

**Consumer Protection Group**



**CAP 595**

**Financial Protection for Scheduled Airlines'  
Passengers**

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## **CHAPTER 1 INTRODUCTION**

- 1.01 The Secretary of State wrote to the Authority on 22 March 1991 asking for advice on protection of scheduled service passengers against financial loss and disruption arising from the failure of their airline. The text of the letter is at Annex 1.
- 1.02 The request from the Secretary of State was for advice on the mechanics and practicality of protection for scheduled service passengers, rather than its desirability. The request also asked for a response in a relatively short time. In these circumstances, the Authority decided to take the views of the industry only on a limited basis. The list of those to whom the Authority wrote is at Annex 2.
- 1.03 The form of this advice is that the text of the original discussion document, which includes some background material, is at Chapter 2. A summary of the views received from the respondents is at Chapter 3, and copies of their letters in full at Annex 3. Chapter 4 discusses the issues, and Chapter 5 contains the Authority's conclusions.

## CHAPTER 2 DISCUSSION DOCUMENT: PROTECTION FOR SCHEDULED SERVICE PASSENGERS

2.01 In a letter of 22 March 1991, the Secretary of State for Transport asked the Authority for advice on whether some arrangements could be introduced to help protect scheduled passengers against financial loss and disruption arising from the failure of their airline. We have been asked to advise on different ways of providing protection; on the necessary coverage of any scheme; whether the Government or the CAA needs to have a role; the options for providing cover; the likely costs; the enforceability of any scheme; and the need for legislation. We have been asked to report by the end of July.

### BACKGROUND

2.02 In the year to June 1990, there were 56m passenger journeys on scheduled services into, out of and within the UK. They can be analysed in a number of ways:

#### *All services*

Domestic	11m	(20%)
International	45m	(80%)
Business	23m	(41%)
Leisure	33m	(59%)
Carried on UK airlines	33m	(59%)
Carried on foreign airlines	23m	(41%)
Passengers resident in UK	33m	(59%)
Passengers resident abroad	23m	(41%)

#### *International-only services*

Business	16m	(36%)
Leisure	29m	(64%)
Carried on UK airlines	21m	(47%)
Carried on foreign airlines	24m	(53%)
Passengers resident in UK	22m	(49%)
Passengers resident abroad	23m	(51%)

#### *Domestic-only services*

Business	7m	(64%)
Leisure	4m	(36%)

Figures are based on IPS and CAA O&D Surveys and are rounded.

In the same period there were about 23m passenger journeys on charter flights, of which 4m were on foreign airlines.

- 2.03 These figures show that taken overall, 60% of passengers on scheduled services are travelling for leisure purposes (and that nearly 60% of the leisure market travels on scheduled services). 60% of total passengers and about 50% of international passengers are UK residents. Similar proportions apply to the distribution of passengers carried on UK and foreign airlines respectively. Because UK airlines dominate the UK-originating charter market, it is not surprising that scheduled services on foreign airlines have a higher proportion of leisure passengers than UK: about 67% of scheduled passengers on foreign airlines are leisure, compared to about 61% on UK. Comparison with the position at the end of the 1970s shows that the scheduled services' share of the leisure market is growing, although only slowly. In the 1980s there was a two percentage point switch to scheduled services in a market which itself grew by about 90%. The proportion of leisure passengers on scheduled services who are travelling on a package is not known. We believe that perhaps as many as 20% of charter passengers do not have a recognisable package.
- 2.04 Increased competition in civil aviation has become more common in the last few years. The principal example of this is deregulation of the US domestic market. It is apparent that the more the market is characterised by competition, the more likely it is that airlines may fail. US experience since deregulation in 1977 suggests that about 75% of the airlines which came into being since then have subsequently ceased to exist. The same proportion is true of UK airlines over a rather longer period.
- 2.05 Another characteristic of recent years has been the relatively shrinking role of state ownership of airlines. US airlines always were in the private sector, and all UK airlines are now in the private sector. In addition, state shareholdings in many foreign airlines have been diminished, and foreign Governments' increased willingness to allow new entrants also increases the number of private sector airlines. It must be true that a higher proportion of airlines in private hands will make airline failure more likely.

### **EXISTING PROTECTION**

- 2.06 So far as the ATOL holder is concerned, the licensing criteria are the fitness of the company and its directors and their financial resources. Nationality of the owners is not a relevant consideration.
- 2.07 The present protection arrangements operate on intermediaries and not airlines. All those who in the UK make available seats which they have purchased from an airline and then resold to the public are required to hold an air travel organiser's licence. A bonding requirement on the individual licence holder backed up by the Air Travel Trust secures that if the travel organiser fails financially, the passenger is either repatriated from abroad or reimbursed if he has yet to travel. The Air Travel Trust is however a limited sum (currently about £26 million) and there is no provision for topping it up should claims upon it exceed its present resources. Seats bought from airlines for resale to the public are very largely made available on charter flights. There has for many years existed so-called 'part-charter', namely seats made available on a charter basis on scheduled services. These, which constitute an unknown but probably small proportion of total 'ATOL' passengers, are also protected by the present arrangements.

- 2.08 The present differentiation between those who are covered and those who are not is based simply on a legal definition: where the intermediary acts as a principal he is required to hold an ATOL and his customers are protected: where he acts an agent, he has no such licensing requirement and his customers are not protected. Thus, for example, only a small proportion of the turnover of Thomas Cook is covered under the ATOL system: their activities as retail agent do not fall within any CAA-administered scheme. It is impossible to explain this distinction clearly to members of the public. Moreover, even the best informed member of the public is unable to distinguish between the two in the case of part-charter, and it is likely (particularly within the EC) that the scheduled/charter distinction will become increasingly blurred as time goes by.
- 2.09 Passengers now covered are those to whom 'licensable' travel (that is, travel for the provision of which an ATOL is required) is made available in the UK. Every person buying such travel in this country is covered completely, irrespective of his usual country of residence, his nationality or his journey purpose. Because the system works on intermediaries, it serves to protect the passenger against the failure of the airline. If the airline ceases to exist, it is the intermediary who is responsible for rebooking the passenger on to another airline. If he can do so, he suffers the additional cost. If he cannot do so and fails financially, the protection arrangements will then come into play to reimburse the passenger. As a consequence of this, the passenger is protected against airline failure, irrespective of the nationality of the airline.
- 2.10 Passengers are covered by an ATOL irrespective of whether they book direct with the licence holder or through an agent of the licence holder. If passengers book through an agent, and the ATOL holder fails, there is the problem of so-called 'pipeline money'. This is money paid by the passenger to the agent which has not yet reached the ATOL holder. Following the failure of Court Line in 1974, there was a protracted legal dispute as to whether agents were entitled to refund pipeline money to the passenger who had paid or whether they were obliged to pass it on to the ATOL holder. As a consequence of this dispute, the Authority has made it a licence condition of ATOLs that once booking confirmation has been issued by the ATOL holder, the agent is acting as agent of that ATOL holder.
- 2.11 The EC directive on package travel comes into effect at the end of 1992. Under this directive, member states are required to establish full protection for passengers against failure to deliver by those who provide him with package travel arrangements. (This protection will cover only those who buy pre-established and advertised packages: it does not extend to ad hoc packages, such as a traveller buying an air ticket and hiring a car at the same time.) Unlike the ATOL system, the directive will place obligations on agents who put together packages (say a scheduled service flight and a hotel) and make them responsible for successful delivery of the package as a whole. In this directive a 'package' consists of two elements, one of which is travel. Thus travel plus car hire, for example, is covered. The proportion of leisure travellers on scheduled services who have bought a package comprising air travel plus accommodation is about 6%. The proportion of business travellers with an air travel plus accommodation package may well be smaller. The remaining 90%-odd will not be covered by the EC directive, when implemented, unless they have bought a package consisting of travel plus elements such as car hire. It is impossible to say what proportion of the market this will cover.



## THE RISKS

- 2.12 Passengers are liable to financial loss in the event of the collapse of the airline with whom they have booked. Collapses of large scheduled airlines are rare. While a large number of small scheduled airlines in the UK have failed in the last 30 years, the only two of any size were Laker in 1982 and Air Europe in 1991. Nevertheless, a further 10 have failed in the UK in the last year, and the number of passengers who have lost money as a result is not inconsiderable. For example, about 30 000 passengers are thought to have incurred losses as a result of the failure of Capital Airlines. Air Europe's liability to scheduled service passengers seems likely to be of the order of £6 millions. In the US, airline failure has become more common since deregulation, and include in Eastern what was once one of the five largest airlines in the world. It is unlikely that the attrition of US airlines has ceased. Further, if the civil aviation policy envisaged by the Commission is successful within the EC, there will be more privately owned airlines in the future than now exist.
- 2.13 About 60% of scheduled airline passengers flying to, from or within the UK are carried on UK airlines, none of which has any state ownership. Of the remainder, another 5 million (or 9%) are carried on privately owned US airlines. In principle, there is no reason why a foreign flag carrier in which the state has a significant shareholding – which is true of most flag carriers – should not also be allowed to fail if it runs into financial trouble. In practice, this seems unlikely.
- 2.14 Scheduled service passengers are also at risk against the failure of the agent to whom they have paid money in advance. At present, money paid to retail agents who are members of ABTA is protected by ABTA's own scheme. Passengers who have paid to agents who are not ABTA members are therefore at risk for a period during which they have paid money but not yet received a ticket. Should ABTA limit or withdraw their scheme, passengers would be substantially more at risk.

## THE ISSUES

(i) **Who needs protection?**

- 2.15 If the failure of scheduled airlines or their agents is deemed to be sufficiently real that protection of some sort is called for, we need to decide which categories of passengers need protection. Are they:
- (a) Business passengers and/or leisure passengers
  - (b) UK residents or all passengers irrespective of residence
  - (c) Passengers on UK airlines or passengers on all airlines
  - (d) Passengers who booked and paid in the UK or those who book and pay abroad
  - (e) Passengers who have not bought an identifiable package (namely travel plus surface accommodation)?

(a) *Passengers' Journey Purpose*

- 2.16 In theory, business passengers need less protection than leisure passengers, in that they tend to book nearer the date of their intended flight (and thus are less exposed to being affected by failure) and in any event air fares are a pre-tax charge on

business. These considerations might lead any proposal to protect scheduled service passengers from airline failure to fall were business passengers the only passengers on the flight. In practice, every scheduled flight will contain some leisure passengers, and most contain a majority of leisure passengers. If a decision were taken to protect leisure passengers, it is difficult to see the rationale for excluding business passengers. If it were thought that they should be excluded, there would then be a problem of definition. The way a business passenger is identified for CAA statistical purposes is if his fare is paid by his employer: this becomes less clear with the self-employed, partnerships and so on, and seems irrelevant for public policy as opposed to statistical reasons. A more appropriate definition might have to be sought.

- 2.17 The case for protecting leisure passengers on scheduled services is in principle the same as that for protecting them on charter services. Those concerned are typically infrequent travellers who cannot be expected to have any intimate knowledge of the industry and the creditworthiness of various airlines. Their fares are often required to be paid well in advance and are paid out of post tax income. If the journey concerned is an annual family holiday, it may be the traveller's biggest single item of revenue expenditure in the year. Other relevant considerations are that the proportion of the leisure market travelling on scheduled services seems to be increasing, albeit slowly, so that ATOL protection – while it may extend to the most vulnerable part of the industry now – will become proportionately less effective over time. Perhaps more significant is that the distinction between charter and scheduled services may well disappear if a journey is within the EC – where the majority of leisure trips take place. The concept of the charter has an economic rationale which will probably mean that while 'charter' flights as such may cease to exist, intermediary tour operators will still wish to buy seats as principals from airlines for package and resale to the public. However, it would be likely that the proportion of passengers on what used to be charter flights who had bought seats direct from the airline would increase substantially.

(b) *Country of Residence*

- 2.18 ATOL cover currently extends in practice only to UK residents. It does in fact cover passengers living abroad who come to this country and then take a charter flight from here to a third country, but the proportion of these latter is very small indeed – probably less than 1%. This has a number of important consequences. First, passengers will have paid in sterling and problems of exchange rates do not arise. Second the UK authorities have a degree of control over the circumstances in which these journeys are sold. All documentary transactions and ticketing take place in the UK.
- 2.19 As discussed in paragraph 2.18 above, ATOLs de facto cover UK residents only. In the event of a failure and in the absence of a protection scheme, passengers either lose their money or are stranded abroad. In the case of a failure of a scheduled airline, passengers are just as likely to be stranded in this country. These people may be UK nationals ordinarily resident abroad or foreign nationals visiting this country. It is not clear whether public policy suggests that these passengers should be covered by a UK-based scheme. To the extent that they are foreign nationals, there is an argument that their own Government should concern itself with their welfare. This however would point to excluding from any protection foreign nationals ordinarily resident in the UK, which would seem to be difficult to justify. Equally, passengers originating abroad who are stranded here may well be UK nationals, for whom a foreign Government is unlikely to wish to take responsibility.

(c) *Nationality of Airline*

2.20 There is no long history of scheduled airline failure. The history such as it is demonstrates that the risk of failure attaches to the ownership of the airline, namely whether it is state owned or privately owned. The two countries with the most extensive experience of scheduled airline failure – the US and the UK – are those where privately owned airlines outnumber state owned. If as is likely the number of airlines in the private sector increases in most countries, particularly in the EC, passengers become more at risk by that fact. It is also true, as a generalisation, that about half the passengers on foreign airlines will be UK nationals. There seems no reason to distinguish in terms of protection between passengers on UK airlines and passengers on foreign airlines.

(d) *Point of Booking and Payment*

2.21 The considerations which apply to extending protection to passengers who either live in the UK or irrespective of their country of residence apply equally to whether they booked and paid in the UK or booked and paid abroad. There are however practical considerations which are dealt with in paragraphs 2.34 and 2.37 below.

(e) *Non-Package Travel*

2.22 The EC directive on package travel is aimed at covering passengers who buy a package, but not those who buy travel only or who buy a package which is essentially ad hoc as opposed to pre-arranged and pre-advertised. The considerations which lead to protecting leisure passengers seem not to lead to distinguishing between package and travel only. A high proportion of leisure travel to some long haul destinations such as Australasia and the US is VFR (visiting friends and relatives), which is typically travel only. These passengers are, on the face of it, no more and no less vulnerable than those leisure passengers who buy packages. There seems no rational argument for excluding those who have not bought a package.

(ii) **How is protection to be afforded?**

(a) *Insurance*

2.23 The first option to protect passengers is insurance, which can be effected either by the airline against its own insolvency or by the passenger against the airline's insolvency.

2.24 Insurance by licence holders against their own insolvency is something which has been looked at on a number of occasions in respect of tour operators since 1974. On each occasion the conclusion has been that these are not risks the insurance market would accept either at reasonable premiums or at all. One substantial difficulty is that the totality of exposure of the insurer is not readily quantifiable. One consequence that this option would bring, which might have repercussions with foreign countries, is that a requirement on all airlines to have in place adequate insurance against their own insolvency would in effect place the ability to trade of an airline in the hands of the insurance market. Were such an obligation to be imposed, the UK authorities would have to ensure that the insurance company was good for its obligations – that is, there would have to be a list of approved insurers. They would then have the de facto ability to decide whether an airline was allowed to

trade. Even if the UK regarded as this as acceptable for its own airlines, it is by no means clear that all other Governments would take the same view in respect of their airlines.

2.25 An alternative is for passengers to insure themselves against an airline's insolvency. This is theoretically possible, although at a cost. There are two apparent difficulties. First, the premiums would vary depending on the degree of risk perceived by the insurance market. Thus state-owned carriers, whatever their economic strengths and financial performance, would be likely to attract only small premiums whereas private sector airlines would probably attract a higher premium, irrespective of their efficiency and performance. It is by no means impossible that a high premium attached to a particular airline might well lead to all passengers avoiding that airline and precipitating its failure. The other difficulty is that a significant proportion of passengers might not buy the insurance which was available. It is a matter for consideration whether passengers who lose money in those circumstances are held to be the authors of their own misfortune and therefore have to bear the consequences, or whether problems created by a major failure would be ones which the Government could not afford to ignore.

(b) *Bonding*

2.26 A bond is an undertaking by a financial institution to make available to a named beneficiary a specified sum of money if one of a series of identified events takes place. It is the responsibility of the licence holder (in the case of ATOLs) to secure that such a bond exists. A typical bond is one given by a UK clearing bank in favour of the bonding committee of ABTA which becomes payable if, for example, the licence holder appoints an administrator, receiver or liquidator. The sum of money is specified, but is usually calculated as a proportion of turnover. Those who administer the protection scheme, ABTA, CAA, TOSG etc, have a responsibility to ensure that the financial institution which gives the bond (the obligor) is good for its obligations: given the number of failures which have taken place in the banking world, this is not always straightforward. It is customary for the obligor to demand a fee from the licence holder and to look for additional security, which may take the form of a generalised charge on assets, a specific charge on assets or even a requirement for the deposit of a specified sum of money. Other obligors are insurance companies who may require simply an insurance premium or an insurance premium plus a charge on assets, deposit of cash etc. Evidently, the amount of premium and the degree of security required by the obligor depends on his assessment of the risk of failure of the licence holder. The level of bond demanded may also reflect a view of the degree of risk involved.

2.27 It is not possible to set bond levels which will, in themselves, guarantee that in the event of failure all outstanding obligations to passengers will be met. Even a bond set at 100% of turnover will not provide a guarantee in every case (although it should in almost every case). This is because the licence holder concerned may underestimate his turnover and operate at a turnover higher than that used to estimate the bond level; or because in some cases the cost of repatriating passengers stranded abroad is larger than the sum of money they have paid for the journey in question. Bonding levels set for ATOL holders are based on experience of the likely time of failure and the pattern of trading through the year. They are also set in the knowledge that a back-up fund exists. For airlines whose date of failure might be less predictable and who have a different annual trading profile, a bonding level which would meet most obligations most of the time would probably have to be of the

order of 30% plus of turnover. It is apparent that bonding levels of this order would have a serious effect on competition between airlines. A state-owned airline whose risk of failure was insignificant would be likely to get a bond of almost any proportion of turnover from its own national bank for no more than a transactions charge. The obligor would, in return, incur no more than a theoretical liability. A medium to small privately owned airline, on the other hand, might well find either that a bond of 30% of turnover could not be obtained at any price or that the price was beyond its resources because of the security required.

