on both passengers and their government. In particular in cases where confidence that capacity would be sufficient is limited, the need for government intervention may be unavoidable.

**Improving the ability to deliver Self-Repatriation**

3.33 Critical to the success of this option is ensuring that passengers are able to access available seats where they exist. Some responses to the Call for Evidence have told us that, thus far, there is no clear and corroborative evidence to support the claim that Rescue Fares are able to offer a complete and resilient consumer protection solution to airline insolvency. Some argued that there is limited clarity or consistency over how passengers are to access such fares, the terms on which they are made available and the approach to pricing.

3.34 As such, in the situations where capacity is available, improvements to the offering could be made to instil greater confidence in the system. We are interested in exploring with the industry ways in which the ‘Rescue Fare’ offer could be better standardised across carriers and improved to give passengers and Government greater confidence in availability, pricing and access to co-ordinated or centralised booking systems with a single consumer entry point. In addition we are interested to see the scope for greater collaborative working between airlines and Government.

3.35 Another factor critical to passenger confidence in Self-Repatriation is the availability of immediately accessible funds. Without this many passengers may find it difficult to participate in a Self-Repatriation and may seek Government assistance. Whilst how funding is generated is handled later, there are still questions of how funding from the sources discussed reaches passengers self-repatriating in a timely manner. We will wish to explore the options further, including temporary increases in card limits, refunds and advances from central funding sources and direct payment to suppliers from funding sources.
Organised Charter

3.36 Where alternative capacity is not sufficient within other scheduled airlines’ operations to guarantee desired outcomes for passengers, the next option to look to in the insolvency toolkit is to organise a charter operation to replace the lost capacity. Hiring the required aircraft and crew to replace those lost by the insolvency of the airline can provide capacity in addition to or instead of that available on other scheduled services. The operation mounted in response to the failure of Monarch is an example of Organised Charter.

3.37 Organised Charter can also be deployed in a hybrid combined with self-repatriation. This could be the case with a larger airline where there would never be sufficient availability to provide a complete solution, but could be deployed in smaller numbers on denser passenger routes, leaving passengers on lower density routes with other transport options to Self Repatriate with assistance.

Delivering Organised Charter

3.38 The key benefit of an Organised Charter operation is the security of having a high level of confidence in the ability to supply and control aircraft to deliver a flying programme. The organiser contracts with third parties to deliver the air transport capacity and does not need to rely on others to deliver a programme. Just as with Self Repatriation such an approach breaks the link between the insolvent airline and its passengers such that passengers are no longer vulnerable to the actions of creditors or suppliers to the failed airline and thus more certain they can complete their journeys.

3.39 One of the biggest limiting factors to a successful Organised Charter is the availability of aircraft in a highly seasonal market, whether that be summer holiday peaks, or other demands, such as Hajj. In the US, a significant factor is also the US military and the demands they often make on civil aviation, particularly in periods of tension.

Wet Leasing

Given the high capital cost of maintaining and running aircraft, scheduled airlines rarely have large numbers of spare aircraft or crews. Instead they often make use of third party ‘on demand’ airlines to cover their adhoc requirements. These ACMI (aircraft, crew, maintenance and insurance) arrangements are often referred to as wet leasing, and are used for various tasks such as replacing an aircraft that has been taken out of service unexpectedly, cover late new aircraft deliveries or gaps left in the schedule through regular maintenance.

Wet-lease companies need to recover the capital cost of the aircraft and the down time for both aircraft and crew in between contracts through their pricing structures. As such chartering these wet-lease aircraft is expensive when compared to self-managed fleet running costs. However, the wet lease market provides an important safety valve in aviation capacity terms, although availability is very seasonal and driven by varied external factors such as disaster relief, troop movements and religious festivals. During the summer and other peak periods there is often very limited capacity available.
3.40 To attempt to replicate a failed airline’s flying programme, a critical mass of aircraft must be secured as a precaution well in advance of a potential failure, to ensure same-day repatriation, whether the failure then materialises or not. The ability to muster sufficient aircraft provides the platform on which planning can take place for their use, and where required, they can be positioned at short-notice into the theatre of operation ready for immediate use.

3.41 The ability to achieve a critical mass of third-party aircraft is chiefly determined by two factors: the scale and nature of the airline being replaced, and the availability of aircraft on the market.

3.42 The failing airline’s fleet and size coupled with the number of passengers requiring repatriation will determine the aircraft requirement. The requirement for aircraft may not be identical to the fleet being replaced as consolidations may be possible particularly for short haul operations, as several narrow body aircraft could potentially be replaced with fewer wide body aircraft. Understanding this minimum requirement or ‘critical mass’ to replicate the flight program is fundamental to a successful operation. Figure 10 shows how the fleets of some of the most significant short haul operators into the UK could have their narrow body fleets consolidated and gives a sense of the potential required critical mass of aircraft that would need to be pre-secured.

3.43 In addition to consolidating smaller into larger aircraft, it is likely that on some routes fewer passengers could require repatriation than were originally booked, further increasing the potential to consolidate the flying programme. This is true for example, where passengers who have not yet begun a the journey, choose not to take the flight and seek a refund of both legs instead. For short haul operations during holiday season the flow of passengers is likely to be 90 per cent or higher holiday-makers outbound from the UK and hence nearly all passengers will require repatriation. For longer haul airlines the flow of passengers is likely to be more balanced and therefore the proportion of passengers requiring repatriation is likely to be nearer 40-60 per

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**Figure 10: Fleet sizes and potential critical mass of key short haul airlines operating into the UK**

<table>
<thead>
<tr>
<th>Airline</th>
<th>Fleet Size</th>
<th>Narrow Body Aircraft</th>
<th>Wide Body Aircraft</th>
<th>Critical Mass</th>
<th>Average</th>
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<tbody>
<tr>
<td>Jet2</td>
<td>83</td>
<td>83</td>
<td>–</td>
<td>52-60</td>
<td>56</td>
</tr>
<tr>
<td>Thomas Cook</td>
<td>43</td>
<td>35</td>
<td>8</td>
<td>28-32</td>
<td>30</td>
</tr>
<tr>
<td>TUI</td>
<td>57</td>
<td>42</td>
<td>15</td>
<td>40-46</td>
<td>43</td>
</tr>
<tr>
<td>British Airways</td>
<td>293</td>
<td>190</td>
<td>103</td>
<td>210-250</td>
<td>230</td>
</tr>
<tr>
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<td>14</td>
<td>15</td>
<td>15</td>
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<td>436</td>
<td>436</td>
<td>–</td>
<td>278-298</td>
<td>288</td>
</tr>
</tbody>
</table>

Source: CAA
3.43 The cost of chartering an aircraft can vary significantly depending on route and carrier. It should be noted that these estimates are for a one-way operation back to the UK, flying passengers both ways would increase the complexity of the operation and possibly the aircraft requirement.