(c) *A Common Fund*

- 2.28 An alternative is a common fund with no requirement for any bond at all. Such a fund could be financed by a charge on airlines of say £1 for each passenger arriving at any UK airport. The charge would need to be levied either on the airline or the airport, rather than passengers individually. Such a levy would raise between £25-30 million a year. Passenger charges for particular purposes are a common feature of international aviation, although they have not been a feature of this country. A levy along these lines would be unlikely to lead to sustainable international opposition. On the analogy of the Air Travel Reserve Fund, the common fund would need to raise enough money to establish working capital, and then any levy could cease. In the case of the ATRF, a levy was imposed for two years and raised about £18 million. There has been no levy since 1976, but in the intervening 15 years the fund has increased to about £26 million despite being called upon on a number of occasions to top up the amounts of available bonds in the event of travel organiser failures. The level of the fund may however be sharply reduced by a substantial call as a result of the ILG failure. It is impossible to forecast in advance the maximum claim on any common fund. The experience of the Air Travel Reserve Fund and its successor the Air Travel Trust suggests that a workable arrangement is for the fund to be sufficiently large that it can meet day to day obligations when they arise without delay. However, for it to be able to guarantee to meet all proper claims powers would need to exist to reimpose a levy should that become necessary and the fund managers would need powers to borrow on the commercial market to bridge between expenditure and receipts from a new levy if required. The ATRF/ATT experience also suggests that the cost of administration is very small once the levy is complete. Provided a cheap and effective method of collecting the levy were found – and this might be achieved by adding £1 to the passenger load supplement charged by all airports and requiring it to be sent to the fund managers, then the administration cost would be minimal.
- 2.29 The advantage of a common fund is that it provides 100% protection for passengers against the consequences of the financial failure of the licence holder. It contains an element of rough justice, in the sense that passengers of airlines which are not likely to fail pay as much as those of risky airlines. On the other hand, such passengers are of course covered if they travel with a risky airline in subsequent years. A flat-rate, short-duration levy is not likely to create significant inequities. In the case of the ATRF/ATT, it has proved to be particularly effective.
- 2.30 One argument against this arrangement is that it fails to encourage responsible financial management among airlines. The suggestion is that because all airline passengers are protected without differentiation as to the airline they use, airline managers are more likely to engage in commercially risky ventures. Although this argument may be widely held, it is difficult to evaluate.

(d) *Bonding plus Back-up Fund*

- 2.31 It was considerations such as those in paragraph 2.27 above which led the Government in 1974 to establish the Air Travel Reserve Fund Agency to back up the bonds which already existed for ATOL holders. The Government of the day concluded that bonding to provide full security was neither feasible nor consistent with its other objectives. The combination of bonding plus back-up fund was seen to be one which carried advantages in that the back-up fund guaranteed complete protection for the passenger if the bond proved to be inadequate but at the same time the need for a bond meant that companies which were poorly financed or engaged in a particularly risky business had to pay a higher 'contribution' to protecting their passengers through the higher costs of getting a bond. Thus the degree by which the strong 'subsidised' the weak was much reduced. This is particularly so if the level of bonding is adjusted for each licence holder against its perceived degree of risk.
- 2.32 Thus it would be possible under this arrangement to require a minimal bond from one airline but a more substantial one from another. If however this requirement were extended to foreign carriers, it might be that differential bonding levels would have repercussions for international relations to the extent that one foreign airline was seen to be more or less creditworthy than another. The same difficulty would apply to judging the quality of the obligors of foreign airlines. A further difficulty still in that respect is that bonds have to be enforceable at law by the beneficiaries. This has so far pointed to accepting bonds only from UK-based obligors. It is not clear this policy could be continued if bonds were required from all foreign airlines.

(e) *Credit Cards*

- 2.33 In the UK, issuers of credit cards are liable equally with the supplier of the service for the satisfactory provision of their service in most circumstances. Thus if a passenger books a holiday with a tour operator and pays that tour operator direct by credit card (but not a charge card), then in the event of the financial failure of the tour operator, the passenger has recourse to the credit card issuer. If however the passenger pays by credit card to an agent, the credit card issuer's liability exists only if the agent fails. Only a small proportion of airline tickets sold in this country are paid for by credit card direct with the airline. In many other countries, the card issuer does not have liability similar to that in the UK. Payment by credit card is therefore unlikely ever to provide a full degree of protection.

(f) *Escrow*

- 2.34 Escrow would involve the placing in trust accounts of all money paid in advance by passengers, to be released to the airline only when the passenger had travelled. It was used in the US to protect passengers on charter flights. It is however likely to be formidably expensive. When used in the US, the rule was that all passengers on charter flights had to travel out and back in plane loads. Thus each flight necessitated only one escrow account. For scheduled services, where 100 passengers on a flight may return on a hundred different flights, the only way of ensuring security would be to have individual escrow accounts for each passenger. The other recognised drawback with escrow is that it deprives the airline concerned of working capital, and hence adds substantially to cost. Whether or not so severe a method of protection would be justified in some cases, it would obviously provoke outright hostility among Governments whose airlines were state owned. In addition, if any system of protection were meant to include passengers who book and pay abroad, escrow is plainly impractical.

(iii) **Practicalities**

- 2.35 There are some practical problems which need to be considered. The first relates to agents. In theory, if a passenger pays a sum of money for a scheduled airline ticket to an agent, if that agent fails before the money reaches the airline the airline is still liable to carry without further payment, as the agent was its agent and not that of the passenger. Thus if the passenger has in his possession an airline ticket, there should be no difficulty at all. In practice however there will be cases where passengers have paid money to agents for scheduled airline tickets, where the agent failed but the passenger's payment cannot be tracked to any airline and thus he suffers a loss. It is arguable that these cases would be de minimis and thus dealing with the failure of agents need not be brought into any scheme for protecting scheduled airline passengers.
- 2.36 The second difficulty, which is likely to be considerable, lies in identifying the amount of compensation for the passenger. This is so, even if a compensation scheme were restricted to passengers who book and pay only in the UK. Many airline tickets are 'illegally' discounted, and in these cases the amount of money shown in the fares box on the ticket as the fare paid is much greater than the sum actually paid by the passenger. In other cases, the fares box contains a code rather than a monetary amount. In many cases, particularly with late bookings, receipts for payment are not issued. A significant proportion of payments are in cash. It will therefore be difficult in a significant proportion of cases to discover exactly what was paid for travel.
- 2.37 A further difficulty is to decide whether the passenger should be covered for all his costs in respect of the failed trip, or simply the cost of flying. If a passenger has booked a combined package of air travel and hotel, he may in the event of the failure of the airline be unable to take up the hotel booking but still be liable to pay the hotel. Any compensation scheme would have to specify whether all the consequences of the failure of a scheduled airline were covered, or only the amount paid for travel on that airline. In some cases the passenger may have paid a combined sum for travel plus an additional service, and the two elements may not be readily separable.
- 2.38 There is also the problem of payment made abroad. Payment may be made in any country in the world, in any currency and by a variety of means. This is so whether or not cover is limited to UK-originating passengers only. The passenger in return may receive either a ticket or a miscellaneous charges order, redeemable for a ticket. To deal with cases such as these, if that were intended, rigid rules as to proof of payment and method of reimbursement (for example, exchange rates prevailing at the time of repayment or the time of original payment) would have to be laid down.

(iv) **Costs**

- 2.39 The cost per passenger of airline self insurance, were it available, is difficult to quantify.
- 2.40 The same considerations apply to the cost per passenger of self insurance against airline failure.

2.41 The quantifiable cost to the passenger of the present ATOL system is the total of licence charges plus the amount levied and put in the back up fund plus the cost to individual licence holders of the work in securing a licence and the sums payable in respect of getting bonds. All the figures which follow are at 1990 prices, that is current prices inflated by the RPI. The levy raised £51 millions: the Reserve Fund still contains £26 millions. Over the period since the levy was introduced, 117 million passenger journeys under ATOLs have been authorised. The cost per passenger authorised in ATOL charges is about 16p. With a net levy cost per passenger of 21p over the period, the cost per passenger of levy and licence charges combined is about 37p. This is equivalent to 0.14% of the current average passenger trip price. It is difficult to estimate the true cost of bonding. Probably 0.5% of turnover is a median figure for the industry, but the largest licence holders (who have a dominant share of the business) are likely, for a variety of reasons, to pay much less. The cost of bonding overall is probably in the range 0.2% to 0.5% of turnover. Added to the other costs already discussed, the cost per passenger of the protection scheme is of the order of 0.35% to 0.65% of the average trip price, or between £1.00 and £1.80. There is no reason to believe that the cost per passenger of a similar scheme for scheduled service passengers would be radically different in the long run. This conclusion is of course sensitive to the rate of bonding (if any) imposed and the rate of failure relative to the total market as a whole. If the proportion of failures and the cost of bonding are lower than among travel organisers (as seems likely given the fact that many airlines are and will remain state-owned) the average cost will be accordingly lower.

(v) **Legislation**

2.42 The only one of the options discussed which could be brought into effect without primary legislation would be self insurance by passengers against airline failure on a voluntary basis. While a requirement for UK airlines to take out bonds might be consistent with Sections 65 and 66 of the Civil Aviation Act 1982, any requirement for a foreign airline to hold bonds or for any airlines to contribute towards a levy – or any requirement for airports to do the same – would need legislation.



## **CHAPTER 3 SUMMARY OF RESPONSES**

- 3.01 This chapter contains a summary of the main parts of the industry responses as they relate to the practicalities of protection. The responses in full, which sometimes go rather wider, are in Annex 3.

### **Accident and General**

- 3.02 Accident and General were a specialist broker to the travel industry. Financial protection for scheduled airline passengers was already available to the public through cover arranged by them. In view of the number of passengers to be protected and the potential loss in the event of the failure of a major airline, the risk would have to be placed with a panel of insurers. However to determine the level of premium and cover would require detailed information concerning the number of passengers and the airlines. It appeared from preliminary discussions with insurers that cover would have to be on a compulsory basis in order to ensure premium income to insurers and keep premiums at an acceptable level.

### **Air Transport Users Committee (AUC)**

- 3.03 Although the AUC was greatly in favour of introducing a scheme to provide passenger protection against scheduled airline failure it believed the problem should be tackled on an international basis. It understood that the EC Commission was itself working on a proposal and therefore urged the government to wait for its publication. The Committee suggested a different way forward which involved providing the passenger of a failed airline with alternative travel arrangements rather than with financial compensation. It would be better if airlines agreed to honour the tickets of failed airlines and then claim from any bond or fund that had been set up.

### **The Air Travel Trust Committee**

- 3.04 The Authority discussed this issue on two occasions with the Air Travel Trust Committee. The Committee made no written submission as a Committee, though various members made submissions in other capacities; it did however offer comment and advice. The Committee noted at the outset that there was a trend towards holidaymakers constructing their own packages, that a significant proportion of leisure traffic now travelled on scheduled fares and that this appeared an area of growth for the future. It therefore welcomed in principle the consideration of extending protection to these passengers. It thought it possible however that the issue might best be approached on a European basis rather than by the UK in isolation.
- 3.05 The Committee acknowledged that there were significant political and practical difficulties in respect of airline bonding, though it noted that the low cost of protection through the ATOL system derived in part from the fact that the majority of claims were met through individual bonds rather than by the Reserve Fund arrangements. The Committee believed that a ticket tax levied on departures from UK airports to provide a common fund was the most feasible method of providing protection; a levy of (say) £1 per departure imposed for a year would create an appreciable fund and might then be discontinued provided that powers to reimpose it if necessary remained in being.

- 3.06 There were significant practical difficulties associated with applying the fund since scheduled air seats were widely discounted and frequently sold without any documentation confirming the price paid by the customer. The Committee endorsed a paper prepared by Mr Gavin Lyall which advocated that these difficulties could be overcome to a large extent if the principle of providing travel rather than reimbursing customers were adopted: the administrators of the Fund would make arrangements to provide alternative airline seats to passengers. The Committee also pointed out that an anomaly could occur if part charter seats were doubly covered.

#### **Air UK Ltd**

- 3.07 Air UK considered that the proposal to create a common fund built up by a passenger levy over a period of time to have most merit. However this would only provide partial protection as it would not cover passengers making payment outside the UK.

#### **Association of British Travel Agents (ABTA)**

- 3.08 ABTA favoured the option of a common fund based upon a small amount paid on each scheduled ticket issued in the UK. Passengers would then pay the same amount for protection regardless of carriers chosen and therefore all passengers travelling with all carriers would benefit. Protection should be limited to tickets purchased in the UK on UK and foreign scheduled carriers and exclude charter tickets covered by the ATOL system. There should be no distinction between business and leisure passengers nor of their nationality. Only the amount paid for the ticket would be compensated and other airlines subsequently carrying the passengers would be able to claim a like amount.
- 3.09 ABTA suggested that a fixed amount such as £1 could be added to the price of each scheduled ticket issued in the UK. Funds could be collected in three ways; through the Passenger Load Supplement on all arriving (or departing) passengers; it could be included in the air fare which would be paid with the agents monthly sales to the UK Bank Settlement Plan (BSP) and then passed on to the fund managers; or from the airline, based upon the number of transactions processed through the BSP. However a mechanism would have to be found for tickets issued directly by the carriers or their GSAs such as a levy on the airline proportionate to the volume of its direct ticket sale. The current Air Travel Trust fund management could readily be adapted to include an airline fund, either as part of the current one or as a separate entity.

#### **Association of Independent Tour Operators (AITO)**

- 3.10 A common fund or a primary bonding system supported by a common fund was the fairest approach as the public would be effectively paying for its own protection. The licensing authority should ensure that the airlines were fit to trade thus reducing the risk to the common fund. If such a fund was created AITO would insist that the same levy facility be extended to all tour operators and that their primary bonds be cancelled. If it was decided to impose a primary bond backed up by a fund created by public levy AITO would expect tour operators whose turnover was non-licensable to be afforded a similar facility.

### **Bowring Aviation Ltd**

- 3.11 There were three possible insurance solutions as means of protection against scheduled airline failure. The first was a 'mutual fund' such as the Air Travel Trust either as a stand alone fund or combined with some form of reinsurance support from the commercial insurance market. Non-compulsory individual insurance was a second option but this would lead to only poor risks being insured which in turn would reflect in high premiums. Compulsory individual insurance appeared to be the most viable solution and would provide the best spread of exposure for insurers and produce competitive premiums.

### **BAA plc**

- 3.12 It was important to ensure that any levy could not be interpreted as an airport charge as defined in the Airports Act 1986, since the revenues from such a charge would count against any price control formula imposed on the airport. Therefore any levy imposed should be clearly and separately identified as a CAA charge to avoid any implication that it was the responsibility of the airport operator or any attempt to include it in any calculations of airport charges. From its own experience BAA believed that there could be considerable international opposition to such a proposal unless it were restricted to passengers travelling on UK airlines. It also expected to have to levy a charge on the fund managers to recover the costs involved if the airports were expected to collect the levy.

### **British Airways plc (BA)**

- 3.13 In the event a scheme were to be introduced BA favoured a common fund financed by a passenger levy which guaranteed the value of airline tickets sold in the UK for journeys commencing in the UK. It would be easy to regulate, be fully effective in its protection and might be the only system which would not encounter significant adverse reactions from other governments. The basic workings of the fund should be as suggested in the Authority's consultation document but that the balance of the fund should be kept at zero. The money would then be made available to the fund as necessary by the government and recovered after the failure of the airline via the levy. If it were decided to keep a positive balance the levy should be set very low so as to build up the fund over a long period. There should be no distinction by reason for travel or nationality of the passenger and this would not lead to any enforcement difficulties. As passenger needs would normally be best met by arrangements which allowed them to continue with their journey, the common fund should meet the failed carrier's liability for all claims against tickets prior to the collapse whether the claim be for refund or from another airline following use. The fund would then recover from the receiver whatever part of this it was able.

### **British Midland Airways Ltd (BM)**

- 3.14 Airline insurance and bonding schemes were unsuitable as the airlines' survival would be in the hands of outside interests. Passengers were already able to insure themselves against the risk of scheduled airline failure and the fact that there was a general lack of policies available showed that there was little call for protection. The common fund was the most practical method of financing a scheme but the method of collection could cause problems for the airlines. Any levy against an airline would discriminate against individual airlines and in any event would be passed on to the passenger. However should a scheme be introduced it should cover all passengers travelling to or from or within the UK on any airline otherwise the scheme would discriminate against British airlines.

### **Cork Bays and Fisher Ltd**

- 3.15 Cork Bays and Fisher did not favour any particular option but believed any scheme introduced should include protection for passengers travelling on foreign airlines serving the UK. It would be very difficult for all airlines to arrange insolvency insurance on an individual basis but it might be possible to arrange 'blanket' insurance. This might be with UK composite insurers backed by appropriate reinsurance, provided cover was restricted to bookings made and paid for in the UK. An extension to the ATOL system was a possible alternative if it were decided to restrict protection to package holidays involving scheduled tickets. However in that event the Air Travel Trust would have to be increased. The final option would be to have a combination of a common fund and blanket insurance where the insurance protection was in excess of the fund and could only be called upon if the fund was exhausted.

### **Dan-Air Services Ltd**

- 3.16 If the Secretary of State decided to introduce a scheme Dan-Air favoured a common fund, built up by a small levy on each passenger landing at UK airports. This would avoid focusing attention on particular airlines and require all passengers over a period of time to insure consumers who suffered from the failure of scheduled airlines. Administration costs would be minimised if airports added the levy to their landing fees and handed over a total sum. It would be equitable to charge the levy on all passengers landing in the UK irrespective of nationality if compensation applied to foreign nationals on UK airlines and UK nationals on foreign airlines. It might also be appropriate to extend compensation to foreign nationals booked on foreign airlines to or from the UK who were stranded in the UK due to failure of the foreign airline. If the common fund was agreed in principle further consultation would be needed as regards the detail before the scheme could go ahead.
- 3.17 There would be problems in identifying the amount of compensation if illegal discounting had taken place. Compensation should be restricted to the amount paid by the passenger and the onus would be on him to establish evidence of payment. There might also be an extra liability on the fund where it was necessary to repatriate passengers stranded abroad.