3.44 North America and Europe provide a higher concentration of on-demand airlines, with smaller numbers elsewhere, including the Far East. Currently the CAA has partnerships with 11 North American and European airlines with over 60 aircraft available to charter through these partnerships. However, it is very unlikely that all of those aircraft would be available at any one time. This capacity could be further augmented through additional arrangements to access aircraft from other airlines on an ACMI/wet lease and spot market charter basis. Further aircraft could be charted from schedule airlines.

CAA pre-secured capacity and the Monarch experience

As part of its work to prepare for an airline insolvency and deliver protection to ATOL protected passengers, the CAA has developed a capability to pre-secure on demand aircraft from various suppliers. The ability to pre-book aircraft when the threat of an insolvency looms is a key element of ensuring capacity is available. Agreements provide certainty of most costs allowing greater accuracy of estimates and forecasting and include the ability to hold aircraft on a less expensive standby rate for a given period – offering something akin to an insurance premium that the capacity will be available.

Turning that pre-agreed capability into an operational flying programme requires several elements in addition to the commercial agreements, many of which were highlighted by the Monarch experience. Critical to the whole operation is a reasonably accurate prediction of when the pre-booked aircraft will be required. Advanced warning will help ensure capacity is available. Beyond this, around a weeks notice is required to ensure that if activation becomes necessary, the airlines can start to prepare itineraries, vet airports and be ready to position aircraft.

Advance operational understanding of likely routes, numbers of passengers etc. gained through advance access to information from a potentially failing airline is therefore of crucial importance. However, even where this is possible it carries with it significant risks that knowledge of an impending insolvency gets into the public domain and so preparation for a failure can actually trigger the failure.

The CAA’s preparations were tested in earnest in the early autumn of 2017 and with hindsight it is possible to identify the elements that were critical in effecting this successful Organised Charter operation:

- proximity of the regulator to the airline and the developing circumstances; including collaboration between both parties, access to vital passenger information and flight plans to facilitate advance planning;
- advanced commercial, operational and confidentiality arrangements with third-party airlines to enable pre-securing of capacity, and prepare operational management
- pre-positioning and advance executions of flight operations
Looking at the Monarch operation that occurred in the shoulder period at the end of the summer peak season, the CAA managed to pre-secure a total of 25 aircraft through their pre-existing commercial agreements. An additional 24 aircraft were sourced post-failure to augment and then replace aircraft as they were returned. Drawing upon the CAA’s recent experience and work to improve access to the charter market, our assumption is that capacity for such operations is likely to be able to replace no more than 60 aircraft with an average load of 202 seats. The Monarch operation is considered a stretching and ambitious use of this capability due to its scale, complexity and difficulty. Moreover, as can be seen from Figure 11 below this capacity is very seasonal dropping away significantly over the summer months.

From Figure 11 it is also possible to see that at no time would it be possible to contract enough aircraft to cover the requirement of a failure of an airline the size of Ryanair, easyJet or British Airways. As Figure 11 shows, within the period shown, during May, June and October only, it is expected to be possible to contract sufficient charter capacity to cover the needs of an airline the size of Jet2, Thomas Cook (UK), TUI (UK) and Virgin Atlantic. Therefore during the peak season – July, August and September – other solutions would need to be found to protect passengers of almost all the key UK airlines.

### Improving the Delivery of Organised Charter

We believe up-scaling the Organised Charter model described above will be realistically limited to circa 60 aircraft within the peak periods. This is based on the assumption of an ability to muster pre-secured aircraft in the order of 25-30 mixed wide and narrow body units, plus an additional 30-35 aircraft from the spot market – mainly narrow body units. Such an increase would only be achieved through close collaboration with the aviation industry. This aspect will be considered further in the next phase of our work.

Figure 11: Organised Charter would only be suitable for a proportion of airlines

![Figure 11](image-url)
3.48 As indicated above a hybrid operation in which organised charter and Self Repatriation using existing scheduled services are both deployed may be feasible. In this model, available chartered aircraft would be designated to denser routes, while less dense routes would be reliant on Self Repatriation arrangements within existing scheduled airline services. Taking this one step further we consider there is scope to apply such a hybrid approach to airlines with a larger fleet if there was the ability to differentiate between passengers due to travel home to the UK and all other passengers. However, there are clearly limits to this approach that mean several airlines currently operating to the UK might not be adequately covered by these methods in any scenario.

3.49 The growing multinational multi-jurisdictional nature of UK aviation and integrated travel groups across Europe, with multiple Operating Licences and Airline Operator Certificate (AOC) whether with or without defined operating units in each State, makes the ability to plan and execute an organised charter operation more complex. How a potential insolvency situation develops within such complex structures will involve many regulators, each of whom may have their own plans on how to intervene to protect consumers, whether broadly on the lines an Air Berlin or a Monarch model.

3.50 It is unclear whether the UK would be able to act on its own; indeed, we consider this aspect is of crucial importance and at its centre there is a strong need for collaborative working and transparency between regulatory bodies, both at State and EU level. We believe an agreement under which these issues are set out and managed will be essential to improve consumer protection outcomes in the UK and across Europe.

Keeping the fleet flying in an orderly wind-down

3.51 In the Call for Evidence document we suggested that there might be some situations where it could be necessary or preferable to keep the fleet of the insolvent airline running for a short period in administration. Indeed, given the limitations in the numbers of charter services that might be available at any time, this may be the only viable option for dealing with the failure of a large airline with an extensive network of routes, or a substantial failure in the peak holiday season. The continuation of services would be needed to meet the immediate travel needs of passengers until there is sufficient capacity in the market to cope with the demand. In responses many stakeholders noted their preference for this method of effecting a repatriation, though many also noted the significant difficulties associated with it.

Rationale for keeping the fleet flying

3.52 The intent, as set out in the Terms of Reference for this Review, is to look at 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 broad aim would be to maintain the airline’s flight schedule using its existing fleet and resources for a short period until the market can cope with demand. The rationale behind this is that the airline is possibly best placed to repatriate it’s own passengers, as it should already have the capability and means to do so.

3.53 On the face of it, there could be a number of benefits to this approach, if it can be delivered effectively. In theory, it would allow the continuity of services using the existing fleet, and thus place less
reliance on both the ability to secure charter services from third party providers, which may not be achievable above c. 60 aircraft, and available capacity on alternative scheduled services. It is dependent on the continuation of key licenses, critical post holders and other functions (including crew, IT, safety etc.) at a difficult period in time for staff. If achieved this would help to minimise some of the upfront challenges and costs of organising a repatriation. In turn, this could provide a better outcome for the consumer, ensuring there is sufficient capacity to get them home and simplifying the booking and claims process. It might also avoid the need for government to intervene, assuming some of the challenges with this approach can be resolved.

**Delivering an orderly wind-down**

3.54 There are a number of significant financial and operational challenges which could prevent or hinder the continued operation of an insolvent UK airline. In our exploration of this option, we will need to consider how the various challenges may be overcome or mitigated.

3.55 The operation of any airline requires several key elements to be in place, which are summarised in the box below. These elements are important, whether the airline is operating in administration or under normal trading conditions. The ability to keep a fleet flying is therefore dependent on the ability to maintain these elements in administration, as any disruption will potentially lead to delay, additional costs or even impede the operation entirely. There is therefore a significant risk that a successful repatriation using an airline’s fleet in administration will be hampered, unless there is widespread cooperation among several parties. This includes the management of the airline, the airline’s key suppliers and the airline’s major creditors including their financing partners, secured creditors and trade creditors (for example, fuel suppliers and ground handling suppliers).

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**Figure 12: Key elements for the operation of an airline**

*Trading essentials: The operation of an airline requires several key elements to be in place, including those below. For an airline to keep flying in administration, several parties would need to support the operation.*

**Airports**

Airport charges are levied on a range of services, including take off and landing. If charges are unpaid there is a risk an airport may seek to exercise a lien and impound aircraft.

**Aircraft Lessors**

Most airlines have several leases for their fleet, including for airframes and engines. These leases may include termination clauses for cases of default.

**Air Traffic Management**

Airlines need to pay for their use of air traffic services. ATM bodies (e.g. Eurocontrol) may seek to detain an aircraft for unpaid charges.

**Employees**

Several key personnel would need to be in place to ensure the smooth and safe operation of an airline in administration.

**IT and Data**

The continued access to IT and data systems and suppliers, both external and internal, are essential to the running of an airline.

**Other essential suppliers**

Including fuel suppliers, ground handling and maintenance and repair (MRO). They may seek to withhold supply for unpaid bills.

**Insurance**

Several policies will be in place to cover potential risks and liabilities as an airline and a business. These may include termination clauses.

**Regulatory compliance**

Airlines will need to maintain an Air Operator Certificate and Operating Licence, and comply with other regulatory requirements.
3.56 If there is a willingness amongst key parties to cooperate, then operating an airline in administration to support a repatriation programme becomes a more viable and deliverable option. However, it is not clear that this would best serve the interest of all the parties whose cooperation would be required. A degree of coercion may therefore be required. We will consider opportunities for ensuring such cooperation as part of this Review.

3.57 It might be possible for the repatriation services to be carried out by the airline itself, through a court appointed administrator, by the directors under a debtor in possession regime, or by a receiver or other agent of the creditors. While there are several precedents overseas where airlines have continued to operate in administration, these tend to be used to support a rescue or restructuring process, rather than just for repatriation purposes, and they are often facilitated by debtor in possession bankruptcy regimes. For example, in the United States of America, airlines in financial distress can file for protection under Chapter 11 of the US Bankruptcy Code. The primary objective of Chapter 11, like UK administration, is to rescue the business, though the methods by which the “rescue” is achieved are quite different. In Chapter 11 the directors, rather than an administrator, remain in control of the airline, and there are protections from creditors and access to mechanisms (including finance) to restructure the business. Arguably, these elements help to support the continuity of service using the airline’s existing infrastructure.

3.58 The failure of Air Berlin in Germany provides a recent example where a large airline has been able to continue running its fleet in administration, while the company was being restructured and ultimately wound down. This provides some useful lessons on the key elements that might help to support the orderly wind-down of an airline. These key elements are summarised below and are discussed in more detail in the Air Berlin case study:

- Availability of sufficient working capital, which allowed the airline to continue operating for a prolonged period in administration.
- A temporary airline operator licence, which ensured the airline could keep flying.
- A favourable administration regime, which supported a “debtor in possession” approach and allowed the existing business to continue operating in administration. This supported the continuation of key elements for the operation of an airline, including supplier and employee contracts, insurance and licences.
- A restructuring plan was agreed at the outset, which had support from key creditors and a reasonable prospect of value realisation. This forbearance of the creditors allowed the airline to continue largely unhindered by creditor action.
- Consumer money was held in escrow accounts, until flights were delivered which helped to maintain consumer confidence.

3.59 Overall, this enabled Air Berlin’s directors to keep operating the airline’s own aircraft until 27 October 2017, and operating services through other carriers until the airline was finally wound down in January 2018. This approach removed or reduced the detriment for many passengers, allowing them to continue flying. It also enabled the sale of assets and the transfer of operations and staff to other carriers.

3.60 In the UK, the practice of operating an airline in administration is rare, though not unheard of. A few respondents to the Call for Evidence mentioned the example of Paramount Airways, a UK registered
Air Berlin Case Study

Air Berlin was a large German registered airline with a fleet of over 140 aircraft, which operated a range of short, medium and long-haul services. It entered administration on 15th August 2017 after Etihad, Air Berlin’s main shareholder, withdrew its financial backing for the loss-making company.