### **European Tour Operators Association (ETOA)**

- 3.18 The ETOA represented international inbound tour operators and destination management companies in Europe whose members brought in excess of three million tourists to Europe during 1990. They believed a levy on passengers arriving in the UK would unfairly disadvantage the inbound travel industry particularly when many of the passengers would not benefit from protection. Therefore a scheme should be introduced on an international basis with the participation of all IATA airlines in the form of a levy on all scheduled tickets issued or a voluntary insurance scheme so that all air travellers would be protected.

### **Guild of Business Travel Agents (GBTA)**

- 3.19 The GBTA supported a common fund but was against a levy on inbound passengers. They believed such a levy would be considered a 'tourism tax' and many inbound foreign passengers would not benefit from protection. It proposed that £1 should be deducted from all international tickets and 50 pence from all domestic tickets settled

through the UK Bank Settlement Plan (BSP). Self certification would be used for airlines selling direct. The GBTA suggested the levy be imposed for one or two years and the fund administered in a similar way to the Air Travel Trust and cover failure of airlines or agents. This would enable airlines to accept tickets from failed airlines with the knowledge that they would be reimbursed from the fund. Also agents could replace or refund unflown failed carriers' tickets immediately and the passenger would therefore be at no time exposed. Compensation should be limited to cost of flying on UK issued tickets only.

#### **Incentive Travel & Meetings Association (ITMA)**

- 3.20 A common fund collected by a passenger levy was the correct option. The fund should be controlled by a central body who would also be in a position to assess the likely liability in the event of a major claim arising. It would be easier to levy departing passengers because there were several points within the airport where the money could be collected.

#### **International Air Transport Association (IATA)**

- 3.21 There was no case for the government to invoke legislation to ensure passengers were protected against scheduled airline failure which would be at the expense of other travellers. The most practical solution was by means of voluntary travel insurance which was already available in the UK. The insurance industry had a vast experience in handling claims and would be able to deal with all the complexities resulting from a scheduled airline failure.

#### **Lane & Partners**

- 3.22 The ATOL system should be extended to all 'packages' sold in the UK. This would offer greater protection for scheduled passengers and address the requirements of the EC Council Directive on package travel. The proposal would be to introduce UK legislation to require any person who sold as a principal a package, as defined by Article 2 of the EC Directive to hold a licence granted by the CAA. Therefore the ATOL system would be extended to include scheduled service based packages for which the principal would require an ATOL. In addition it avoided the need to distinguish between business and leisure passengers. It would cover packages bought in the UK only and would enable the UK authorities to retain control. Legislation should be introduced which addressed contracts made within the jurisdiction. The Government would be able to introduce some commercial discipline into the market place because the travel organiser would know that it was his responsibility if his passengers were booked with a risky scheduled airline. Lane & Partners were also of the view that there was no need to distinguish between British and foreign airlines. If the ATOL system was extended powers would have to be taken to impose a levy on package holiday customers whose protection was an issue in order to top up the Air Travel Trust.

#### **The States of Guernsey Transport Board**

- 3.23 Airlines should be required to provide insurance cover against their failure on all flights or holidays costing in excess of £100. This insurance cover should be passed onto the consumer as part of the ticket charge.

## **Travel & General Insurance Company Plc**

3.24 Travel and General commented on all the options covered by the Authority's consultation documentation but thought the creation of a common fund was a good idea. It could be merged with the Air Travel Trust to create a new Super fund. A levy collected by adding a fixed amount to the passenger load supplement would appear to be easy to put into operation and apply to all passengers departing the UK. There could also be a bonding system for new airlines and financially weak carriers which would protect the fund. An airline bond might run initially up to three years so that the airline had time to develop its potential. Bonds could be looked at in the event airlines started to show annual losses or the net current liability position deteriorated. In those circumstances it might be difficult for those airlines to fund a bond but it would enable the Authority to suspend its licence for non-provision of a bond. Passenger self insurance was a viable proposition and cover could already be obtained at reasonable rates. Open-ended insolvency cover for small emerging airlines was not an attractive proposition. However if an airline was asked to provide a bond, that bond might be insurable in the same way tour operators currently insure their bonds. It viewed the risk of insuring a bond for a small airline to be as four or five times the risk of a small tour operator.

## **CHAPTER 4 DISCUSSION**

### **INTRODUCTION**

- 4.01 This chapter reviews the issues in the discussion document (Chapter 2 above) and the responses (Chapter 3). It deals with the issues in the order in which they are expressed in paragraphs 2.15 et seq.
- 4.02 An initial issue which merits review is the scope of existing protection, which is referred to in paragraphs 2.06 to 2.11 above. Under the Civil Aviation (Air Travel Organisers' Licensing) Regulations, licences are required in respect of – and protection therefore extended to – travellers by air where the arrangements are made by a person who in the United Kingdom buys seats from an airline and resells them to the passenger. These passengers may travel on charter flights (as the great majority do) or on scheduled service flights. They may be travelling as part of a packaged arrangement, as the majority are, but they may have bought only travel. By no means all package travel on scheduled services is covered by these arrangements: if the air portion of the package is obtained direct from the airline or through its agent (as opposed to through an intermediary principal), there is no protection under the ATOL scheme. Thus the basis of the protection is the legal definition of the basis of purchase of the ticket, and the passenger may or may not be travelling on a package.
- 4.03 Under the EC Directive which must be brought into effect by 1 January 1993, member states are required to secure the protection of passengers who are travelling on packaged arrangements, irrespective of the legal basis of the flight portion of the package, provided that the package in question is prepared and advertised in advance. Passengers who buy travel only, or who buy an ad hoc rather than pre-packaged and pre-advertised package, are not required to be covered.
- 4.04 Thus the two schemes overlap but do not coincide. Under the ATOL scheme, those who buy travel only on a charter basis are covered. Some of those who buy prearranged packages are covered under the EC Directive, but not under the ATOL scheme.
- 4.05 The Authority understands that the European Commission is in the early stages of considering whether the package travel directive should be extended to all passengers on scheduled service flights. If such a scheme were adopted in those terms, there would still be a gap in the protection afforded through the EC Directive, in that the arrangements would still not extend to travel only on charter flights. If EC thinking does develop in this area, the Commission will doubtless wish to consider this apparent gap.

### **THE ISSUES**

- 4.06 The consultation paper first considered whether passengers should be differentiated by journey purpose. The Authority's provisional conclusion was that they should not. Those respondents who commented on this aspect agreed. No-one has suggested that only passengers travelling for leisure purposes (howsoever defined) should be covered. The practical difficulties in deciding who would be covered and who not would be formidable. Even if there were a 'social' case for not covering business passengers, or passengers whose ticket was paid for by someone else, the distinction is not one which can be practically drawn.

- 4.07 Country of residence as a means of distinction was discussed in paragraphs 2.18 and 2.19. Limiting protection only to passengers who book and pay in the UK (discussed in paragraphs 2.21, 2.34 and 2.38) was linked in the minds of many respondents, and this discussion covers both aspects.
- 4.08 Most respondents did not see country of residence as a relevant distinction. However, most of those who addressed the issue thought that protection should be limited to those who had booked and paid in the United Kingdom. The principal exceptions were the AUC, who advocated an EC solution, IATA, British Airways, for practical reasons, and BMA, for general competition reasons.
- 4.09 The Authority sees considerable difficulties in limiting protection to those resident in the UK or those who book and pay in the UK. A UK resident may book and pay for a UK originating flight in a foreign country. In that circumstance, he would not be covered. Equally, a foreign resident may travel to the UK with an open ticket and have it endorsed for travel in this country. He presumably would be regarded as having booked and paid in the UK, even though no money would change hands here. A passenger may book travel in this country and pay by means of a document or voucher, such as a miscellaneous charges order, issued abroad. None of these seem to be rational distinctions on which to decide whether a passenger should be protected. In any event, one of the purposes of introducing protection might be the social one of avoiding passengers being stranded in mid journey. In that event these distinctions would be inappropriate.
- 4.10 On the other hand, refunding passengers who have paid in a foreign currency will present a range of practical problems. These seem not to be insoluble, but will need to be considered in advance if those concerned are to benefit from any scheme of protection.
- 4.11 Nationality of airlines was discussed in paragraph 2.20. The Authority's conclusion was that there is no point of principle to protect passengers on UK airlines but not those on foreign airlines. This was strongly supported by all respondents who addressed the issue. UK airlines have made the point forcefully that protection on UK airlines only would, because of the cost, put them at a competitive disadvantage compared to foreign carriers, particularly as many foreign carriers, being state owned, are perceived to be free of the risk of financial failure. The Authority agrees with that view.
- 4.12 Non-packaged travel as a means of distinction was considered in paragraph 2.22. The Authority felt that this was not a valid distinction to be made, and those respondents who addressed the issue agreed. Leisure passengers may pay substantial amounts for travel only arrangements, particularly on long haul flights where the flight cost can easily equal or exceed the cost of a complete package within Europe. There is also a substantial amount of travel-only by leisure passengers within the EC, and there is no obvious reason why these passengers should be excluded from any scheme of protection.
- 4.13 The Authority concludes that distinguishing passengers on the basis of journey purpose, country of residence, nationality of airline on which they travel, place of booking and payment and package or non-packaged travel would all present significant drawbacks in equity and for practical or competitive reasons. In reaching this conclusion it does not overlook the formidable practical difficulties which might ensue from adopting an all embracing scheme.



## THE MEANS OF PROTECTION

- 4.14 To a limited extent passengers may already provide themselves on a voluntary basis with insurance against airline failure. The cover is however patchy both as to airlines covered and the conditions under which claims may be made. This discussion assumes that the Government would not be satisfied with a voluntary system of protection if it desired to ensure that passengers did not suffer loss from a scheduled airline failure. The advice the Authority has received is that it is improbable that on a voluntary basis the insurance market would provide the necessary amount of cover. It is likely that only those passengers who feel they have an exposure to the risk of an airline failing would buy the cover. The Authority is advised by the insurance industry that this would be an unattractive proposition for insurance because premium income would necessarily relate only to those airlines perceived to be at some risk, and would certainly exclude foreign state-owned airlines. Self insurance by airlines is not seen as a practical proposition by the Authority or by any of the respondents, including those in the insurance business. All respondents saw the risk that compulsory self insurance by airlines would give the insurance industry de facto control as to whether an airline was allowed to trade and that this would be unacceptable even in respect only of UK airlines. The implications if it were extended to foreign carriers for bilateral agreements are apparent.
- 4.15 The only desirable insurance option therefore seems to be protection of scheduled passengers by a collective insurance policy in respect of individual passengers to which all airlines are obliged to subscribe. Discussions with insurers are inevitably unsatisfactory to the extent that the insurance industry cannot be expected to provide firm answers to hypothetical questions. All responses were necessarily tentative. One respondent did however suggest that a collective insurance scheme could be put together to cover UK nationals and residents, provided insurance were compulsory. In that case, a premium of £5 per passenger might be achievable if cover were limited to £800 for a short haul trip or £1,500 for a long haul trip. The respondent also suggested that this rate might be considerably less if the premium were built into the cost of the airline ticket. It should however be noted that while the sums concerned would protect most passengers travelling at promotional fares, many travelling at higher fares would not be protected in full. Another respondent from the insurance industry thought that such a collective scheme might be viable but had been unable to confirm that the scheme would be workable in practice.

### **Bonding**

- 4.16 Bonding is discussed in paragraphs 2.26 and 2.27. All respondents who commented on the issue agreed that bonding in itself could not provide a complete answer: for the reasons given in paragraph 2.27, there are near-insoluble problems in arranging bonds to give entire cover. Some respondents also pointed to the distortion in the competitive balance of the aviation industry that a bonding requirement would create. State-owned airlines, perceived to be at no risk, could doubtless secure bonds from state-owned financial institutions at virtually no cost. Private sector airlines, on the other hand, would be liable to pay substantial premiums in some cases. Bonding requirements frequently reduce a company's borrowing capacity, which again would affect only private sector airlines.

## **Common Fund**

- 4.17 A common fund is discussed in paragraphs 2.28 to 2.30. This was the solution which was seen as the most acceptable by almost all the respondents who commented on this aspect. It was seen as having the advantage of being largely neutral in its effect on inter airline competition, in that all airlines pay the same per passenger, irrespective of their ownership or financial state. It was also seen as being the most acceptable (or perhaps the least unacceptable) to the generality of foreign airlines. One advantage seen by the Authority (and supported by British Airways) is that the organisers of such a fund do not need to have large amounts of cash to hand, as opposed to the ability to raise it by levy from the industry as required. For this reason if for no other it is likely to be the cheapest of the options, in that expense is incurred only when a loss crystallises: the alternatives of insurance and bonding require expense in anticipation of a loss.

## **Bonding plus backup fund**

- 4.18 This option is what now exists in respect of air travel organisers' licensing. Its antecedents are historical, in that bonding was initially the sole form of protection, and the Reserve Fund was added when bonding was found to be inadequate on its own. The arguments about the adverse effects on the competitive environment of bonding as the sole means of protection were seen by respondents to apply equally in this case.
- 4.19 The perceived advantage of this option over the Common Fund as the sole line of defence is that the cost of the requirement to hold a bond to some extent redresses the point that the Common Fund does not reflect the financial status of the airline. Nevertheless, all respondents who considered the point supported the Common Fund rather than bonding plus the Common Fund.

## **Escrow**

- 4.20 Paragraph 2.34 discussed escrow. Those respondents who considered the point agreed that this was not a serious proposition because of the cost.

## **PRACTICALITIES**

- 4.21 A number of practical problems were discussed in paragraphs 2.35 to 2.38. Respondents agreed with the problems identified in Chapter 2 and indeed identified additional ones – such as the position of the passenger travelling on the middle sector of a multi-sector journey who finds himself in the UK when the airline fails.
- 4.22 Mr Gavin Lyall, a member of the Air Travel Trust Committee and a consultant to the Airline Users Committee, suggested that the problems of identifying how much passengers had paid and refunding them accordingly could be to some extent overcome if the administrators of the reserve arrangements made it their first task to supply the passenger with alternative travel rather than a cash refund, which they could do by making arrangements with airlines flying on the same or similar routes. This seems to the Authority to be a suggestion of considerable merit. If the principal line of defence were that the tickets on the failed carrier would be honoured by surviving carriers, who would in turn be reimbursed from the reserve arrangements at the published price for the appropriate class of travel, this would go a long way to

reducing administrative problems as well as solving the difficulties such as payment not identified on the ticket, payments actually made not reflected by the price on the ticket, payment made in foreign currency and so on. To the extent that alternative travel could be provided, it would also solve some of the problems identified in paragraph 2.37. While Mr Lyall's suggestion, if adopted, would solve many of the practical problems, it could not of course solve them all, particularly where the failed airline was the sole operator on a route or routes.

## **COSTS**

- 4.23 For reasons discussed in paragraph 4.15 above it has not been possible to identify costs of the insurance options any more than is recorded in that paragraph. No doubt better figures could be obtained once the type of scheme had been more precisely identified.
- 4.24 Paragraph 2.41 shows the cost of the Air Travel Organisers' Licensing Scheme. While the protection cost per trip works out between £1.00 and £1.80 historically, it will be seen that the greater part of this cost is an estimate of the cost of bonding. Administration costs are very low. If a common fund only solution were adopted, there is no reason to think that the administration costs would be significantly higher than in the ATOL case, and possibly lower. If, for example, a levy on all departing passengers were made (and added to the passenger load supplement at airports where the PLS was charged on departing passengers) the collection cost would be unlikely to be more than three or four percent and possibly less, of the total raised, which would represent a minuscule amount per passenger covered. It would of course be essential that the levy be raised on either all departing or all arriving passengers, or domestic passengers might pay twice on the same flight.

## **LEGISLATION**

- 4.25 The view expressed by the Authority in paragraph 2.42 was that the only solutions not requiring legislation were voluntary insurance and a bonding requirement on UK airlines only. If it is the case that the European Commission is actively pursuing protection of all scheduled passengers on an EC-wide basis (which was not known to the Authority at the time the consultation document was written), then subordinate legislation might be made as a consequence of an EC directive. Any such directive might however be confined, like the Package Travel Directive, to travel booked within the EC.

## CHAPTER 5    ADVICE

- 5.01    The Authority was not asked by the Secretary of State to comment on the desirability of extending protection in respect of financial failure to the passengers of scheduled service airlines and, despite the invitation of at least one respondent, does not do so. What follows are the views of the Authority on the principal considerations which those taking the decision are likely to have in mind.
- 5.02    It is apparent that some form of protection could be achieved for at least some passengers at relatively modest cost, and that the number of options is large. Other bodies are also engaged in trying to extend some form of protection, most notably IATA and (perhaps) the EC. It seems to the Authority that the risks of scheduled airline failure are likely to increase in the future as governments encourage more private sector ownership of airlines and allow a more competitive environment. The speed at which these risks increase and the seriousness of them is a matter of debate.
- 5.03    If a decision to extend protection in some way is taken, the Authority believes that it is of considerable importance that the means chosen should have the minimum (and preferably no) impact on the competitive environment. There are already major inequalities between airlines operating in the same markets because of ownership, existing route networks and entrenched positions at congested airports. Any protection measures which made these inequalities worse, by for example advantaging airlines in state ownership, would ill serve the passengers on whose behalf they were ostensibly being taken. This was a matter to which all the airline respondents attached great importance and the Authority believes they were right to do so.
- 5.04    As explained earlier, there already exists one protection scheme (ATOLs) with another stemming from the EC Directive on Package Travel likely to be implemented in the next 18 months. It is desirable that any proposal to extend protection to all scheduled service passengers should take account of what already exists and preferably should build upon it. As shown in paragraphs 4.02-4.04, some scheduled service passengers are already covered under the ATOL scheme and others are likely to be following the implementation of the Package Travel Directive. Within the EC 'scheduled services' may become an outmoded concept as the Single Market is achieved, and airlines are authorised to operate services between two points without any restriction on whether the passenger bought his ticket from the airline or from an intermediate principal. These considerations point to extending protection, if that be the decision, on a basis wider than simply the UK.
- 5.05    The Authority was not specifically asked to comment on the international implications of protection, although some inevitably arose en passant in the consultation document and in the responses. There can be little doubt that if protection is to be afforded, it would be more easily and better achieved on a multilateral basis than unilaterally. IATA has proposals which it is urging on its members and which, if they were achieved multilaterally, might be the best answer. IATA is however a voluntary body with no authority to bind its members. Nor does it cover a number of small airlines who, while few, are more likely to fail financially. No EC proposal now exists to extend protection to all scheduled service passengers. Were there a proposal to extend protection at least to all passengers who book and pay in an EC country, this might go a long way to meeting a perceived need. A

proposal relating only to EC airlines might however be seen in a different light, given the importance of long haul travel.