Faced with a sudden failure, the German Government agreed to grant a €150m bridging loan to Air Berlin, which was provided through a credit facility from the German public credit institution Kreditanstalt für Wiederaufbau (KfW). The purpose of the loan was to allow Air Berlin to continue its operations for a short period while it concluded ongoing negotiations to sell its assets before it exited the market. The German Government anticipated that the loan would be paid in full as it was secured against the expected proceeds from the asset sales, which had a reasonable prospect of value realisation.

The restructuring plan and loan were also agreed by a panel of key creditors before the company went into administration, which allowed Air Berlin’s Directors to continue trading and operating the airline in administration with lower risks of creditor action. This was also supported by an administration regime, which permits a debtor in possession approach to administration. The airline was still able to sell tickets to consumers during the administration period, however the money raised from these sales was protected in an escrow account until the service was delivered.

Air Berlin’s aircraft continued flying until 27 October 2017, and the airline continued operating services through other carriers until the company finally exited the market in January 2018. During that period the Directors managed an orderly wind down, completing the sale of several assets and the transfer of some operations and staff to other carriers. It has been reported that a proportion of the loan has been repaid, though the full amount may not be be recovered after a deal to sell parts of the airline to Lufthansa fell through.
Paramount Airways Case Study

The following case study is based upon evidence provided by ABTA in their call for evidence response.

Paramount Airways Limited was a UK registered charter airline operating flights between UK airports and destinations in the Mediterranean. The failure of the business in 1989 led to one of the only examples of an attempt to operate an orderly wind-down of a UK airline operation while in Administration. The wind-down was attempted in order to prevent an even greater detriment to consumers and the travel companies involved. While the Administration met its operational objective to keep customers flying during the peak summer period the costs and operational issues were very significant.

The reality was that an Administration Order from the UK Courts provided some protection from creditors, but it had a very limited effect on securing the unencumbered right to continue operating a flying programme. Airports and other key suppliers are detention creditors or effective monopoly suppliers and any standstill position on historic debts does not compel such suppliers to support future operators.

Insolvency practitioners seeking an Administration Order will only likely do so with sufficient funding in place to support the need to pre-pay key suppliers going forward and to meet all liabilities. This will then require those financing the Administration to fully fund operations that may already have been paid for in whole or part and, often, to settle historic debts in order to avoid detention of aircraft at airports. In the case of Paramount Airways, despite an Administration Order, it was necessary to go to court to have snowploughs parked around an aircraft at a UK airport removed. The aircraft was released, but the de facto detention power of such suppliers (including ground handlers and fuel suppliers) should not be under-estimated, particularly beyond the European Economic Area where these powers may be unconstrained by a UK administration order.

3.61 While there was some success in keeping the airline and its customers flying for a short period, we understand the costs and operational issues were significant. In particular, it highlighted the potential for creditors in the UK and overseas to frustrate the operation by detaining aircraft, and demanding payment for their release.

3.62 An orderly wind-down of an airline could in principle be agreed in advance of entering administration, which might reduce the likelihood that a creditor will act in this way. In practice, this is likely to require an agreement with all parties that could potentially frustrate the operation, which is untested and could be difficult. In theory a Company Voluntary Arrangement or potentially a scheme of Arrangement under the Companies Act could be used, but experience of these in the UK indicates that without the statutory backing of an amenable insolvency regime, to mitigate the many risks, in general it is not advisable to place reliance on such an approach.
3.63 Such a statutory regime could provide a temporary stay from creditors and facilitate the continuation of key suppliers and services. This might include the use of the airline’s existing fleet of aircraft, services and key personnel. This is discussed further below.

3.64 The failure of Paramount Airways and the recent collapse of Monarch Airlines, have also highlighted the challenges faced by office-holders appointed to oversee the insolvency of an airline. Their primary duty in a UK insolvency procedure would be to return funds to creditors either through an orderly wind-down or sale. Any additional tasks to keep operations running in support of a repatriation may be inconsistent with this duty. This is because the costs of running an airline can be significant and are likely to make the airline’s financial position worse with every additional flight. Some respondents to the Call for Evidence suggested that insolvency practitioners may be reluctant to take on the additional tasks of operating an airline in administration without substantive assurances over funding and risk liabilities.

Improving the ability to deliver an orderly wind-down

We consider there are two broad areas of development that may help to create an environment where a UK airline could continue to operate in administration as part of an orderly wind-down. The first relates to insolvency rules and the ability to create an insolvency regime that is better suited to an orderly wind down of an airline. The other is the UK’s regulatory framework for air operator and safety licensing, and whether this could be enhanced to provide better oversight and control of the situation.

Insolvency rules

3.65 We are aware that the Insolvency Service are currently undertaking a review of the UK’s Corporate Insolvency Framework. They have already consulted on whether the UK’s regime needs updating to improve the efficiency of the rescue and restructuring tools available to companies in the UK. This included the following proposals, which might help support the running of an airline while in or in the approach to administration:

- provisions to make it easier to maintain contracts, including supply contracts, that are essential for the continuation of the business; and
- provision for a pre-insolvency creditor moratorium for distressed businesses in some circumstances.

3.66 We will await the outcome of that review and will continue to explore the potential for utilising the UK’s existing corporate insolvency framework. We will also consider whether there might be benefits in recommending further changes to insolvency laws and rules to support the running of an airline in administration. For example, it might be possible to design a special airline administration regime, to support a continuation of services and ensure passengers can be repatriated if necessary. We would need to give this more consideration, but we are of the view that the design could feasibly include the following elements, which have similarities to Special Administration Regimes in other sectors:

- An amendment to the purpose of airline administration to include a repatriation exercise, and ensure the administrator’s duties to the creditors do not over-ride this purpose. This could eliminate any ambiguity, and provide comfort to the appointed administrator.
● Restriction on placing an airline into administration until the Secretary of State or Civil Aviation Authority (CAA) have been provided with 14 days notice of intent to appoint an administrator. In this notice period, the Secretary of State or CAA may apply for a Special Administration Order, and the Court may not make any other kind of order (such as ordinary administration or liquidation).

● An ability for the Secretary of State or CAA to propose the administrator, which could be from a panel of approved Insolvency Practitioners who are familiar with the requirements of a repatriation exercise.