- 5.06 The minimum protection which would have any impact would be for passengers who book and pay in the UK for travel on UK airlines. The Authority believes such a scheme is unacceptable and would advise against it. It takes this view because of the impact it would have on the competitive environment and because if protection is actually needed limiting it in this way would deprive many passengers arbitrarily.
- 5.07 In the Authority's view, a minimum scheme would cover all passengers who book and pay in the UK, irrespective of the nationality of the carrier with whom they have contracted. Limiting protection in this way would however bring the difficulties described in paragraph 4.09 above. If it were achievable, a scheme covering all passengers making an air journey to, from or within the UK would be the most desirable.
- 5.08 The Authority sees no case for limiting protection to passengers travelling for leisure purposes, however defined. Not least, the practical difficulties seem insurmountable. If however this were thought to be a socially desirable objective, it could be achieved in part by limiting refunds to a specific amount (as described in paragraph 4.15) or if alternative travel were offered by restricting the class of travel.
- 5.09 So far as the means of protection are concerned, the Authority has not been able to establish as much detail on the possibilities of insurance as it would have wished, for the reasons described above. Nevertheless, it has little difficulty in agreeing with the majority of respondents that the preferable course is in any event the establishment of a common fund. This has the least effect on the competitive environment and, providing it is used as a facility rather than actually raising a large sum of money, it is the cheapest method.
- 5.10 Many of the Authority's observations on the practical problems must be tentative in the absence of a decision on whether protection will be extended and if so to what extent. It will be glad to comment further if so requested in due course.

**ANNEX 1            TEXT OF A LETTER DATED 22 MARCH 1991 FROM THE  
SECRETARY OF STATE FOR TRANSPORT TO THE CHAIRMAN OF  
THE CIVIL AVIATION AUTHORITY**

**FINANCIAL PROTECTION FOR AIRLINES' PASSENGERS**

As you know, I informed the House of Commons on 11 March that I had asked the Authority to consider whether some arrangements could be introduced to help protect scheduled passengers against financial loss and disruption. Our officials have had some initial discussion on the question and I am writing now to set out in more detail what the advice should cover, and to suggest a timescale.

Although the need for protection for scheduled passengers was raised in the context of the successful operation of the bonding scheme for charter passengers, there are clearly a number of possible ways of providing protection, and I would not want to imply that a bonding scheme must be the answer, or to rule out any option in advance.

I would therefore be grateful if your advice could consider what options there are for protecting airlines' scheduled passengers (ie all those passengers not covered by the existing ATOL arrangements) in cases where an airline fails. Among the issues you will need to advise on are the coverage of a scheme, whether Government or the Authority needs to have any role, the options for providing cover, the likely costs, enforceability of any scheme, and the need for legislation (if any). Your views on the general practicability of the options will also be welcome.

You may wish to consult the industry, and if so you will need to allow adequate time for responses. I would be grateful for your advice by the end of July.

**ANNEX 2      CIRCULATION LIST FOR DISCUSSION DOCUMENT**

ABTA      Mr J Dunscombe  
            President  
            Association of British Travel Agents

Air UK     Mr A Grey  
            Managing Director  
            Air UK Limited

ATTC      Lord Lane of Horsell  
            Chairman  
            Air Travel Trust Committee

AUC        Mr J Cox  
            Chairman  
            Air Transport Users Committee

BA         Sir Colin Marshall  
            Deputy Chairman and Chief Executive  
            British Airways plc

BMA        Sir Michael Bishop  
            Chairman  
            British Midland Airways Limited

Dan-Air   Mr D James  
            Chairman  
            Davies and Newman Limited

GBTA      Mr D Reynolds  
            Chief Executive  
            Guild of Business Travel Agents

IATA      Mr D Viggers  
            IATA

ITMA      Mr R J White  
            Chairman  
            Incentive Travel and Meetings Association

JEA        Mr D McCulloch  
            Managing Director  
            Jersey European Airways Limited

**ANNEX 3****LETTERS RECEIVED IN RESPONSE TO DISCUSSION DOCUMENT**

The letters received by the Authority in response to its Discussion Document are reproduced in the following pages.





## Accident & General Limited

Black Lion House, 45 Whitechapel Road, London E1 1DU  
Telephone 071-377 6131 Telex 884639 Fax 071-377 6151

Mr K. A. Hind  
Civil Aviation Authority  
CAA House  
45-59 Kingsway  
London  
WC2B 6TE

REF: SN/SM

13th June 1991

Dear Mr Hind,

RE: FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS

Thank you for your letter of the 31st May addressed to Mr Weston in respect of the above.

We are pleased to be asked to offer proposals and would firstly like to outline our activities.

Accident & General Limited, a specialist broker to the travel industry is part of the D. G. Durham Group plc. Its sister company Durham Hadley Cannon is a Lloyds broker. Accident & General has amongst its portfolio Owner's Abroad, Thomas Cook, Pickfords, Jetsave, Unijet and many leading tour operators and we are also the appointed ABTA broker in respect of our retail products TravelGuard and are responsible for many innovative covers which today are regarded as "Standard" to travel policies.

I would advise you that financial protection for scheduled airline passengers has been available to the public on the previously mentioned Travelguard Gold product, the ABTA recommended retail scheme and offered by Thomas Cook on their Independent Traveller product, both covers arranged by Accident & General Limited.

This protection was introduced on policies designed by Accident & General some 3 years ago and is therefore an insurable risk. Please note that travellers who purchased the above policies were covered for the Capital Airlines and Air Europe failures, mentioned in your report, and I enclose sample wordings for your information.

On the basis of providing cover to UK nationals/residents and utilising your figure of 56 million passengers then it is our view that this risk would have to be placed with a panel/consortium of Insurers having in mind the potential loss in the event of the failure of a major airline. We would be able to arrange this consortium.

The information we would require to determine the level of premium and cover

.../...



## Accident & General Limited

Black Lion House, 45 Whitechapel Road, London E1 1DU  
Telephone 071-377 6131 Telex 884639 Fax 071-377 6151

- 2 -

would be as follows:

- a) The anticipated number of passengers requiring cover,
- b) The names of the airlines involved including:
  - (i) details of their fleet size,
  - (ii) annual turnover, including capacity and a full set of independently audited accounts,
  - (iii) details of their routes, including a split between Worldwide and European traffic.

In preliminary discussions with Insurers, it has been mentioned that to ensure premium income to Insurers and to keep premiums to an acceptable level, Insurers would require the cover to be on a compulsory basis. It is not possible to confirm premium at this stage without the above information, but we have indications from Insurers that cover could be effected for a Sum Insured of £800 (European) and £1,500 (Worldwide) at rates not exceeding £5.00 per passenger. The indication from Insurers is that the rate could be considerably lower than this if the premium is built into the cost of the air ticket on a mandatory basis.

Accident & General would be pleased to provide further information and quotations subject to receiving your instructions.

We look forward to hearing from you.

Kind regards,

Yours sincerely,

  
**STEVE NICKERSON**  
**SALES DIRECTOR**

# Air Transport Users Committee

Representing Air Passengers and Shippers

# AUC

2nd Floor  
Kingsway House  
103 Kingsway  
London WC2B 6QX

Mr K Hind, Coordinator  
Civil Aviation Authority  
45-59 Kingsway  
London WC2B 6TE

Telephone: 071-242 3882  
Fax: 071-831 4132

14 June 1991

Dear Mr Hind

## **FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS**

Thank you for your letter of 10 May inviting the AUC's views on the issues raised in the Authority's paper on Financial Protection for Scheduled Airline Passengers.

This matter has twice been considered by the Committee meanwhile, more recently at its meeting on 12 June. It no doubt goes without saying that we are greatly in favour of introducing a scheme to provide protection against financial risk and disruption to passengers in case of airline failure. The Committee notes, however, that the only one of the options discussed in your paper which could be brought into effect without primary legislation would be voluntary self-insurance by passengers - a course which the Authority itself recognises is open to two important objections. As to possible legislative action, we have some real doubts - although this must of course be a matter of opinion - as to whether the present Government could find time for legislation before the next General Election and as to whether a new Government, of whatever complexion, would make it a priority matter in the next Parliament.

Meanwhile the Committee understands that the Brussels Commission intends to come forward by the end of this year with a proposal aimed at providing protection of the kind which the Secretary of State has in mind on a Community-wide basis. It seems highly unlikely that once this proposal is made, the governments of other Member States would take kindly to national legislation being brought forward in the United Kingdom, even if HMG's intentions happened to coincide with those of the Commission. Accordingly, we are inclined to think that the question put to the Authority by the Secretary of State is to a large extent, academic. Since in any event we would think it preferable for the issue to be tackled on an international basis, our view is that HMG should hold its fire pending the arrival of the Commission proposal.

I recognise that none of this is of any help to the Authority in responding to the Secretary of State. On the substantive issue, we note that the Authority itself considers a number of the options in your paper to be plainly unsatisfactory and that it considers none of them to be wholly satisfactory. This is also the AUC's view. It does occur to the Committee, however, that there is another possible way forward, of a radically different kind. This would involve providing the customers of a failed airline with alternative travel arrangements rather than with financial compensation. The bare bones of such a scheme are given in the enclosed note by one of the Committee's Honorary Consultants, Mr Gavin Lyall, which the Committee has endorsed as a possible way forward. Indeed, the Committee considers it to be sufficiently promising as to be worth passing to the Commission and I am therefore sending them a copy too.

Yours sincerely

**JOHN PARR**  
Director-General



## PROTECTION FOR THE SCHEDULED PASSENGER IN AN AIRLINE FAILURE

1. A major element in the Bond-and-Fund protection afforded the package holidaymaker is the assignability of claims. In other words, somebody who has bought a package holiday from X (who fails) can take the paperwork to Y, who will provide a holiday at the same date and probably same place, so that then Y makes a claim on the bond or fund and the holidaymaker gets what he or she originally paid for. From the holidaymaker's point of view, this is probably the major benefit of the scheme: he would rather have the holiday at the right time than the money back.
2. Presumably this is also true of the scheduled passenger who has, by buying a ticket, taken a decision to fly and would rather do so than get the money back. Given the problems we have discussed of actually proving how much a passenger paid for an unused ticket and of refunding that money, it would seem far better if other airlines could be persuaded to honour the failed airline's tickets, fly the passenger (at the time and date nearest to the originally planned flight) and then claim from any bond or fund that had been set up.
3. Obviously these other airlines will not usually act out of charity, nor will they want the laborious business of checking the value of every ticket presented to them. It will not work if the onus is simply shifted from the administrators of the compensation money to the airlines. But it might work if the administrators could guarantee the airlines that they would not lose money and perhaps make a tiny profit: offer them something like 'cost plus one per cent' or ask airlines for bids.
4. In effect, this means reversing our thinking: stop bothering about how much each passenger paid, just think how much it will cost to give that passenger a flight: this would possibly be a far simpler problem. Probably some money would be wasted, but a lot would be saved on administration (recall the £2 million admin costs of paying out to Laker's package passengers for their compensation). It would be rough justice but quick and cheap - provided passengers had no legal right to get everything they had paid for such as

exactly the same timing and date of flight, Club Class seating etc. Try and give them precise compensation and the paperwork will overwhelm any scheme; just give them a flight.

5. This could not work for every passenger in every failure. But if it solved the problems of a decent percentage of passengers, then the administrators would only have to worry about the remaining special cases. There will always be those anyway.

The CAA seems convinced that there would be no basic problem in collecting together a fund, probably from a £1 levy on all departing passengers for a year, which would bring in about £25 million. This levy would be collected from airlines by the airports, not direct from each and every passenger. If the administrators of the resulting fund were given the power to re-impose the levy whenever needed, they would have sufficient security to borrow whatever was needed to top up the fund in case of a major airline failure.

However, details of the funding side of the scheme would presumably depend on whom the scheme is planned to protect. Would it be all holders of tickets on the failed airline, no matter where those tickets were bought? Or only holders of tickets bought in the UK? Or only holders of ticket coupons for departure from the UK (ie passengers stranded here) and not for coupons to the UK (those stranded abroad)? And so on. The question about whether it is fair to levy those who may not benefit from the scheme will be asked (although all levies are to some extent unfair, charging today's passengers to compensate tomorrow's) and clearly it would appear fairer if any scheme were EC-wide: the levy could then be charged only on domestic and EC departures, which will presumably use different gates from other international flights after 1992. And it would obviously be more reassuring if passengers knew they were covered against failure on any EC airline.

That said, other EC governments (few of whom have any current protection scheme for package passengers) now have to legislate for the failure of any travel package, not just one involving the air, by 1993. They may not welcome the idea of yet another piece of legislation to protect the travel-only scheduled passenger as well. What about the ship and long-distance coach passenger? The Rhine cruise passenger? (or is that a package?).

AG/BM/697

17th June 1991

Mr K Hind  
Coordinator  
Civil Aviation Authority  
CAA House  
Room T505  
45-59 Kingsway  
London  
WC2B 6TE

Dear Mr Hind

## FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS

Following our telephone conversation, I am briefly summarising the points I made on behalf of Air UK regarding a scheme for the financial protection of passengers travelling on scheduled services.

Air UK would have no objection in principle to a scheme of financial protection that was adopted generally by the industry, both airlines and agents, subject to the following criteria:

- i) it should be transparent,
- ii) it should be fair and equitable both for passengers and airlines.

By transparency is meant the clear publication of the conditions of the scheme, its operation and the passenger's entitlements.

A number of the proposed options would have difficulty in meeting the second criteria.

Any insurance policy effected by the airline would inevitably penalise the smaller independent carriers who would be considered very much more significant risks than national carriers who are, for the most part, majority state owned. The same argument would apply if it were the passenger who effected the insurance since premiums would be higher for travel on independent carriers.

Continued.....

Any bonding scheme would have the same objections since it would impose a greater financial penalty on non-state owned or non-national carriers.

There are in addition the problems raised in the CAA regarding either an insurance or a bonding scheme.

The proposal which has most merit is that put forward by ABTA who have proposed a passenger levy which would be imposed during a period of time and be used to create a common fund. However such a scheme would create the anomalies mentioned in the paper since passengers making payment outside the UK would not be covered and thus it would only provide partial protection.

I hope the above is useful. Should you have any requirement for clarification or further detail please let me know.

Yours sincerely

A handwritten signature in cursive script that reads "Andrew Gray". The signature is written in dark ink and is positioned above the typed name.

Andrew Gray  
Managing Director





The Association of British Travel Agents Ltd

*Registered in England No. 35137 London*

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London W1P 4AH  
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Telex: 22254 ABTA G  
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DX 85900  
Oxford Circus East

ABTA RESPONSE TO THE CAA

FINANCIAL PROTECTION FOR SCHEDULED AIRLINES' PASSENGERS

1. The Association welcomes the opportunity to comment on proposed financial protection for scheduled airlines' passengers. It is of the view that there is great confusion among members of the British public as to which elements connected to travel are protected and which are not.

2. The Authority rightly points out that protection can be obtained through self insurance by passengers which would obviate the need for legislation. However this is equally true for package holidaymakers. Such solution was presumably rejected by government at the time the Air Travel Reserve Fund Bill was enacted and, not least for the sake of consistency, should be rejected as a solution to the matter now under discussion.

DL Epstein FCA  
Director General

AG Bowen LLB  
Secretary



## A Common Fund

3. The Association acknowledges the options submitted by the Authority in its document. It has been working on the issue for some months and favours the option of a common fund, based upon a small amount paid on each scheduled airline ticket issued in the UK. The Association accepts that a common fund, whereby each passenger would pay the same amount for protection regardless of the carrier chosen, would benefit all passengers travelling with all carriers, as it is the complete protection of the consumer, which we believe to be of paramount importance.

4. The necessary legislation should offer protection through a common fund over the limited basis outlined below. However provision should also be made to widen the scope in the light of experience. Such protection should:

- be limited to tickets purchased in the UK on UK registered and foreign scheduled carriers
- exclude charter tickets issued under ATOLs
- not distinguish between business and leisure passengers
- be regardless of the nationality of the passenger

5. It is suggested that only that amount paid for the ticket be compensated. This would be in line with current claims under CAA and ABTA regulations. Other airlines subsequently carrying the passengers would also be able to claim a like amount. Just as consumers claiming under ATOL regulations are required to provide proof of payment, so should airline passengers.

## Method of Collection

6. A fixed amount, say £1.00, could be added to the price of each scheduled ticket issued in the UK. The following options have been considered for the collection of such funds:

- (a) through the Passenger Load Supplement on all arriving (or departing) passengers. Whilst this would ensure easy collection and remittance to the fund managers, it could be difficult to distinguish between passengers with UK issued tickets and those with foreign tickets.
- (b) by being directly included in the air fare or shown separately, for example in the tax box. The amount would be paid through with the agent's monthly sales to the UK Bank Settlement Plan. (The BSP UK currently has 92 IATA and non-IATA carriers participating and some 4,800 (IATA and domestic) agents and accounts for some 20 million tickets per annum. Many off-line carriers are represented by other airlines or GSAs already participating in the BSP.) The BSP, against a small administration fee, which is understood to be minimal would pay the amount to the fund managers.
- (c) from the airline, based upon the number of transactions processed through the BSP (again well documented). Such charge could ultimately be passed on to the passenger in the air fare. This

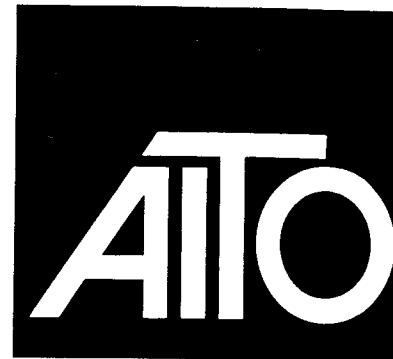
would be more practical than (b) involving fewer  
larger amounts.

It must however be appreciated that although the vast majority of airline revenue in the UK comes from agent sales and thus through the BSP, it excludes tickets issued directly by carriers or their GSAs. A mechanism would have to be found for these; such as a levy on the airline proportionate to the volume of its direct ticket sales.

7. Considerable experience has been gained on the fund management of ATRF/ATT which the Association feels presents itself as an excellent model. It is believed that the current ATT fund management could readily be adapted to include an airline fund, either as a part of the current one or as a separate entity.

SMP/DCW/1150

10th June 1991



12th June, 1991

K. Hind, Esq.,  
Co-ordinator,  
Civil Aviation Authority,  
CAA House (Room T505),  
45-59 Kingsway,  
LONDON.  
WC2B 6TE

P.O. Box 180  
Isleworth, Middlesex  
TW7 7EA  
Fax 081 568 8330  
Telephone 081 569 8092

Dear Mr. Hind,

Justin Fleming, formerly Chairman of ABTA's Tour Operators' Council, has kindly passed a copy of the discussion document on "Financial Protection for Airlines' Scheduled Passengers" to us. Although we are not on the list of those whose views have been sought, we hope that, nevertheless, the Civil Aviation Authority will be interested in our comments.

First of all, we should like to congratulate you on an excellent working paper - the subject has been covered very thoroughly, with considerable insight into the workings of the industry. AITO's comments are few and in the nature of general background observations, as our members will not be affected directly by the course of action which is ultimately taken.

Our main initial comment is that we feel that, because distinctions between the various sectors of the industry are now becoming blurred, everyone who travels, whether by coach, air, train, ferry, etc., should be protected equally.

We should now like to comment in respect of various paragraphs, as indicated:

Paragraph 16

We agree that any protection effected should cover both business and leisure passengers.

Paragraph 22

We agree that such protection should also cover those who have not bought a package. (In other words, that the cover proposed by the EC Directive should be extended to those who buy travel only.)

Paragraph 25

MKC PLC, insurers, currently offer a transporter failure policy which can be bolted on to a customer's travel insurance, if taken through MKC, for an additional premium of £5. They do not differentiate between those transporters they consider safe and those they feel could be at risk. The small print states that they would not pay out if a bond were already in

force. No doubt the insurers would gather sufficient premium income from policies taken out on "safe" carriers to enable them cover any small losses they might anticipate suffering on those that collapsed.

Paragraph 26

AITO has, of course, also established a bonding scheme covering non-ABTA operators with non-licensable business.

Paragraph 27

Bonding levels of 30% are punitive, no matter what the size of the company - everything is relative. ABTA is currently demanding 20% to 30% bonding levels from many of its members.

It would be unfair to treat airlines as a "special case" by assuming they were less able to cope with bonds than tour operators. Whatever is ultimately decided for airlines should also apply to tour operators.

You rightly comment that bonding may unfairly burden independent airlines as opposed to state-owned or heavily protected airlines, such as British Airways. In the tour operating sector, independent operators are similarly at a considerable disadvantage under current bonding regulations when compared with those operators owned by Midland Bank, Granada, Thomson Corporation or one of the state-owned foreign airlines.

We feel, therefore, that any decisions taken to ensure the fair play of a system to be applied to airlines should also be applied to the existing bonding system for tour operators.

Paragraph 28

The common fund idea, or a primary bonding system supported by a common fund, is the fairest approach in our view as it does mean that the public is, effectively, paying for its own protection. It should be the task of the licensing authority to make sure that the airlines are fit to trade and thus reduce the risk to the common fund, in the same way as the CAA currently vets tour operators' finances.

However, the fact that the CAA could not examine accounts or enforce requirements on foreign airlines does really point to a primary bond (to prevent irresponsibility), backed by a common fund created by public levy, as the only fair solution.

Paragraph 30

This argument seems to assume that airline finances, whether UK or foreign, would not be scrutinised in order to determine their fitness to trade. We would argue that airline finances should be scrutinised, while accepting that this would be easier to ensure for UK-based airlines than for foreign airlines.



Paragraph 37

Hotels generally only charge a maximum of 1 to 3 days' cancellation fees. To attempt to cover this cost as well as the cost of the airline seat would be complicating matters. If the customer knew he would be refunded for his flight costs in respect of the collapsed carrier, then he would probably still travel, using another airline.

Paragraph 38

Old MCOs (Miscellaneous Charges Orders) lying forgotten in drawers or briefcases probably add up to quite a large sum of money. They represent a considerable additional source of revenue to airlines as customers tend not to cash them for some time - but, of course, if an airline collapsed, there would be a flood of MCOs appearing with requests for refund. It could be very difficult to quantify the amounts likely to be reclaimed should such a situation arise.

Comment

As tour operators, we are interested to note that a levy on the airline passenger in order to create a fund seems to be the likely solution. Should this course of action be chosen, then we would insist that the same levy facility be extended to all tour operators and that primary bonds be cancelled. If it was decided to impose a primary bond backed up by a fund created by levy on the public, then we would expect tour operators whose turnover was non-licensable and who were, therefore, not covered by the Air Travel Trust, to be afforded a similar facility. It would be unfair commercially to rule out bonds for airlines and yet insist on them for tour operators; it would afford the airlines an unjustifiable privilege.

We should be pleased to discuss the above, or any other issues, further with you if you felt this would be of assistance.

Yours sincerely,

Noel Josephides  
Chairman





Bowring Aviation Ltd.  
The Bowring Building  
Tower Place  
London EC3P 3BE  
Telephone 071 357 1000

# Bowring

7th June, 1991

Mr C. Paice  
Group Director  
Economic Regulation Group  
Civil Aviation Authority  
CAA House  
45-59 Kingsway  
London WC2B 6TE

Dear Mr Paice,

## FINANCIAL PROTECTION FOR AIRLINES' SCHEDULE PASSENGERS

Further to my letter dated 30th May, 1991, I regret to advise that the insurance market has still not provided anything concrete for me to report to you as regards an insurance solution to the above captioned. It would appear that a new product is required and that the lead time on this is greater than originally envisaged. However, there are three possible solutions to be considered :-

1. Mutual Fund A fund along the lines of Air Travel Trust is a possible solution either as a stand alone fund or combined with some form of reinsurance support from the commercial insurance market.
2. Individual Insurance - Non-Compulsory Allowing individual passengers to purchase the insurance required is a solution but as we discussed this would give rise to only those passengers who feel they have an exposure buying the cover. This would lead directly to selection against underwriters which would be reflected in exorbitant premiums.
3. Individual Insurance - Compulsory. Given that this basis will provide the best spread of exposure for Insurers, it would undoubtedly produce the most competitive premium rating level. It would also allow a group of insurers to be assembled who would then generate sufficient capacity to underwrite the risk.

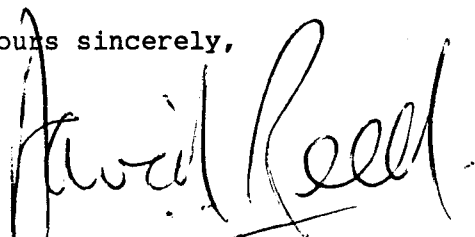
/2.....

Based upon the foregoing I feel that the only viable solution is that as set out in 3 above, and this would give a fairly well based structure to any proposal. Unfortunately, it would take some time to generate sufficient interest amongst Insurers before I am able to confirm to you that the commitment exists.

As regards pricing, given the compulsory nature of the insurance, I would have felt that a premium well below £1 per head would be the target to aim for.

I trust that the foregoing assists and confirm that I am making investigations in more detail. In the meantime, I attach for your reference and information an article which recently appeared in the insurance press.

Yours sincerely,

A handwritten signature in cursive script that reads "David Reed". The signature is written in dark ink and is positioned above the typed name and title.

D.P. REED  
Director

**BAA plc**

Corporate Office  
130 Wilton Road  
London SW1V 1LQ  
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Telex 919268 BAAPLC G  
Fax 071-932 6699

**Mr K A Hind**  
Coordinator  
Civil Aviation Authority  
CAA House  
45-59 Kingsway  
LONDON WC2B 6TE



12 June 1991

Dear Mr Hind

**FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS**

Thank you for your letter of 4 June 1991 inviting BAA's response to the CAA's consultation paper. This letter does not offer any general comment on the broad issues raised by the CAA, but only on those concerning airport charges mentioned in paragraph 28.

At the outset it would be important to ensure that any charge could not be interpreted as an airport charge, as defined in the Airports Act 1986, since the revenues from such a charge would then count against any price control formula imposed on the airport. This would require a revision to the price control formula, which would be administratively onerous, and could provoke a full scale review of airport charges at a time when it would not otherwise be required.

BAA would of course wish for such a charge to be clearly and separately identified as a CAA charge, to avoid any implication that it is the responsibility of the airport operator, or any attempt to include it in any calculations of the burden of airport charges. We are also less sanguine than the CAA on the degree of international opposition to such a charge. It is our experience that airlines can mount formidable and sustained opposition to charges at BAA airports. In this case, as we understand it, passengers on foreign airlines may be called upon to pay a charge which may only be used to refund passengers on failed UK airlines. There could be very considerable opposition to such a proposal, unless it is restricted to passengers on UK registered airlines. This would, however, presumably affect the competitive position of the UK airlines.

Finally, the paper suggests that administration of such a scheme would be simple if undertaken by airports through the normal charging process. Nonetheless, we envisage that there would be material costs, particularly since none of our airports currently collects charges for passengers on arrival. The size of invoices would increase, computer processing time would be increased, and there would no doubt be invoicing queries to be checked. We would expect to have to levy a charge on the fund managers to recover the costs involved.

I hope that you find these comments useful. If I can be of any further assistance, please let me know.

Yours sincerely

**M R Toms**  
**Economic Regulation Manager**



14 June 1991

K Hind Esq  
Civil Aviation Authority  
CAA House  
Room T505  
45-59 Kingsway  
London WC2B 6TE

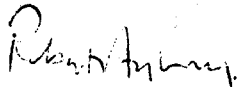
Dear Mr Hind

## FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS

Sir Colin Marshall has asked me to reply on his behalf your letter of 10 May 1991 inviting British Airways' comments on this matter.

Attached to this letter is a paper which we have drawn up in response to your request. I hope that this will help you in your response to the Secretary of State. If you wish for any expansion of what is said in it we shall be pleased to provide it.

Yours sincerely



R J Ayling



## FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS

### A INTRODUCTION

1. The Secretary of State for Transport has asked the Civil Aviation Authority to advise on "the options there are for protecting airlines' scheduled passengers (i.e. all those passengers not covered by the existing ATOL arrangements) in cases where an airline fails". In turn the Authority has invited British Airways for comments. This paper is written in response to this invitation.
2. Although the Secretary of State has not sought advice on the desirability of such a scheme there would seem to be no reason that the response to him should not include observations on this aspect, particularly as the practicalities of any scheme probably impact on the desirability. For this reason in this paper British Airways has commented both on the desirability of a scheme (Section B) and the practicalities (Section C). In Section D, consideration is given to what protection should be given, to whom and how, without prejudice to British Airways' view that it is not desirable to have a protection scheme.
3. British Airways believes that it is undesirable to introduce a scheme to afford consumers of air services a degree of financial protection that does not apply to other purchases, many more substantial than air tickets. This implies a degree of interference in the workings of the marketplace which is unjustified.

4. If a scheme were to be introduced it should be based on a common fund to guarantee the value of airline tickets sold in the United Kingdom. This should minimise the anti-competitive aspects of any scheme and avoid relative disadvantage to UK carriers, provided the fund is not financed by UK carriers alone or disproportionately.

B DESIRABILITY

4. The air transport industry is gradually being liberalised. Government regulation and intervention is being reduced and users are benefitting from the consequential increase in the range of products available and the declining cost of them. The introduction of a compulsory scheme for providing protection is a step in the wrong direction. It treats airlines as different from other providers of goods and services; it eliminates one aspect of competition between airlines and, depending on the scheme chosen, may distort competition.
6. Individuals make numerous purchases besides airline tickets which involve payments in advance for services or goods to be delivered. In making these purchases they have to assess the risk that in the event the goods or services will not be delivered because the supplier becomes bankrupt in the mean time. These purchases may involve amounts of money significantly more than are involved in airline tickets. Yet it is not general practice to protect purchasers against failure of the supplier. There is no reason to treat purchasers of airline tickets differently. To do so would be to move a step away from allowing the marketplace rather than the regulators to shape the industry. This is undesirable.



7. If passengers purchase tickets which will not allow them to obtain refunds or to change their bookings they are able to protect themselves against loss arising out of their inability to make use of the ticket by taking out insurance. There is no reason that they should not do the same to protect themselves against failure by the supplier. This would be the normal market-related approach to the problem. There is no need for regulators to impose on the industry a form of compulsory insurance; it is therefore undesirable to do so.
8. Even if the general undesirability of a scheme of protection is ignored, there remains undesirable features of individual schemes. These are considered, where relevant, in the comment below on practicalities.

C PRACTICALITIES

9. In asking for advice, the Secretary of State has not said precisely whom he wishes to protect. It is reasonable to assume that it is one of the following five categories of passengers:
  - (i) all passengers holding tickets issued by UK airlines;
  - (ii) all passengers holding tickets bought in the United Kingdom;
  - (iii) all passengers with tickets to travel to, from or within the United Kingdom;
  - (iv) all passengers holding tickets to travel on UK airlines and issued by a UK airline; and
  - (v) all passengers holding tickets to travel on UK airlines.

There are within these categories sub-divisions which might be distinguished (e.g. within (iii) coupons within the ticket which include travel to, from or within the United Kingdom and coupons which cover any other travel). Between these categories the practicality (and desirability) of schemes will differ.

10. In considering various schemes it has to be borne in mind that a passenger may, within certain limits, hold tickets issued by any airline anywhere in the world for whatever journey he proposes to undertake.
11. The Authority in its consultation document identifies the four practical methods of providing protection (a fifth is simply a mixture of two others). These are:
- (a) insurance;
  - (b) bonding;
  - (c) a common fund; and
  - (d) escrow.

Below these are each considered in turn.

(a) Insurance

12. As the Authority says, insurance can be insurance by either the airlines or the passengers against insolvency of the airline. Passengers already have the option of taking out insurance themselves. It would be an extraordinary action for government to force passengers to insure themselves against a risk in which only they have an interest, but that could in fact be enforced (in the way that sale of road fund tax discs are available only against proof of insurance) but generally only within the United Kingdom. Thus it could be applied to category (ii) passengers. It could also be enforced against UK airline for sales by themselves outside the United Kingdom but this would be to put them at a peculiar disadvantage vis-a-vis their competitors. It would appear to be extraordinarily bureaucratic in its operation however it is done.

13. Insurance by the airlines themselves could be enforced in respect of airlines holding licences or operating permits issued by the UK authorities; these would be conditional upon the holding of a valid insurance. Rather less easily, it would also be enforceable against airlines where tickets are sold in the United Kingdom; in this case one assumes it would be made unlawful to sell tickets in the United Kingdom issued by airlines which are not insured, with some agency checking on, and providing lists of, airlines which do hold insurance.
14. Requiring airlines to provide their own insurance will have an impact upon the marketplace. First, it can be assumed that state-owned airlines will be able to furnish the necessary insurance policy at next to no cost whereas, for example, small UK competitors may have to pay a high price for the policy even though their balance sheet might actually be far stronger. It may even be a barrier to entry unrelated to the true viability of the would-be new entrant. Assessing the necessary level of insurance would be extremely difficult, not least because one airline's tickets may cover many airlines services.
15. Insurance by airlines could not directly be enforced in respect of category (iii) or (v) passengers although one might require all UK airlines, or other airlines operating into, out of or within the United Kingdom, in respect of such travel, to carry all passengers holding valid tickets for travel on them to honour the tickets regardless of whether the issuing airline was solvent or not; thus in effect making these airlines the insurers for the issuing airlines. However, it is difficult to see how this could be enforced properly or how it could be done without creating great opportunities for fraud. It would also seem an unreasonable burden to put on UK airlines, which will disadvantage them in competition with others.

(b) Bonding

16. Bonding is really a variation of insurance by airlines but rather more difficult to apply to sales outside the United Kingdom. Its disadvantages in terms of its differential impact on airlines independent of any real differences between them in respect of the viability of their operations are the same. The Authority's paper sets out clearly some of the major practical objections.

(c) A Common Fund

17. The creation of a common fund would undoubtedly be the least bad way of giving passengers protection because it would be easy to regulate and fully effective in its protection (it would be very difficult to guarantee that bonding or insurance by airlines would in the event meet 100% of any liabilities). It may also be the only system which would not encounter significant adverse reactions from other governments. The major objection to this method is that its costs would impinge equally on all passengers and airlines and not, as would be reasonable, most heavily on airlines at greatest risk or on passengers choosing them.
18. The basic workings of the fund should be as the Authority has suggested in its consultation document. That is, the Government would take powers to require airport operators to levy a charge on passenger throughput, to be paid by the airlines. Money raised this way would be placed in a fund. The Government would use its powers as necessary from time to time to maintain the desired balance of the fund. In British Airways' view the balance should be kept at zero with money being made available to the fund as necessary by the Government and recovered after the event via the levy. If it was decided to build up and to maintain a positive balance in the fund then the levy should be set very low so as to build up the fund over a long period. This avoids making a relatively few passengers pay for the eventual beneficiaries, who, by the nature of it, will probably not themselves have contributed.

19. Because claims from passengers would be met by a common fund, it would be open to the Government to make this fund available to any category of passenger, even ones not included in the list at paragraph 9, and this would not lead to any enforcement difficulties. If the fund was used too widely it may cause complaint from other governments about their airlines being required to pay for it, but this would not seem to be a significant problem.

(d) Escrow

20. An escrow scheme could only be applied to sales made within the United Kingdom and to overseas sales of UK airlines. In practice it seems unlikely that the Government could enforce the system against foreign airlines' sales in the United Kingdom without infringing bilateral air service agreements and causing much diplomatic upset.

21. Although the administrative arrangements for an escrow scheme may not be quite as complex as the Authority suggests it would certainly be costly and its impact upon the airlines would be considerable. Forward sales are a significant source of working capital for airlines. If in effect these revenues are given to some third party and drawn by the airline only after a passenger has travelled the airlines will be forced to borrow the lost working capital which will increase their costs significantly. Quite how this system would cope with paying amounts to airlines for no-shows is impossible to see unless major changes are made to the whole way in which seats are booked and tickets bought adding enormous bureaucratic costs. Presumably somebody would have to guarantee the escrow account in order to ensure the airlines are not out of pocket if the fund holder goes bankrupt.