● A temporary moratorium to prohibit suppliers and other creditors from withdrawing services, demanding payments, and restrictions on enforcing security over an airline’s property during a short repatriation period.

3.67 It should be noted that Special Administration Regimes in other sectors are generally used to ensure continuity of strategically important services by facilitating the transfer of the business as a going concern. In this situation, the need for continuity of service could be limited to the short term in order to return all passengers stranded abroad. Once the primary statutory aim of repatriation is concluded, the administrator would then proceed in effect as if it were a normal administration. When exploring this approach, we would wish to consider the potential reactions from creditors.

3.68 It should also be noted that continuity of service provision requires the availability of financial resources to meet the associated costs. Though not impossible, it is not in general likely that those could be obtained from commercial sources without reasonable assurances that they will in due course be recovered. In other Special Administration Regimes provision is made for the relevant Secretary of State to provide or guarantee loans out of funds voted by Parliament. In the case of airline administrations, it may be more appropriate to provide funding from a suitable reserve fund or insurance scheme. We will consider these possibilities further in the next phase of our work.

3.69 We would also need to take account of the highly mobile nature of an airline’s assets, and the fact that they operate in multiple jurisdictions. There may be jurisdictional limitations if the UK administration regime is not recognised by international lessors or by foreign creditors, and international treaty
obligations such as the Cape Town Convention which could apply.5

Regulatory framework

3.70 Several respondents to the Call for Evidence have suggested that the CAA should develop its regulatory approach and processes towards airlines that are entering into financial distress. The purpose would be to ensure that the CAA has the right toolkit available to it in these situations, and that airlines understand their obligations and what to expect from the regulator.

3.71 As the CAA’s website sets out, UK airline licensing reflects the nature, ownership and financial health of a business. It does not cover operational safety, which is assessed under the Air Operator Certificate (AOC) scheme. All commercial airlines based in the European Economic Area (EEA) are required to hold an Operating Licence, and for the UK, these are issued by the CAA. An Operating Licence can only be granted to applicants who hold a valid AOC. Holders are able to fly on almost all routes within the EEA, and are also able to apply for Route Licences for flights outside the EEA.

3.72 CAA actively monitors the financial health of airlines on an ongoing basis and will increase its monitoring for individual airlines if they appear to be entering financial distress. If necessary it can take action to revoke the Operating Licence, though this is very much an extreme option and has protracted timescales associated with it. One area to be explored, therefore, is how to alter CAA’s powers to give more options for dealing flexibly and proportionately with emerging signs of financial distress in a UK licenced airline with a view to preventing or managing a failure more effectively. In particular, this could explore whether it is possible to adapt the existing licensing framework to provide a mechanism that could deliver an

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5 The Cape Town Convention is an international treaty to standardise transactions involving movable property such as aircraft and creates global standards for registration of contracts of sale, security interests (liens), leases, and various legal remedies for default in financing agreements, including repossession and the effect of particular states’ bankruptcy laws.
orderly wind-down of a UK airline. This will explore the following areas:

- **Trigger point** – The power for CAA to intervene when financial resources fall below a minimum level, at which point the CAA could have discretion to apply a temporary licence or special licensing conditions. For example, a trigger point could be when the airline ceases to have sufficient unencumbered financial resources available to effect a two or three week continuation of service without needing to generate further revenue.

- **Temporary Licence** – The ability for CAA to issue a temporary licence or special licensing conditions. This could include requirements for passenger monies to be placed in escrow, a requirement to file more frequent financial statements with the regulator and passenger manifest, route and booking data.

- **Cash in the bank** – Licence conditions could also include hypothecating or otherwise protecting sufficient financial resources to be used exclusively for the purposes of passenger repatriation, or to continue running for a short period in administration.

- **Resolution plan** – CAA could require an airline to prepare and maintain a resolution plan, similar to those required by the Prudential Regulation Authority for financial institutions. These are sometimes referred to as “living wills”. They are effectively a contingency plan that prepares for an orderly wind-down in case the entity becomes insolvent.

3.73 It is important to highlight the need for stability and confidence in such an emerging situation that allows a regulator to be satisfied and able to maintain licences, and the crucial role the company and any insolvency practitioner has in demonstrating these. However, current insolvency law may not provide a fully satisfactory and stable environment for a temporary licence regime to exist and until such time as this is addressed these risks continue.

3.74 The growing multinational and multi-jurisdictional nature of aviation in the UK, with multiple Operating Licences and AOCs in operation, makes for more complex handling arrangements. We consider this aspect is of crucial importance.

### Non-UK registered airlines flying from the UK

Ryanair, Norwegian and Wizz Air are amongst the more significant non-UK airlines with considerable numbers of passengers originating in the UK. They are multifaceted businesses with multiple licences in Europe, often with complex cross-border operations and diffuse passenger origins, making consumer protection of UK passengers difficult without cooperation amongst licensing authorities.

These are publicly quoted businesses of size and importance, employing thousands and often delivering considerable economic and social benefits to their local economies. Often, as was the case with Air Berlin, Governments have stepped in when such companies enter insolvency to avoid a large-scale disorderly collapse. Some options to repatriate passengers such as keeping the fleet flying or mounting an organised charter operation require action in advance of the point a company enters administration and or the participation of the airline’s licensing authority. This speaks to the need for cooperation amongst licensing authorities and any protection measures designed to protect UK passengers, to ensure the full suite of options remains available to all groups of passengers.
importance and at its centre is strong collaborative working and transparency between regulatory bodies, both at Member State, EU and international level.

3.75 Therefore, while keeping the fleet flying may only be a viable option for dealing with the largest and most complex failures, it is essential that this issue is addressed. As can be seen from the Paramount example Keeping the Fleet Flying is possible under current UK law. However, we consider further developments to create more favourable insolvency provisions in the UK, and more agreement internationally by which these issues are set out and managed across borders, will be essential to improve consumer protection outcomes across Europe.
4. Funding passenger protection

4.1 Earlier in this report we set out the different options to bring passengers home in the immediate aftermath of an airline insolvency. Common to all these solutions is a requirement for funding. In many of them access to an immediate and extensive source of capital can avoid the creation of further problems for passengers, e.g. access to funds to book another flight or pay for accommodation. In some the credibility and confidence that a secure source of funding offers help to reduce the risk that creditors take action to protect their financial interests and interfere with any repatriation operation, as they have greater confidence that they will be paid. For example, hotel companies sometimes refuse to honour bookings until further payment is made.