22. Because the escrow system could at best only impinge on sales in the United Kingdom and overseas sales of UK airlines and because UK airlines rely on sales in the United Kingdom for a much higher proportion of their revenues than do foreign airlines the damaging effect of the loss of working capital would bear most heavily on British airlines. Its disturbing effect on competition would be severe.

D THE NATURE OF ANY SCHEME

23. If a protection scheme for scheduled passengers were to be put in place it could operate in one of two ways: it could be designed to repay the purchasers of tickets any money lost as a result of the airline's failure; or it could work so as to facilitate the ability of the passenger to continue with his or her arrangements without financial penalty. If the former of these were the aim then it would have to be decided whether money repaid should be related only to the air journey actually lost or to any ancillary losses including, for example, holiday accommodation and other, onward, flights.
24. It is self-evident that passengers' needs will generally be best met by arrangements which allow them to continue with their plans. Because there is usually an alternative to the failed airline to meet the transport needs, this will normally be possible. Therefore the funds available, whether through insurance, bonding, escrow, or a common fund should be applied this way.
25. Easily the simplest arrangement would be to set up a common fund which would meet the failed carrier's liability for all claims against tickets issued prior to the collapse whether the claim be for refund or from another airline following use. The fund would then recover from the receiver whatever part of this it was able. Although it may not be the intention that the fund should meet claims in respect of tickets already used prior to the collapse but not recharged to the airline at the time of its collapse it would be difficult to ensure that this did not happen and it might be that it should be accepted.

(e) General Comments

26. The existence of a protection scheme in the United Kingdom could distort competition by affecting consumer behaviour. How this happened would depend upon the scheme. For example if the scheme applied only to UK airlines it might encourage passengers to switch airlines. To the extent this happened it might offset at least part of the damage done to UK airlines relative to their foreign competitors by some of the schemes. It is, though, difficult to assess this. If the scheme applied to sales in the United Kingdom then this might lead passengers to buy tickets (presumably through agents) in the United Kingdom which in the normal course of events they would have bought elsewhere. This would seem to be undesirable if it leads to those who pay nothing to cover the scheme benefitting from it. This could be avoided by restricting the scheme to sales in the United Kingdom for journeys commencing in the United Kingdom.
27. The Authority in its consultation document discusses the question of who needs protection. Clearly from what has been said above, British Airways believes the answer to this question is no-one. However, if protection is to be given then there is no case for trying to segment the market below the level of the categories set out in paragraph 9 above. That is, distinctions by reason for travel or nationality of the passenger should not be made (probably could not be, in any case).

CONCLUSION

28. British Airways believes that the introduction of a scheme to protect scheduled passengers is unnecessary and undesirable. It would represent an unwarranted interference with the normal free play of market forces.

29. If a scheme were to be introduced then it should minimise the anti-competitive impact and in particular avoid being damaging to the UK airlines relative to their foreign competitors. This requires that the system be based on a common fund financed by a passenger levy and that the protection be afforded in respect of tickets purchased in the United Kingdom for a journey commencing in the United Kingdom (protection would be given in respect of any segment of that journey).



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Mr K Hind  
Civil Aviation Authority  
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Quoted: TWW/mht  
Your ref:

June 14, 1991

Dear Mr Hind

I refer to your letter of 10th May with which you request our comments on the Financial Protection for Airline's Scheduled Passengers.

In the first instance it is essential that, if it is at all necessary to have such a scheme, any scheme devised is applicable to all passengers travelling to, from or within the United Kingdom irrespective of the passengers country of residence, nationality, origin of journey or airline with whom the passenger travels.

To introduce a scheme that was applicable only to UK originating passengers or to those travelling only on British airlines would be discriminatory and wrong and would be quite likely to cause passengers to conclude that booking travel via a British airline was financially risky.

Despite the collapse of Air Europe and the smaller collapse of Capital Airlines and other much smaller airlines the requirement for passenger protection from passengers themselves does not appear to be great.

Passengers have always been able to insure themselves against all types of risks and the fact that there is a general lack of policies available for purchase is indicative that there is very little call for such protection. Indeed following various ABTA campaigns to persuade passengers to book through its association members because of the protection it offers, there are and there will continue to be, vast numbers of passengers who book travel through non licensed outlets (known previously as "bucket shops").

Travel appears to be a very emotive subject and any incident attracts front page publicity as the media tends to exaggerate such incidents.

The purchase of travel, however, is not different from the purchase of any other service where the accepted practice in the particular trade or profession is that down payment is made in advance of delivery of the product. Apart from purchases made

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Mr Hind

June 14, 1991

by credit card (under the protection of a credit card issuers liability) the general public is not protected when purchasing other services or goods. It seems incongruous, therefore, to isolate travel and place this burden on airlines - and their passengers - when such a burden is not applied in other walks of life.

The imposition of a levy against an airline actually discriminates against individual airlines. At the popularly suggested levy of one pound the short haul airline is paying a higher proportion for shorter (and therefore cheaper) journeys than the long haul airline. Yet of the two the passenger is at greater risk from a failure by the long haul carrier because the amount of actual money involved is more.

In any event if such a levy is imposed, airlines will need to pass it to the passenger either via a tax on the ticket or an increase in the passenger fare.

This increase cost will also be very unfair to a great many passengers. An airline such as British Midland, operating the majority of its services on mainly business routes, carries a high proportion of its traffic as last minute purchases. Many thousands of our passengers purchase tickets on the day of the flight and, therefore, are at risk for only a very short time. In fact many single ticket purchasers have travelled before our offices have banked the money.

British Midland submits, therefore, that it is not necessary to introduce a scheme to protect passengers' advanced payments. However in the event such a scheme is deemed necessary British Midland comments as follows with regard to the practicality of such a scheme.

The issues:

- 1) Who needs protection? If protection is deemed necessary it can only be achieved by having protection for all whether or not they are UK residents, purchased the ticket in the UK, travelling to or from the UK, whether or not they are flying on a British airline or travelling for business or leisure purposes. Whatever system is eventually used it will be necessary for airlines to pass the cost straight to the passengers in the form of an additional tax on the ticket or by increasing the passenger fare. Either method causes anomalies in that the person flying on a first class ticket from London to Sydney would pay the same as a single fare from Guernsey

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June 14, 1991

to Jersey. Proportionately, however, the difference is very much higher for the short journey whereas the risk to the passenger, in terms of value, is several hundred times greater for the Sydney journey. An increase in the price of the passengers ticket also causes problems for airlines as in excess of 90% of most airline sales are conducted through the Travel Trade and are commissionable. The airline would, therefore, be at a loss for 9% of the levy.

In so far as choice of airline is concerned it would be grossly unfair to make the levy applicable only to UK airlines or to private airlines as in that event those airlines could not pass on the cost and would be disadvantaged.

- ii) How is protection to be afforded? Insurance by the passenger on his own account for a person who seeks protection is a viable option and is actually available now. That it is rarely used indicates the interests passengers have in protection when the cost of such protection is to come from their own pockets.

Insurance by the airlines is totally impracticable and, as stated in the Authority's review, airlines would be at the mercy of insurance companies. An example of the ransom to which airlines will be held is the insurance companies performance during the recent Gulf war when premiums were demanded that were far in excess of the risks being taken.

Bonding has the same difficulties as insurance in that airline's survival will be in the hands of outside interests. A common fund is the most practical method of funding a scheme but the method of collection can cause problems for airlines. Any charge to airlines would need to be passed on to the traveller either by a separate tax on each ticket or by an increase in the fare. Should the Authority's review suggestion of one pound per arriving passenger be used and fares be increased, the airline, in most cases, will have to pay one pound to the fund and will only be able to collect ninety one pence from the passengers' travel agent. Similarly the airline will only collect forty five pence when the passenger is a child. Therefore if it is necessary to introduce a scheme and if it is necessary to fund it in this manner the only way it can be funded is to levy the one pound as a tax to be shown separately on the ticket.

All other methods of funding such a scheme are totally impractical.

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iii) Practicalities. Contrary to paragraph 35 of the Authority's review, cases are not rare where passengers pay travel agents who subsequently fail before either issuing the ticket or fail after issuing the ticket but before paying the airline.

If it is necessary to set up such a fund then the airlines themselves should be able to claim recompense from the fund in the event that an agent fails after it has taken passengers' money.


Any money paid out by the fund should be limited to the sum paid for the actual air ticket.

All in all such a scheme will become yet another charge on airlines which will not be recoverable from the user. It has moral issues such as why should the strong support the weak. It is likely to encourage small, so called entrepreneurial, airlines to enter into competition with an unrealistically priced product knowing that if they fail their customers are protected. That will only facilitate the re-emergence of these failed "entrepreneurs" who will claim their earlier failure was not due to their own incompetence.

Such a scheme as discussed in the Authority's review paper will be discriminatory unless it affects all passengers travelling on all airlines.

British Midland feels such a scheme is not necessary and urges the Authority to advise the Secretary of State accordingly.

Yours sincerely

  
T W WALDEN  
Industry Affairs Manager

**FINANCIAL PROTECTION  
FOR  
AIRLINES' SCHEDULED PASSENGERS**

**RESPONSE TO  
CIVIL AVIATION AUTHORITIES  
CONSULTATIVE DOCUMENT  
DATED 13TH MAY 1991**

**BY  
CORK BAYS AND FISHER LIMITED  
10 CHARTERHOUSE SQUARE  
LONDON EC1M 6JS**

**Prepared by J.W.Edrupt A.C.I.I., F.B.I.M.**

**7th June 1991**



**FINANCIAL PROTECTION FOR AIRLINES'  
SCHEDULED PASSENGERS**

In the main, we will concentrate our remarks on possible insurance and bonding solutions. Before we do so however, we would like to make a brief comment on who needs protection.

For the sake of clarity, we will refer to the appropriate paragraphs in the C.A.A. document.

**(i) Who needs protection?**

**(c) Nationality of Airline**

20. We believe it is desirable that foreign airlines serving the U.K. should be included in any scheme, otherwise a high percentage of U.K. originating passengers will have no protection. The government can presumably legislate for this.

**(d) Point of Booking and Payment**

21. We do not see how a scheme can be introduced which covers passengers who have booked and paid for a flight abroad. We believe this should be the responsibility of the government of the country in question. To impose such a regulation on U.K. airlines (which presumably the government could do) will place them at a commercial disadvantage and will not protect all outgoing and incoming passengers.

Should the EC propose a Directive to extend financial protection to include scheduled flights in future (we are not aware of such a proposal), it would presumably fall upon each member state to introduce the appropriate measures.

**ii            How is protection to be afforded?**

**(a)**

**Insurance**

(paragraphs 23 & 24)

We agree that it will be difficult, if not impossible, for all airlines to arrange insolvency insurance on an individual basis and with security which is known by, and therefore acceptable to U.K. authorities.

We believe, however, that it may be possible to arrange a 'blanket' insurance with major U.K. composite insurers, backed by appropriate reinsurance (which may be placed world wide), provided cover is restricted to bookings made, and paid for in the United Kingdom.

We have recently embarked on a restricted exercise for A.B.T.A. to see if it is possible to arrange cover for tickets sold through A.B.T.A. outlets, and paid for through Bank Settlement Plan. The initial reaction of one or two major composite insurers has been promising, although we must emphasise that it is early days yet.

Based on certain information kindly provided on a confidential basis by I.A.T.A. B.S.P., we have been able to calculate an approximate maximum probable loss figure for tickets purchased in the U.K. through B.S.P. Provided, there is a willingness by U.K. insurers to underwrite the risk, we believe the market capacity exists to cover the maximum probable loss. The possible exception would be the financial failure of British Airways. To arrange sufficient cover for such an eventuality would require a substantial reinsurance programme.



It is envisaged that within a blanket scheme, a standard charge per ticket be made, irrespective of the airline. This overcomes two objections raised in the consultative document, namely:-

- a) the insurance market will not control which airlines can or cannot trade;
- b) state controlled and larger airlines will have no commercial advantage over their rivals.

25.

In recent months, we have seen an increasing number of Travel Insurance Schemes extended to include 'Tour Organiser Financial Failure', or Airline Financial Failure. Some schemes include cover within the Standard 'Package', whilst others enable the client to purchase an optional extension.

We believe the number of schemes offering this cover will increase.

These schemes offer a simple solution but there are a number of serious shortcomings.

- a) Cover is not universal. Many people will not be aware that it is available. Of those who are, many will chose not to purchase it.
- b) Travel Agents take a high commission (frequently 40% - 50%). This will increase the cost unnecessarily.
- c) Policy wordings are not standardised - different conditions/exclusions will apply. The result will be confusion and a lack of co-ordination in claims handling/repatriation.
- d) Passengers stranded abroad are likely to have to pay to be repatriated, then seek reimbursement later.

**(b) Bonding and (d) Back Up Funds**  
(paragraphs 26, 27, 31 & 32)

Bonding is a possible alternative if it is decided to restrict protection to package holidays (as per EC Directive definition) involving scheduled ticket arrangements. This would however, exclude business travellers and those leisure passengers taking flights only (e.g. V.F.R.).

We are bound to say that the latter exclusion is a potentially serious one, and whilst insurance may be available, the shortcomings expressed previously are appropriate.

Bonding could be arranged by the extension of the existing A.T.O.L. scheme to embrace all Tour Operators offering holidays by air. The scheme does of course, protect against the failure of the Tour Operator (i.e. not the airline). It does, however, ensure that the Tour Operator will be responsible for providing an alternative seat, should the airline fail financially.

Should the A.T.O.L. system be extended, it would be necessary to increase the size of the Air Travel Trust, possibly by way of an additional levy, or alternatively, by buying insurance in order to increase the protection afforded by the Trust Fund.

**(c) A Common Fund**  
(paragraphs 28, 29 & 30)

A common fund financed by a levy on each airline is a solution but substantial failures whilst the fund is being established, could create a problem if there are insufficient funds available to meet claims from passengers. For this reason, we strongly recommend a combination of a common fund and blanket insurance as previously described.

We envisage an arrangement whereby the insurance protection could be 'excess of' the common fund. In other words, it would only be called upon if the fund is exhausted. In the initial stages, the fund will be low, and the insurance protection high. Part of the levy will be used to pay the insurance premium, the balance going into the fund. As the fund becomes established, the insurance protection can be reduced with a corresponding reduction in premium.

We do not believe this solution is any more likely than the others to encourage a lack of responsible financial management.

Irrespective of the solution which may ultimately be chosen, it will only be successful if there are not too many claims. It is common knowledge that a number of airlines have serious financial problems. We would question if any steps are being taken to strengthen the financial vetting of airlines who serve the U.K., to minimise the chances of financial failure.

We trust that our comments are of assistance to you and will be happy to discuss our proposals further, should you wish us to do so.

0155





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*From The Chairman's Office:*

10 June 1991

K Hind Esq  
Coordinator  
Civil Aviation Authority  
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Room T505  
45-49 Kingsway  
LONDON  
WC2B 6TE

**Dear Mr Hind**

**FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS**

I am now in a position to let you have our response to your letter of 16 May 1991 on this subject.

It is a matter for political judgement as to whether or not there should be a scheme for protection for scheduled passengers. In general, consumers are not protected against the demise of suppliers, however there are special factors in aviation. As your paper explains, there has been a large number of scheduled airline failures over the past thirty years. Because most tickets are paid for in advance, individual passengers are put at risk of financial loss by aviation policies aimed at increasing competition and liberalisation. Furthermore there is already the system of compensation for tour operators' clients on charter flights and on part charters.

However, despite the publicity surrounding the occasional larger airline failure such as Air Europe, the number of scheduled passengers losing out through failure is extremely small. It is imperative to keep the matter in perspective, and not seek to solve this small problem by introducing a system such as the insurance or bonding method, which will make it harder for airlines to enter and survive in the market. To do so would be to reduce the benefits of competition and choice for all users in trying to be helpful to a few.

If the Secretary of State does decide to introduce a scheme our views on the issues which you raise are as follows:

i) Who needs protection?

It would be difficult on practical grounds and perhaps in equity to distinguish between business and leisure passengers, although in the case of the business traveller, the individual is unlikely to suffer.

Our view on who should be protected must be related to the decision on how protection is to be afforded. If as we advocate below, a common fund is used and applied to passengers landing in the UK on foreign as well as UK airlines, we would favour covering all scheduled passengers not already covered by the ATOL scheme (e.g. on part-charter).

If insurance or bonding is the method, business travellers and especially large corporate travel spenders such as oil companies with perhaps 30,000 movements a year, will when practicable switch to the dominant carrier seriously threatening the business traffic of smaller carriers. Likewise if foreign carriers are exempt there will be a switch of business away from UK carriers.

As regards country of residence and nationality of airline, there is a case for arguing that all who bought tickets on a UK airline on routes to or from the UK and were prevented by its failure from using them should be compensated irrespective of country of origin. Likewise there is a case for compensating UK nationals booked with any failed foreign airline on routes to or from the UK.

ii) How is protection to be afforded?

We fully agree with your analysis of the problems of using insurance or bonding as the methodology. Airlines seeking to establish themselves or going through a temporary period of difficulty could face high premiums, adding to their problems. The situation could also lead to passengers avoiding them. This latter point would also apply to a system of passengers insuring themselves, in addition to which many may not take it out, leaving practical problems remaining in the event of an airline failure. We are therefore opposed to the insurance and bonding methods.

We strongly support the suggestion of a common fund, built up by a small levy on each passenger landing at any UK airport. An analogous system has been proved to work for the back up Air Travel Reserve Fund. It avoids focusing attention on particular airlines, possibly precipitating them into difficulty. In effect it requires all passengers over a period to insure the proportionately few who suffer from failures. By requiring airports to add it to their landing fee and hand over a total sum, administration costs would be minimised.

It would be equitable to charge the levy on all passengers

landing in the UK whether foreign or UK if as suggested, compensation is to apply to foreign nationals on UK airlines and UK nationals on foreign airlines. It might also be appropriate if this system of funding is used, to extend compensation to foreign nationals booked on foreign airlines to or from the UK who are stranded in the UK due to failure of the foreign airline.

If the common fund approach is agreed in principle further consultation would be needed as regards the detail, which would have to be settled before a scheme could go ahead. For example any scheme needs to be kept simple, but a flat rate £1 levy would bear more heavily on a short domestic route yield than on a long haul.

iii) Practicalities

Clearly where the passenger suffers no loss because despite agent failure the airline retains a liability to carry him no compensation claim will arise. In other cases involving agent failure it would be equitable to bring cases within the common fund provisions.

We agree that there are problems in identifying the amount of compensation particularly if illegal discounting has occurred. Compensation as regards the air fare should be restricted to the amount paid by the passenger and the onus should be upon him to establish evidence of payment. This may mean that those who buy deeply discounted tickets from certain sources take the risk of not being compensated in the event of an airline failure. There may also be an extra liability on the fund where it is necessary to repatriate passengers stranded abroad.

We have no strong view as to whether compensation should extend to consequential liabilities such as hotel booking liabilities. It would be equitable to do so but the cost and administrative efforts involved might be considerable. It is also already possible for passengers if they wish to insure themselves against hotel and similar cancellation risks.

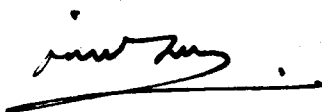
iv) Cost &

v) Legislation

We have no comment on these sections.

There are no further issues which we consider should be included.

Yours sincerely



DAVID N JAMES





**E T O A**  
E U R O P E A N  
T O U R  
O P E R A T O R S  
A S S O C I A T I O N

Ref:0611PLJ/CAA

The Civil Aviation Authority  
CAA House  
45-59 Kingsway  
London W1N 4PD

June 11, 1991

Dear Sirs

Ref: Proposed UK Arrival levy

It is our understanding that the Civil Aviation Authority (CAA) is looking at the possibility of raising a levy on all arriving passengers in order to create a fund to give financial protection to scheduled airline passengers. We further understand that comments are sought from interested parties in the travel industry on this proposal.

The European Tour Operators Association (ETOA), representing the international inbound tour operators and destination management companies in Europe whose member companies brought in excess of 3 million tourists to Europe last year. The Association feels that such a levy would unfairly disadvantage the inbound travel industry many of whose passengers could not benefit from such protection as non UK or non EC citizens.

Currently Europe is still enjoying world dominance in the inbound tourism sector but over the last ten years it has been losing ground steadily to other world regions. Europe is seen by many third country tourists as an already expensive destination. This situation has to be reversed if the economic and social benefits derived from the inbound tourism sector are to be preserved. Any additional financial burdens will only help to turn tourists to travel to these other regions rather than Europe. When combined with the already excessive visa charges levied on many citizens of other countries wishing to visit the UK, this will represent an additional unacceptable financial outlay.

ETOA welcomes the idea of offering financial protection to scheduled airline passengers, but believes that this has to be administered on an international basis with the participation of

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all IATA airlines in the form of a levy on all scheduled tickets issued or a voluntary insurance scheme as proposed by IATA themselves. This would afford protection to all air-travellers and not just those originating in the UK.

In the light of the fact that the European Community is moving towards common tariffs, it would also appear that such a levy was contrary to European Commission rules pertaining to common tariffs within the Community. (Treaty of Rome Article 75 section 1)

In the light of these arguments, we hope that the CAA will reconsider its recommendation to the Minister of Transport.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Lloyd-Jones', written over a horizontal line.

Peter Lloyd-Jones  
Executive Director



## GUILD OF BUSINESS TRAVEL AGENTS

Mr. K. Hind:  
Co-ordinator,  
Civil Aviation Authority,  
CAA House,  
Room T505,  
45-49 Kingsway,  
London WC2B 6TE

7th June 1991

Dear Mr. Hind:

### **Financial protection for Airlines Scheduled Passengers**

Thank you for your letter of 10th May requesting the view of the GBTA on your paper on this subject. I am sure you are aware that our members handle over 75% of the business travel generated by UK Agents. We have a total turnover of £3.25 bn.

We consider that the Authority has considered nearly all of the broad options remotely capable of providing a solution.

We believe strongly that protection for passengers against failure of scheduled airlines or agents should be introduced and that in the absence of any voluntary action by the International Air Transport Association (IATA), mandatory protection requirements should be imposed by Government directive through the auspices of the CAA.

There is currently no protection for the majority of scheduled seats which are sold by agents as agents for the airline principals.

The EC package travel directive will not cover the bulk of our members business which is an airline seat perhaps with an hotel and/or car booking and not sold as a pre-advertised package.

Scheduled service passengers are also at risk from failure of Agents where tickets are issued on agreed credit terms which is the usual manner for business travel.

Cont/d....2

Protection is required for:

- a) both business and leisure passengers without distinction
- b. all passengers on all carriers who are ticketed and paid for in the UK irrespective of residence.

Insurance is not a viable option, there would be different premium levels for carriers due to differing regional/hub risks. It would be impractical to force this on foreign carriers. We believe there would be a very low take up rate if the onus of insurance was put onto passengers.

We support the Common Fund approach, but are against a levy on inbound passengers. This would be seen as a Tourism Tax and would mean that inbound foreign passengers would eventually be paying but receiving no cover.

We propose that £1.00 be deducted from all International tickets and 50 pence from all domestic tickets settled through UK BSP. Self certification should be used for direct issues by airlines. The levy should be made for one or two years and the fund generated should be administered in a similar way to the ATRF, and would cover failure of airlines or agents. Total value of UK BSP is approximately £3 bn. from a ticket throughput of approximately 15 m. This would enable airlines to accept tickets from failed airlines with the knowledge that they would be reimbursed from the fund. Similarly Agents could replace or refund unflown failed carriers tickets immediately. The consumer would therefore be at no time exposed. Although there is resistance from flag carriers, we see this as a major benefit to consumers, carriers and agents.

We do not agree with your contention in paragraph 30 that this arrangement would fail to encourage responsible airline/agent financial management. Nobody manages for failure.

Turning to paragraph 33, passengers are unclear of the difference between credit and charge cards. A large proportion of business travel is paid by cards. Agents have encouraged the use of Lodge Cards to minimise credit risk. In some cases this accounts for more than half their business. Any card insurance is secondary in its nature. The vast proportion of air traffic is long charge i.e. the airlines pay the merchant fee. Evidence from the Air Europe collapse is that the credit card companies are concerned about their exposure. Credit Card insurance is unlikely to be an effective solution.

Escrow accounts would be impractical and impossible to administer.

Cont/d.....3

Cont/d.....

3

Moving on to practicalities, airline failures have a big impact on agents due to credit terms, refunds etc. We agree that it will be difficult to determine the actual fare paid. There is however a move towards nett BSP ticketing which in addition to the codes would help somewhat. Compensation should be limited to cost of flying on UK issued tickets only.

I hope the above is helpful. If you require any further clarification please give me a ring.

Yours sincerely,



David K. Reynolds  
Chief Executive



Mr K Hind  
Coordinator  
Room T505  
Civil Aviation Authority  
CAA House  
45-49 Kingsway  
London WC2B 6TE.

Friday, 7th June 1991.

Dear Mr Hind,

### **FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS**

Thank for first of all for considering our Association's Members worthy of consulting on this issue.

It is indeed extremely relevant to not just those companies who trade in the Conference and Incentive Travel sectors, but also for all the industrial clients for whom the monetary risk of a supplier's failure is as great as that of a normal member of the public, but whose potential loss is significantly greater (as they would be settling the full amount for all their guests, of course).

Our Committee having given the matter serious consideration, Mr White has passed your letter to me for reply, as my Committee duties include liaison with official organisations such as your own Authority.

Recent circumstances in the UK travel industry have shown that bonding cannot be relied upon by its nature to fulfil the criteria of passenger protection that the Minister seeks to achieve. It is our view that it also discriminates against the smaller company, especially in a market which is still dominated by so many large state-owned airlines.

Passenger Insurance could only be a suitable option if it could be applied to every single passenger, and not left to the individual to accept or decline. This would cause great practical difficulties, unless the premium were to be collected at either the point of travel or the point of payment for the travel ticket/s.

As the premiums would by their very nature be market-led, the vagaries of inflation would enter the equation, and future insurance costs for the traveller would possibly escalate dramatically - especially when/if the first claims arise from as major a source as Air Europe.

We also feel that it would prove highly lucrative for the insurers, which in the long term would mean that no ongoing accruals would result. In other words, each year starts with an empty coffer, rather than a growing safety net of funding achieving significantly greater return that is eroded by inflation.

Our members are not infrequently placed in the position of running their businesses without the full benefit of cash flow as a result of clients' demanding that funds are held 'in escrow' in order to safeguard the client.

As a principle it does appeal, but in practice it ties up the very funds which companies employ to improve their overall profitability.

In terms of airlines being restricted in their investment of monies, this could only lead to increased fares in order to cover the shortfall – which in essence means that the passenger pays in the end – but the control of how much is charged goes out of the hands of any administrative body and into the control of the airlines themselves.

We do not feel this is either advisable or will in fact achieve the Minister's goals.

To introduce a passenger levy for arrivals seems to us to be rather back to front.

It is our belief that this is the option which will in the long run prove the most successful, for it will accrue ever-greater amounts to cover the ever-growing risk (assuming world inflation continues).

In addition, the levy is controlled by a central body who will oversee both the fund and be in a position to assess the likely liability in the event of a major claim arising. Thus, control is out of private hands, the fund grows as time passes, and the general public see a system in operation which charges them according to how often they travel.

It is our view that a Passenger Levy is the correct option.

However, we are somewhat bemused by the suggestion that 'arriving' passengers should carry the financial burden, since this will probably be interpreted by the public as applying to foreigners reaching our shores, whereas of course it will in fact apply equally to residents returning from overseas.

Currently arriving passengers are not introduced to any system which requires payment from them during their arrival transit; however, departing passengers are introduced to several points within the airport where collection of the Levy would prove significantly more straightforward in our view – for instance, at flight check-in or passport control.

#### INCENTIVE TRAVEL & MEETINGS ASSOCIATION

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In addition, arriving passengers are generally in a hurry to clear the airport, whereas all departing passengers are committed to spending an amount of time within the airport buildings.

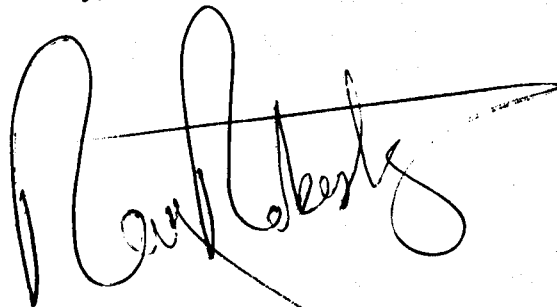
Having deliberated at some length on the various options, and in particular those mentioned above, we do come most strongly to the view that a Passenger Levy is the fairest option, the easiest to control, the most suitable for growth of the available funds as time progresses, and the most likely to find favour with the public.

How the collection of the Levy should be handled (in accounting terms) is not an aspect that we are able to judge, as our Members and their clients view the airline industry from outside its 'walls' and rarely get more than a glimpse of the mechanics which operate within.

The collection of revenue rarely seems a problem for airlines – especially with the monthly direct payment collection system operated by IATA, so one would expect that they could adjust systems already in place to incorporate the collection of this Levy.

Mr Hind, I hope our views prove of use in your deliberations and those of your colleagues, and if you feel we can be of further assistance on either this issue or any other matters under similar consideration, then we shall be honoured to be consulted.

Yours sincerely,



**Ray Roberts**

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# International Air Transport Association

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**SUBMISSION OF THE  
INTERNATIONAL AIR TRANSPORT ASSOCIATION  
TO THE UK CIVIL AVIATION AUTHORITY  
CONCERNING  
FINANCIAL PROTECTION FOR AIRLINES' SCHEDULED PASSENGERS**

The International Air Transport Association (IATA) is a worldwide association comprised of 200 member airlines. The members of IATA carry out the bulk of the world's scheduled international and domestic air transportation under the flags of some 116 nations. The stated purposes of IATA include the promotion of safe, regular and economical air transport for the benefit of the peoples of the world and the fostering of international air commerce.

Included in IATA's membership are 12 airlines which have been duly established under the laws of the United Kingdom. In addition to these UK carriers, 90 IATA Member airlines also serve various UK destinations on a scheduled basis. These non-UK airlines have been established under the laws of their respective countries being designated and licensed to provide international transportation of passengers, cargo and mail to and from points within the UK. Each of these non-UK airlines has its headquarters in its respective country and is substantially owned and controlled by the government or by nationals of that country.

There are 3770 IATA accredited travel agency locations in the UK, who are appointed for the sale of international air transport, by IATA Member airlines. It should also be noted that there are approximately 61,000 travel agency locations worldwide, which are accredited, or otherwise appointed by IATA, for the sale of international air transport. Many of these travel agencies can sell air transport on UK airlines or on foreign airlines operating into and out of the UK.

#### Position of IATA

As indicated in an IATA press release issued on 25 March 1991 (a copy of which is attached), IATA believes that the most practical solution to the problem of passengers stranded by the failure of an airline is by means of travel insurance. In this regard, protection is now available in the UK to scheduled air travellers as part of travel insurance packages.

IATA is in touch with several insurance intermediaries to promote the further development of such insurance cover to make it more attractive to the public. IATA is also investigating what role it can play in facilitating the marketing and selling of such insurance through the normal ticket sales outlets of travel agents and airlines.

There is always the possibility that passengers choose not to purchase travel insurance and therefore expose themselves to the risk of suffering from the financial failure of an airline. It is more likely though, that a traveller will suffer other misadventures which cause him considerable financial loss, e.g. stolen baggage/personal effects, illness or injury involving medical, cancellation and repatriation

costs. However, there is no suggestion that government legislation should be invoked to ensure that these passengers are protected at the expense of other travellers.

We suggest that HMG should promote to passengers the idea that they should purchase insurance protection.

#### Reasons for non-intervention

IATA suggests that there are many valid reasons why UK Government intervention in this matter would be against the interests of the travelling public and the air transport industry, or would be in conflict with UK Government policy.

##### (i) Need for protection

The decision of a consumer to choose a cheaper, but lower quality product or service, is a legitimate consumer prerogative. The role of any government surely is to ensure that a real choice exists, and that the consumer has the information needed to make a choice.

The public are exposed to other, and in many cases, much more financially damaging risks in purchasing goods and services, other than air transport. Every time they purchase goods or services which are paid for in advance they are exposed to the risk that the goods or services may not be delivered because of financial failure of the supplier. It is not the UK Government's general practice to protect the public against these failures. There is no reason to treat the purchase of airline tickets differently.

(ii) Cost to other passengers

The majority of travellers who opt to fly on financially secure airlines should not have to bear the cost of the increased risk taken by those travellers who prefer to use lower priced, but more financially exposed options.

(iii) Cost to other airlines

Those airlines which take care to ensure that their operations and pricing are based on financially sound principles, should not have to bear the extra cost and administrative burden of ensuring the financial protection of passengers choosing to fly with less financially sound competitors.

(iv) UK Government Policy

The air transport industry in the UK and the rest of the world, and particularly in the EC, is on a path to liberalisation. This is an admitted goal of both the UK Government and the EC Commission. The introduction of a compulsory protection scheme would be completely against this trend. It is probable that the introduction of such a scheme by the UK would be anti-competitive, if not discriminatory.

Even in the field of air travel, the passenger experiences a much greater exposure to financial loss through illness or accident while abroad than through financial failure of a scheduled airline. There has not been any suggestion that these greater risks should be covered by compulsory protection schemes.

(v) Dilution of financial responsibility

The introduction of a compulsory protection scheme covering all passengers weakens the obligation on airlines to exercise financial restraint. Such a scheme could be exploited by airlines not concerned with putting their passengers at financial risk, in an attempt to take unfair advantage of more responsible competitors.

(vi) Complexity of air transport

The international scheduled air transport system is an integrated and interdependent network. It is possible to purchase one ticket in one currency which permits the traveller to use any number of airlines on any multi-stop international journey as if it were inside a single country. The free negotiability of airline tickets among airlines allows passengers to purchase, not necessarily at their point of departure, travel on any number of airlines as required to get them to their destinations.

Furthermore, passengers are able to alter or cancel their routings as well as the dates and times of their departures. To attempt to introduce a new fee or levy within this scenario necessitates equally complex rules and procedures. This could be extremely costly and administratively burdensome for the airlines because of the sheer volume of the tickets issued around the world on any given day.

(vii) International compatibility

To introduce a compulsory scheme in the United Kingdom,

while such protection does not exist in other countries, particularly in the other countries of the European Community, would distort competition amongst States and could possibly lead to objections or retaliation on the part of other States.

(viii) Economic considerations

The imposition of a further levy or fee on international air transport militates against the development of international travel and trade and economic growth. This is because such a levy or fee would increase the cost of air fares paid by the travellers and such an increase could deter travel. Furthermore, by being administratively burdensome and by increasing the operating costs of airlines, any such levy or fee would make it more difficult for the airline industry to increase its productivity and efficiency.

(ix) Charter passenger experience not relevant

As indicated in paragraph (vi) scheduled air transport is a much more complex affair than the charter system. The latter usually involves point to point travel, with the same airline being used in both directions, with no possibility for change of routing, date or airline.

It is quite common for many passengers purchasing charter packages to have no knowledge, before arriving at the airport, on which airline they are actually flying. Protection is appropriate in these circumstances since the passenger no longer has the freedom of choice of the scheduled passenger.



(x) Administrative complexity

Experience with the introduction of other taxes fees and charges on airlines and their passengers throughout the world has shown that clear rules are necessary to control the system over time. These must cover issues such as record keeping, remittance of funds and auditing and must recognise the unique nature of airline accounting.

(xi) Passengers on foreign airlines

It is not clear from the Civil Aviation Authority's paper whether passengers on foreign airlines would be covered by the proposed scheme. If they are this will increase the complexity of the administration and control of the scheme. If they are not, it will introduce an element of discrimination, which would quite obviously not be acceptable and would of itself further increase the complexity.

(xii) Claims handling

Again it must be recognised that scheduled air transport is more complex than charter. The experience to date with bonding and ATOL will not be relevant in trying to satisfy the claims of scheduled passengers. However, the insurance industry has a vast experience in claims handling which could deal with all of the complexities which may arise.

(xiii) Legislation

The only option not requiring legislation is the insurance solution proposed by IATA.