4.2 The Review’s Terms of Reference set out the need to consider how to minimise the Government and taxpayer involvement in any airline failure. A critical element of this will be ensuring that taxpayers are protected from the financial consequences of airline failure. This in part would address the political risk described earlier in the document and deal with any potential moral hazard considerations to the extent that passengers are ultimately paying for the actions that Governments find themselves compelled to take to protect them. As discussed in previous chapters, certainty of funding is therefore a critical factor in several of the options to repatriate affected passengers. These were all areas that received significant discussion in responses to the Call for Evidence.

4.3 Amongst respondents there was significant support for a commercial solution or levy. Although both were considered partial solutions to be combined with other initiatives e.g. consumer awareness. There was general agreement that the burden of costs resulting from airline failure should not be borne by the taxpayer. Furthermore as we set out in the Call for Evidence and as many respondents have echoed, the review should seek to ensure that the cost of protections against an airline’s

Figure 13: Options to fund passenger protection

**Insurance based:** Contingent capital provides funding via insurance, bonds or other mutual products arranged by airlines or passengers.

**Levy based:** Centrally managed fund (possible risk based charging) to pay for actions to protect passengers when an airline fails.

**Non-Financial:** Measures to reduce exposure or likelihood of failure e.g. more active operator licensing, consumer monies in escrow etc.
insolvency is borne by the passenger rather than the taxpayer.

4.4 There are several methods to provide financial protection which we will consider over the next few months. These can be ordered into three broad groups as set out in Figure 13 above.

- **Insurance based** – Some solutions would seek to use multiple providers of protection products such as insurance policies, bonds or other forms of contingent capital. These could be purchased by the passenger, the airline or ticket vendor and potentially form a mandatory feature of flying from a UK airport.

- **Levy based** – Another group of solutions rely on creating a single form of protection that applies to all passengers departing the UK. Participation in such a scheme would be mandatory to all and could be a centrally run risked based levy or tax system that protects passengers.

- **Non-Financial** – The final set of solutions would look to use alternative methods that do not require payment into some scheme of protection to ensure passengers were better positioned in the immediate aftermath of an airline insolvency. Examples here could include awareness raising programmes to improve passengers’ own abilities to protect themselves. Or it could involve changes to the airline licensing and administration regimes to enable repatriation operations to be undertaken without taxpayer subsidy or measures that encourage greater discipline in the financial management and governance of an airline to reduce the risk of insolvency.

4.5 Any solutions developed will need to take account of the existing and future protection landscape including the card payments, travel insurance and Air Travel Organiser’s License (ATOL) regimes. In their responses to the Call for Evidence stakeholders offered many thoughts and opinions on the suitability or potential for these different methods and these are analysed below.

**Commercial based solution**

4.6 It is recognised that consumers are sometimes confused between levels of protections in consumer travel insurance and other types of protection such as under the Package Travel Regulations (PTR), Air Travel Organiser’s Licence (ATOL) or Association of British Travel Agents (ABTA) bonding. There is scope for the financial services industry to play a greater role through consumer travel insurance, which the consumer may choose to buy, and a form of insurance, bond or credit risk, which airlines could access. The provision of ample, affordable commercial protection against airline failure by financial markets would go a long way towards providing confidence against a range of insolvency situations.

4.7 There are existing consumer travel insurance policies providing protection in the event of an airline’s failure. These products tend to be at the higher end of the market, which not all consumers might find affordable or have the desire to purchase. Any move to increase or make it compulsory for consumer insurance to protect against airline failure would only be effective if sufficient cover were available for all passengers to purchase. We heard this could create additional cost and might discriminate against high risk consumers, such as those with pre-existing medical conditions.

4.8 ABTA research published in 2017 found 25 per cent of those that travelled in the 12 months to May 2017 had not purchased travel insurance. To avoid this risk it may be necessary to mandate both
the inclusion of airline failure cover in consumer travel insurance and that all passengers must obtain such travel insurance ahead of travel. Compliance would be constrained without the proper infrastructure in place, which might require the development of a complex regime and overseeing authority.

4.9 An alternative would be to offer cover at the point of sale, as is the case in Germany. Airlines would arrange cover with a provider and the consumer could opt in when purchasing the ticket. This approach has its appeals: simplicity, consumer choice and proportionality. However, it could only provide universal cover if all passengers made the choice to opt in or it were made mandatory.

4.10 Building on this basis, an alternative to consumer purchased products would be for airlines to purchase a financial product. This could take the form of insurance, bonds, or any other suitable form of financial protection product, purchased in the market with the costs then included in the price of the ticket. The supplier would undertake an assessment of the airline’s credit-worthiness, providing the product at a premium based on the assessment. The protection would pay out for the repatriation or refund of passengers in the event of the airline’s failure. The obvious advantage is that risk would be priced on a commercial basis and reflected in the premiums charged. This could be financially beneficial, particularly for many low-risk airlines and their passengers.

4.11 Financially sound airlines would be able to negotiate better premiums than airlines with a poor credit rating. We would expect such difference to be reflected in the ticket price paid by passengers. We received strong support for a proportionate solution; a risk based approach is more likely to provide such a solution and diminishes cross subsidy and mutualisation of risk.

4.12 In addition this option places protection on a more commercial basis, in turn minimising or removing risk to the tax payer, providing universal cover in a simple form for consumers and potentially reducing duplication of protection. To be effective a commercial solution of this kind would require mandating to ensure that it applied to all passengers.

4.13 There were mixed views expressed about market capacity or appetite for a commercial solution. Some respondents stated there would be insufficient capacity in the insurance market, potentially requiring Government intervention to develop a market for the desired financial services needed.

4.14 There was varying support for a variety of commercial financial protection solutions (including bonding, insurance and funds) with views offered on the relative merits of each and with reference to schemes in other EU Member States e.g. Denmark. We will be looking to explore these options with a range of commercial institutions so that we can make firm proposals in the Final Report. In line with our principles, we consider the insolvency protection should be proportionate to the risk and affordable for industry and consumers.

**Levy or tax based solution**

4.15 There is an option to adopt a levy or tax to capitalise a fund to underwrite consumer protections and assist an insolvent airline operating through administration. A levy could be charged on eligible flights, payable by the passenger at the point of purchase. The proceeds of
the levy would then pay for any repatriation and refund of UK passengers if a participating airline collapsed. A compensation cap could be put in place to limit the amount of any compensation an individual could claim to ensure affordability of the measure.

4.16 Some views expressed through the Call for Evidence and public evidence sessions showed support for an all flights levy or tax on passengers departing from the UK. A levy would have the advantage of simplifying the landscape by removing the need for tour operators to have airline failure insurance. This option meets the principles of ‘the beneficiary pays for protection’ and ‘efficient allocation of risk’ – the cost is paid by the airline, who in turn would pass this onto the passenger.

4.17 There was a strong preference for a risk based levy over a flat-rate levy such as the Air Passenger Duty or ATOL. The risk based levy would take account of the likelihood of a particular airline’s becoming insolvent and might be calculated on an annual cycle or possibly reviewed more frequently, for example each quarter.

4.18 In the UK the government has endorsed the use of a risk based levy to protect recipients of pensions through the Pension Protection Fund and financial services through the Financial Service Compensation Scheme. In both these cases a risk based approach is used to charge market participants for the protection offered to the consumer.

4.19 Some respondents indicated a flat rate levy could result in airlines with weaker financial positions benefiting from funds provided by more prudent airlines, as well as creating a large cash fund which may go unused. A careful assessment of the appropriate cost of a flat rate levy would be required to mitigate this risk. In theory, the implementation of a flat rate might be simpler, but it would mean expensive flights cost the same to protect as cheaper flights and riskier airlines pay the same levy as more stable airlines. There is a possibility this could encourage perverse consumer and competitor behaviours, which would exacerbate the moral hazard problem and have a negative effect on the travel market. In contrast, a risk based levy would treat airlines and consumers more equitably by pricing in relation to the risk exposure of each airline.
4.20 Some respondents pointed to the Danish levy. The Danish model has relatively low costs per passenger at 2DKK (around 20p), collected at point of departure and capped when it reaches a certain limit. Airlines, in particular, were sceptical that such an approach would prove effective amid concerns over cross-subsidies of risk and the competitiveness of UK industry versus other countries’ operators not exposed to this additional cost.

4.21 While the position on refunds is clearer, repatriation as referenced earlier may depend on the licensing authority to take action and it therefore remains unclear how a levy paid by consumers departing the UK could be used to effect repatriation in the event of the insolvency of a non-UK registered carrier. We will be looking to explore these points in order to make a firm proposal in the Final Report.

**Rejsegarantifonden: Danish Travel Guarantee Fund (TGF)**

**Funding**
From 2010 to 2015 Danish customers could purchase airline bankruptcy cover from TGF limited to Danish registered airlines only. It was not widely utilised by the public.

Following the failure of Cimber Sterling Airlines in 2015 the Danish government implemented changes to TGF under the Travel Guarantee Act in July 2015 to extend cover by turning the scheme into a tax on all flights departing Denmark.

All airlines now pay a contribution to the TGF air transport sub-fund of DKK 2 (around 20p) per passenger departing from an airport in Denmark. The sub-fund will hold a maximum of DKK 100 million, at which point contributions are suspended. Should a significant bankruptcy occur drawing the sub-fund to below DKK 25 million, contributions of DKK 4 per passenger will be required.

Since July 2015, the sub-fund has been built up to almost DKK 70 million. Air Berlin drew down the fund by approx. DKK 1.5 million.

**Operation**
Contributions to the TGF are collected monthly in arrears by the Trafik-Bygge-og Boligstyrelsen, Danish Transport and Construction Agency.

In the event of an airline bankruptcy, the TGF is required to facilitate the repatriation of all passengers stranded abroad if they had bought a return ticket from Denmark to a destination abroad. TGF has outsourced arrangements for this to a private company: SOS International A/S.

Repatriation will be provided “within a reasonable period of time”. If passengers are delayed TGF appears to cover accommodation costs, but not lost wages. If a passenger wishes to make their own arrangements, they may do so at their own cost; they are not eligible for a refund or compensation.

Passengers with forward bookings are entitled to be refunded, with a deduction of DKK 1 per passenger being made. If there are insufficient funds in the sub-fund to fully cover prepayments, TGF will reduce refunds on pro-rata basis.
Non-financial solutions

4.22 There are options to provide protection by strengthening existing structures in the landscape through non-financial means. Respondents often felt these options might be more effective as complementary measures to a financial solution.

4.23 As identified in the Call for Evidence passengers should understand the protection available, be able to identify what risks are covered and at what level. We recognise the existing landscape is complex. The lack of clarity has led to gaps, with some consumers not protecting themselves at all, as well as overlaps, where some consumers are covered by multiple products. We will engage with consumers through focus groups and a wider survey to explore their understanding of the risks, their awareness of existing protections and their appetite for additional protection.

4.24 The Foreign Office led ‘Travel Aware’ campaign gives advice to UK citizens on how to prepare for travel abroad and what help is available if an incident occurs. Advice is given on the level of insurance cover necessary to provide protection in common medical situations. There are lessons that can be learnt from ‘Travel Aware’ on the implementation and effectiveness of a consumer campaign. In particular there maybe lessons to be learned in protecting Government from the moral hazard of passengers who, aware of the risk, choose not to buy protection, but expect Government to act.

4.25 We heard views that more could be done by insurers to raise the awareness of airline failure protection, either at the point of sale or before travel. It would then be for the consumer to make a conscious choice to protect themselves or run the risk of having to self-repatriate or lose monies paid for flights. Options to improve consumer awareness might create a more transparent environment where the consumer knowingly chose to insure or not, giving Government the moral confidence not to intervene. However, this would not address the political risk described earlier that a Government may feel compelled to act regardless of the moral hazard if wider public policy arguments are persuasive in favour of intervention e.g. the protection of citizen’s welfare, efficiency to the taxpayer of early intervention, etc.