SUMMARY

Based upon the foregoing, IATA respectfully submits that it does not believe that there is a case for the intervention of the UK Government concerning financial protection for airlines' scheduled passengers. IATA believes that the solution for such protection rests with passengers purchasing insurance as part of travel policies underwritten by the insurance market.

\* \* \* \* \*



QUALITY IN AIR TRANSPORT

NEWS

DATE: March 25, 1991

NO. 6

FOR IMMEDIATE RELEASE

## IATA URGES INSURERS TO ACT TO PROTECT STRANDED AIR PASSENGERS

IATA believes that the most practical solution to the problem of passengers stranded by the failure of an airline is for the travel insurance underwriters to offer coverage based on their assessment of the risk. IATA is contacting the underwriters' associations in various countries to seek their support on this issue.

Recent airline failures, particularly in Europe, have highlighted the predicament of travellers holding tickets for scheduled airline flights and finding themselves unable to use them. Since, in most cases, no readily available insurance cover exists, the travellers were unable to recover their money.

IATA recognizes that there is no perfect solution to the problem, since there will always be passengers who fail to buy insurance. However, by offering passengers on scheduled flights an opportunity to protect themselves suitably, the insurance industry will have provided a much-needed service.

If the insurance underwriters are unable to offer a workable solution, IATA will explore other possibilities in the interest of the travelling public.

- IATA -



**FINANCIAL PROTECTION FOR AIRLINES' PASSENGERS**

**1. INTRODUCTION**

- 1.1 Lane & Partners represents and advises airlines, tour operators and travel agents. We are therefore interested in the outcome of the CAA's deliberations in this area, and in the decision which the Government ultimately takes in the light of the CAA's advice.
- 1.2 Our view is that the ATOL bonding scheme should be extended, as described in Section 2 below. We believe, having read the CAA's consultation paper, that such an extension would have many advantages and relatively few disadvantages.
- 1.3 The ATOL Scheme has not been foolproof in the sense that it has not prevented tour operator failure since it was introduced in 1974, but that was not its intention. The intention to protect purchasers of inclusive tours against the financial consequences of tour operator failure has been fully and successfully implemented.
- 1.4 The package tour industry has a number of special characteristics which justify, politically, an ATOL scheme. As the CAA paper points out, for many, the purchase of a package holiday is the biggest single investment of the year. A second point is that successful tour operation depends to a degree upon the use of other people's money paid well in advance of the time when any consideration is to be given for that money. Thirdly, the spectre of Britons abroad (women and children in particular) being turned out on to the beach with no food or means of return home, whilst probably exaggerated in his mind, is enough to persuade any politician in power that a bonding scheme is a good thing.
- 1.5 From the regulatory point of view, the package tour industry has also been conspicuously successful. It has provided a good example of liberalisation with a retention of a degree of regulation in the consumer's interest. The charter

airlines, certainly within IATA Europe and increasingly elsewhere, have been free to fly where they please at a price which is fixed in accordance with market conditions. The charter airlines' customers, the tour operators, have also benefited from deregulation to the extent that price controls no longer exist, and they are, in theory, not limited in the number of package holidays which they put into the market. But the financial constraints imposed by the ATOL system has brought a degree of reality to many an over ambitious pioneer, and the CAA has been able to monitor the finances of all tour operators with the result that no customer of a licensed travel organiser has lost money, since the ATOL scheme was introduced.

- 1.6 The Proposal, which is described below, does not set out to protect passengers travelling on business from the consequences of scheduled airline failure. They are less at risk and more able to look after themselves. In fact, if the Proposal were accepted, business passengers would be able to bring themselves within the umbrella of protection by the simple expedient of requiring their travel agent to arrange a hire car for them and paying one price for the "package".

2. **WHAT IS THE MOST PRACTICABLE STEP WHICH WILL HELP PROTECT SCHEDULED PASSENGERS AGAINST FINANCIAL LOSS AND DISRUPTION?**

- 2.1 In our view, the most practicable step which should be taken within the next eighteen months is to extend the ATOL system to all "packages" sold in the United Kingdom.
- 2.2 The principal advantage of this solution is that would not only satisfy, to a reasonable extent, what is perceived to be a public demand for greater protection for scheduled passengers, but it would also address the requirements of the EC Council Directive (90/314/EEC) on package travel, package holidays and package tours.
- 2.3 There are many other issues raised by the Directive which are outside the scope of this paper (and which we understand are shortly to be discussed in a Green Paper).

What we have done below is to set out the Proposal in brief and then to discuss points in its favour.

### 3. THE PROPOSAL

- 3.1 The Proposal is to introduce UK legislation which requires any person who sells as a principal a package, as defined by Article 2 of the EC Directive (but in which the transport is air transport) to hold a licence granted to him by the CAA.
- 3.2 In other words, the ATOL system would be extended to scheduled service based package for which the principal, whether he be a tour operator or a travel agent, would require an ATOL.

### 4. POINTS IN FAVOUR OF THE PROPOSAL

- 4.1 In addition to the principal point, mentioned above, that it addresses the EC Directive, the following points are, we submit, worthy of consideration.

4.1.1 It avoids the need to address the difficult task of distinguishing between business passengers and leisure passengers.

In our view, it is impractical for the Government to aim at the introduction of financial protection for all categories of passenger by air. As the CAA paper points out, the case for protection of the day trip passenger to Glasgow is less compelling than the case for the family of four making the trip of a lifetime to Orlando. In any event, experience has shown that trying to distinguish between passengers travelling for leisure purposes and those travelling on business produces difficulties of definition, and it is an unsafe basis for legislation.

4.1.2 It addresses the blurring of the distinction between scheduled and charter

The point made in the CAA paper is well taken. Seat only on charter, towards which the CAA continues to adopt a Nelsonian posture, began the blurring process and liberalisation in Europe is bound to accelerate it. It has long seemed illogical that the back-packer who bought a technically illegal seat only to Athens should enjoy ATOL protection whereas his colleague who bought an Apex on the same aircraft did not.

4.1.3 By extending the protection to the public through the ATOL system, the Government would be building upon the success of that Scheme

Undoubtedly, the practicalities, and the extent of the CAA's resources to operate an enlarged ATOL system, would have to be addressed. But it is unarguable that there would be a considerable benefit from using a scheme which is already tried and tested.

4.1.4 The Proposal would cover packages bought in the UK only and would enable the UK authorities to retain control

As the CAA paper has shown, there are many difficulties about who should be covered and how. Should UK nationals abroad be covered, should passengers on foreign airlines enjoy protection, what about UK nationals who bought tickets abroad being stranded in the UK ...?

In our view, the only practical solution is to introduce legislation which addresses contracts made within the jurisdiction. By targeting the travel organiser, the Government is able to introduce some commercial discipline into the market place because the travel organiser will know that, if he is putting his passengers on a risky scheduled airline, it is his risk. At the same time, controls are introduced through the CAA's supervisory powers and there will be less likelihood of members of the public being duped by unscrupulous bucket shop operators.



There is no need to distinguish between passengers of British airlines and those of foreign airlines.

4.1.5 The Proposal produces a means of widening the protection without encountering the insurance difficulties discussed at paragraphs 23-25 of the CAA's paper

Under the proposed extended ATOL system, there would be a continuing need for commercial vigilance on the part of the travel organiser with some additional supervision from the CAA. Provided that the system continued to work as well as in the past, this is a better method of seeking to protect passengers against the consequences of failure of scheduled airlines than is credit risk insurance of the airline.

The point is made in the CAA's paper that the Air Travel Trust has available to it only a finite amount, and that there is no provision for top-up. Clearly, the point will need to be addressed under an extended system, and we suggest that powers be taken for the imposition of a levy to be collected (as in 1974) from the package holiday customers whose protection is in issue.

The insurance industry would, of course, have a part to play, as at present, in the provision of bonding for travel organisers.

4.1.6 Low Cost

The cost of administering the back-up fund could be expected to be relatively low. The administration of the wider ATOL scheme would be commensurately more expensive, but could be paid for through licence fees (and ultimately by the travellers whose protection was being organised).

**5. WHAT ARE THE DISADVANTAGES OF THE PROPOSAL?**

- 5.1 We do not believe that there is currently a compelling case for the introduction of legislation to protect passengers travelling on business, who, as has been noted above, are not expressly targeted by the proposal.
- 5.2 The category of passenger perhaps most deserving of protection, who is not covered by the Proposal is the long-haul VFR passenger identified at paragraph 22 of the CAA's paper. The answer to this omission is that a well advised passenger could organise his own protection either
- (a) by buying car hire as well (thus making the arrangement a package for the purposes of the directive);
  - (b) by paying the airline for the long-haul seats by credit card; or
  - (c) by buying holiday insurance which covered airline failure.

**6. CONCLUSION**

- 6.1 We hope that the above remarks will be of some assistance to the CAA in their deliberations.
- 6.2 If any wider scheme is introduced, and the practical answer may well be that it should be discussed with other issues raised in the forthcoming Green Paper, it is very important, in our view, that maximum publicity should be given to the changes.
- 6.3 One of the principal reasons why there is perceived to be public demand for wider protection is that it is so difficult for lawyers and regulators, let alone the general public, to work out when an ATOL is required and therefore whether a Bond is in

existence to cover the actual arrangements. As with fares, the law in this area should be simple, rational and understandable!

4 June 1991

R.W. VENABLES





# States of Guernsey Transport Board

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05 June 1991

Mr K Hind  
Civil Aviation Authority  
45-59 Kingsway  
London  
WC2B 6TE

Dear Mr Hind

## PROTECTION FOR SCHEDULED AIRLINE PASSENGERS

It has come to the Guernsey Transport Board's attention that you are co-ordinating a group of representative bodies and airlines looking into the practicality of extending consumer protection to scheduled airline passengers, with a view to advising the Secretary of State.

With the recent demise of Air Europe, the lack of consumer protection for scheduled airline passengers has become a matter of concern for the Board, which has received representations from members of the public surprised to find they have no means of reclaiming the full price of their ticket from Air Europe.

The Board is of the view that for all flights or holidays costing in excess of £100, the carrier should be required to provide insurance cover against the cancellation of a flight due to an airline ceasing trading. The Board further believes that this insurance cover should be passed onto the consumer as part of the ticket charge.

I should, therefore, be grateful if you would give consideration to this proposal as part of the CAA's deliberations on this matter.

Yours sincerely

R C Berry  
President



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Our ref: AJK/lfg

29 May 1991

K A Hind Esq  
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45-49 Kingsway  
London WC2B 6TE



Dear Mr Hind

Thank you for your letter of 13 May 1991 and as requested, I am responding to the various points. If in due course you think it would be helpful for me to attend a meeting to discuss further the insurance aspects I will, of course, be pleased to do so.

In trying to formulate a response, I have tried to take a view of what would be acceptable on a practical basis.

I am not an expert on world-wide aviation but I would agree that the prospects of National Flag Carriers collapsing is reasonably remote. Looking around Europe, I would see the problem areas as countries such as Spain and Italy, where there have been collapses on the holiday charter side and also on the student flight side. From a UK view point, the USA offers a considerable number of risky airlines and on a smaller scale, some of the Canadian airlines must be vulnerable. However, it appears to me that the perceived area of greatest consumer concern is where UK originating passengers flying on airlines licensed and financially monitored by the CAA lose their money due to airline failure.

In your report, you have separated the various types of travel and you have made some valid comments regarding the difference between business and leisure flying. It must be a fact that most businessmen, certainly in Europe, will fly with airlines that are financially secure. In any event, losing the money is more of an irritation for the businessman rather than a disaster as it would be for a family booked on a VFR flight.

But at the end of the day, it still comes back to whether or not the airline is financially sound, irrespective of whether the passengers are business travellers or leisure travellers. It then becomes necessary to take a view on the strength of the individual airlines.



Continuation

The problem in many areas of the travel industry as we both know, is that the strong companies object to paying to keep the weak in business. I could not imagine British Airways reacting kindly to having to provide a bond or any sort of insolvency insurance. On the basis that it would be politically difficult to involve foreign airlines in a UK based financial guarantee scheme, then British Airways would probably say with some justification that it was being singled out for unfair treatment vis a vis its foreign competitors. Looking at the international scene, I would think that the only way that some cover could be organised would be on a voluntary basis with airline failure cover attached to a travel insurance or to the ticket cost as a separate insurance item. This cover could provide for returning the funds paid in the event of the airline collapse and possibly for any additional costs if the client is obliged to switch to another airline at the last minute at a higher price. A businessman travelling on British Airways would not bother to take it and a businessman travelling on Pan Am might not bother to take it, but a family going to visit their relatives might wish to make a small extra payment to buy peace of mind. I have returned to this subject later in my letter.

Turning to consider the UK airline situation, it would appear that we have quite a large number of small airlines for a small country and it has not been a good period for these independants. It cannot only be said that it is the new fledgling airlines that have the problems as obviously Air Europe have gone and Dan Air came fairly close to the brink themselves. I know that your Authority monitors the financial state of airlines but I have often thought that the ease with which airlines can expand on a very limited capital base is an area likely to give concern in these recessionary times. I would think that there is a strong case for bringing in some sort of bonding system for new emerging airlines although I do not know at what level any bond would be pitched. The start-up costs for a new airline are considerable and the prospects of attracting new customers are very uncertain. The bond would be used for the same purposes as the tour operators bond, eg, to make refunds and also to allow passengers to buy return tickets when they are stranded abroad. If the airline wished to expand, then it would need to increase its bond as and when it took on new aircraft and I would also consider whether the underlying sharecapital base of the company should be linked to the leasing commitments, so that as the leasing commitments increased, so the share capital would be forced to follow in a certain percentage. It may be that the Authority already follows such a pattern, but I don't know the way it views airline finances.



## Continuation

It may be that the airline bond would run initially up to three years so that the airline had time to develop its potential. Obviously a considerable cost would be involved for a newly formed airline and I say slightly tongue in cheek, perhaps the suppliers such as the aircraft manufacturers or the leasing companies such as GPA could incorporate the bond costs in to the aircraft package. It may be that airports certainly in the Regions could help to meet part of the cost of bonding if they wish to encourage new airlines to fly from their airports. In general terms, bonds could be looked at in the event that airlines started to show annual losses, or the net current liability position deteriorated, or that the company was viewed as being over-expansive in its programme. This would be aimed at airlines who have been in existence for sometime, but who are showing signs of a weakening financial position. The problem always comes there that it may not be easy for them to find a bond under those circumstances. However, it would enable the authority to say enough is enough and withdraw the operating licence for non-provision of a bond.

In paragraphs 28-32 you deal with the possibilities of a common fund and a mixture of bonding and back up fund. The creation of such a fund must be a good idea at this time and possibly the airline common fund could be merged in with the ATT to create a new "Super Fund" perhaps building up to a level of £100 million over three years. As you have pointed out, the levy could be collected by adding a fixed amount to the passenger load supplement. This would appear to have the merit of being simple and fairly painless to put in to operation and would apply to passengers departing from the UK, whether on UK registered or foreign carriers.

Below this fund there would be a bonding system for the new airlines and the financially weak carriers which would serve to protect the fund in the same way as the tour operators bond does for the ATT.

There is one weak link in this system, as you have pointed out, and that financial vetting and control over foreign airlines will still be difficult. In many cases, a failure of an airline like Odyssey will throw the problem back in to the lap of the ATOL holder chartering the aircraft to find a suitable alternative. On the scheduled side, there are a number of large airlines especially in the USA whose financial state of health is decidedly uncertain. I do not know if there is a way of excluding these companies but if they have contributed to the Fund, then they would presumably have a right to the cover. Whether you can make them provide a bond is, I would believe, rather doubtful politically and financially at the moment.



Continuation

If claims from the fund are restricted to passengers originating from the UK and returning to the UK and requiring that the payment for the ticket is made in the UK, then the likelihood of a foreign airline collapse providing a massive claim on the Fund is, I hope, reasonably remote.

Before terminating this letter, I would like to turn briefly to section iv costs, in particular 39 and 40. It is naturally very difficult to advise on airline self insurance at this stage other than in very general terms. Leaving out the big airlines who could probably buy insolvency cover at an affordable price, but would not want to, I believe that insurers would want to see a financial limit to their risk. Open ended insolvency cover for small emerging airlines is not an attractive proposition to me. However, if the airline is well funded, monitored by the CAA and is asked to provide a bond, then that bond may be insurable in the way that tour operators currently insure their bonds. The risk profile is, I would suggest, rather different. Tour operators have the opportunity to reduce or increase their commitments and overheads in a fairly flexible manner. From my limited experience of small airline accounts, I would say that they are normally hostage to their leasing agreements. There is also very little flexibility available to a two or three aircraft operation. So although the concept may be the same, we would view the risk of insuring a bond for a small airline as four or five times the risk of a small tour operator.

Turning to passenger self insurance, I can see this as being an insurable proposition and indeed cover can already be obtained at very reasonable rates. At the present time, this cover is often linked to the sale of a travel insurance policy and evaluation of individual risks is minimal. The costs will vary in the future depending on whether it is genuine financial failure cover with no recourse or a funding operation where the insurer expects to be able to claim against a bond or a common fund. It is however an area that could be encouraged and if guidance notes advised passengers to pay by credit card or buy airline insolvency cover, then I could see a lot of calls on the Fund being averted. There could also be the factor that the bond provided by the high risk airlines would be spared a number of claims and would thus be better placed to look after claimants who had no other means of recourse.

There is a factor that if the public knows it can get its money back from a central fund then why should it pay a premium.



Continuation

This would depend on the size of the premium but cover could provide some 'extras' such as rapid return of monies paid, cover against the agent failing and additional costs of purchasing a new ticket if the same priced flight could not be obtained. It might also cover the accomodation or other services element where this was an 'ad hoc' package creation.

As I have made a number of points in this letter, it might be helpful to summarize them as follows:

- (a) The encouragement of a voluntary insurance scheme for travellers to buy airline failure cover on whatever terms and at whatever price such cover was to become available.
- (b) That new airlines should be bonded for the period of their initial development on whatever basis and for whatever period the CAA deemed appropriate.
- (c) That airlines who show signs of a deteriorating performance should be required to provide bonds or have their operating licences revoked.
- (d) The creation of a fund by way of a levy to provide refunds which cannot be obtained from any other source.
- (e) The possibility of merging the ATT with the airline protection fund.

Yours sincerely



A J Kaye  
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