4.26 Many respondents to the Call for Evidence also expressed the view that stricter licensing controls could help reduce the likelihood and impact of an insolvency. Given the Civil Aviation Authority’s (CAA) existing role in assessing the financial health of airlines as part of its licensing process, we consider that there are several options worth further exploration in this space. For example, to protect consumers both in terms of repatriation (as discussed earlier in the report) but also refunds, airlines could be made subject to licence conditions that included ensuring financial resources were available to refund any ‘unflown revenue’ at least in part. Licence conditions could also be established that would require new passenger monies to be placed into a trust account or similar once an airline reaches a certain threshold of risk.

4.27 Some travel businesses already put customer money into a trust so that it is...
not available as working capital. It is available for refunds or to manage the continuation of customers holidays should the business become insolvent. Segregation of money under an escrow or trust account arrangement has a cost in that if these potentially large sums of money are segregated, working capital and therefore liquidity are effectively reduced and would, for some businesses, need to be replaced, perhaps through re-financing entailing increased cost.

4.28 An obvious advantage of a stronger licensing regime that mitigates insolvency risk and minimises market distortion, would likely result in a better outcome for the consumer and less need for government to become involved in a repatriation. However, the impacts on an airline’s current business models could be substantial and transitional arrangements may be necessary to effect a smooth change. For airlines licensed outside the UK it would be for those state authorities to determine whether to take similar steps.

4.29 The question of whether any financial protection solution should provide for refund or repatriation only is difficult to answer at this stage. Many respondents felt the existing regimes were providing sufficient protection. However, protections that rely on current credit and debit card systems may be less effective as new alternative electronic payment methods become available which may not have the same levels of protection. Costs associated with different methods of repatriation must also be taken into account in determining whether the solution can feasibly provide protection for both repatriation and refund, whilst remaining affordable and proportionate.

4.30 We recognise solutions that increase the cost of airlines doing business in the UK may indirectly impact the competitiveness of UK airlines compared to others not exposed to those costs over the same proportion of their business. However, we have yet to see evidence that these costs would be more determinative to airlines’ decision-making than other factors such as tax base and ease of doing business. We are interested in hearing further views and evidence on this point and in line with our principles will consider how to structure any solution to minimise competitive distortion.

4.31 Government policy is in favour of market-based solutions unless there is good reason for Government to intervene. We would like to understand more about the pros and cons of market-based financial mechanisms in this context. For example, what changes might be necessary for this to become a more attractive market for financiers, as well as an area where the market can be relied upon to deliver an appropriate level of protection for consumers, without exposing the general taxpayer. Similarly, we would like to consider potential governance options for an independent industry fund approach. Further, we will consider how best to structure contributions to a fund, taking into account the relative merits and demerits of flat-rate and risk-based pricing.
5. Reforming the existing landscape

5.1 At this stage in the Review’s work we have yet to develop significant options for the reform of the current protection arrangements for air-travel holidays and answer the call in our Terms of Reference to put them “on a more commercial basis”. To an extent these will fall out of the recommendations to provide a broader basic level of financial protection to consumers outlined above. In designing recommendations, the review will have to make clear how these interact with and potentially change current systems of protection for air-travel holidays.

5.2 For example, if all flights are covered by some form of comprehensive financial protection against the airline’s insolvency, some of what the Air Travel Organiser’s License (ATOL) scheme protects will be duplicated. There may therefore be an argument to reduce the cost and coverage of the scheme commensurately. This would offer an opportunity to introduce more commercial arrangements at the same time.

5.3 The Package Travel Regulations (PTR) requirements are met by travel organisers holding a licence under the ATOL Regulations, with regards to packages that contain a flight. For other holidays, the PTR offer various commercial means of providing financial protection: bonding via an approved bonding body; obtaining suitable insurance under which the consumer is the insured person; or organising a trust account whereby monies paid in respect of packages are not released to the business until the contract has been performed.

5.4 There are a range of financing options available to actors in the travel industry to protect the consumer. Following this review, it might be right to consider the extent of efficiencies to be achieved in streamlining the financial mechanisms behind PTR, ATOL and airline failure protection. We may find having established measures to protect against airline failure it might become easier to manage other ATOL risks on a more commercial basis. An obvious advantage of consolidation is complete consumer protection irrespective of how and from whom travel products are purchased. At the same time, it may prove unmanageable to transfer all the risk away from the Government and eliminate its role completely.

5.5 Respondents to the Call for Evidence identified the significance of ATOL and the effective responses to passenger repatriation during small tour operator failures. Further, the CAA is recognised and valued for its strong risk management and enforcement capability, giving confidence to the insurance market to reinsure risks. The extent of insurance capacity made available to the Air Travel Trust (ATT) is based on the implied or real government support associated with the
CAA, along with their strong risk mitigations which have arguably improved the strength of the UK sector. Any reform will need to take account of this and ensure that these benefits are not needlessly lost.

5.6 We will explore whether there may be scope for consolidation of the ATOL scheme into any new proposed arrangements or conversely a reduction in the scope of ATOL to cover simply the remaining elements of the package holiday not covered by the protections recommended by this review. Depending on the outcome of such deliberations we will also consider what further measures can be taken to put the remaining ATOL arrangements on a more commercial basis.
6. Next Steps

6.1 The timeline in Figure 14 below sets out the next steps for the Review. In summary the Review will now consider the issues raised in this Interim Report further with the aim of presenting its final recommendations to Government by the end of the year. To this end we will be organising stakeholder workshops to discuss the various options for recommendations in the autumn. We would encourage anyone with an interest and relevant experience or knowledge to share, if they have not already done so, to make their interest known by emailing airlineinsolvency@dft.gov.uk.

6.2 This Interim Report represents the end of the formal consultation phase of the Review, as we now take time to develop our recommendations. However, this is not the end of our engagement with those with an interest and we would encourage thoughts or comments on this report and its contents. Please send any such contributions to airlineinsolvency@dft.gov.uk noting that unless you inform us of your wishes to the contrary and provide an explanation why it would not be appropriate, we shall seek to publish any relevant contributions to our work alongside our final report.

Figure 14: Airline Insolvency Review – 2018/19 Timeline