



Tides

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THE IMPACT OF REFORMING AIR PASSENGER RIGHTS IN THE EUROPEAN UNION

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INDEX

1. INTRODUCTION	1
1.1 Motivation	1
1.2 Importance of Aviation and its Regulation	3
1.3 Brief History of Aviation Regulation	4
2. REGULATION	6
2.1 Current Situation.....	6
2.1.1 Overview of Regulation 261/2004.....	7
2.2 Upcoming Reform.....	9
2.2.1 Restructuring Passenger Rights	9
2.2.2 Interventions on the supplier side	12
3. IMPACT ANALYSIS.....	19
3.1 Leading Question	19
3.2 A Well-Designed Regulation.....	19
3.3 Impact Analysis	20
3.3.1 Harmonized Regulation	20
3.3.2 Passenger Rights	21
3.4 Overbooking	24
3.4 Taxation.....	26
4. EMPIRICAL SUPPORT	30
5. CONCLUSION	33
6. REFERENCES	34

The impact of reforming air passenger rights in the European Union

1. INTRODUCTION

1.1 MOTIVATION

After we finished our regular classes, sometime around March, the most frightening moment for us students arrived: we finally ought to select a topic for our final Master's Thesis. For me, a law student to whom the word "market" meant nothing more than a tangible place where one could spend money in buying different goods, choosing one subject out of the variety of lectures we had attended during the previous months was everything but an easy task. I had discovered multiple branches of a completely new discipline and all of them I found appealing and diverse.

However, I was particularly attracted by the subject "Transport Economics"; mainly because it was not until the end of those two weeks of lectures that I truly became aware of the importance of transportation in today's global economy.

Among the various transport modes, it was aviation the one that most caught my attention. Not only is the airplane something I personally have enjoyed a lot since I was a child but nowadays it is the only transport mode being able to travel very long distances in a relatively short amount of time.

The significance of air transportation, however, goes far beyond the mere economic aspect: I have come to realize that although the Internet has connected humans on a virtual dimension, the plane is the one phenomenon that has truly linked societies.

Especially for people like me, born on an island, aviation has allowed us to discover the world in a way that would never have been possible, or at least highly unlikely, otherwise. It brings together families and friends, ties cultures and spreads ideas.

This new-awakened interest led me to the second floor of the “Módulo D”, where I met Professor Juan Carlos Martín Hernández and asked him whether he knew of any stimulating topics related to transport economics that would allow me to write a decent piece of paper. Contrary to what I first feared would be my biggest weakness, he encouraged me to take my legal background as my main advantage and rapidly came up with the idea of writing about the recent European legislative reform within the air passenger rights and compare it to what has been done in other parts of the world. This mixture of pragmatism and curiosity resulted in these roughly 30 pages you now have in front of you.

The focus of this Thesis is to analyze the next generation of aviation regulation and briefly assess the possible impact the aforementioned reform might have on the industry.

The first section will concentrate on the key role air transportation plays in a global economy as well as concisely describe the history of governments’ ruling on this topic.

The next segment narrowly describes and enumerates the content of the scheduled changes of passenger rights regulation within the European Union. The potential impact of these measures will then be assessed in the third fragment.

Finally, during the last part of this Thesis it is my intention to present some empirical support for my theories through the use of short case studies found in the literature as well as wrap up this essay with my final conclusion.

1.2 IMPORTANCE OF AVIATION AND ITS REGULATION

Regulation within the aviation sector has indeed become more and more important for the last decade for several reasons:

- a) Despite the economic crises we are facing, both demand and supply for aviation product rose during 2012. According to the most recent IATA's annual report of 2013, nearly three billion people and over 47 million metric tons of cargo were transported two years ago and these figures have kept rising.
- b) Air transport plays a key role in today's global economy, creating around 57 million jobs and \$2 trillion in economic activity, almost 3.5% of global GDP.
- c) The 9/11 terrorist attacks rose questions on airport security and this demand led to a profound change in regulation.
- d) The tourism sector, a particularly essential segment of Spain's economy, strongly relies on the proper functioning of the aviation industry: almost 35% of all tourists choose the plane as their transport mode. According to the World Travel and Tourism Council, by 2021 more than 120 million people are expected to directly work in the tourism sector.

As the reader has noticed, a strong aviation network is of utmost importance. Only powerful air connectivity can open new markets and enhance exports. However, it would be inaccurate to solely concentrate on these positive figures because we would fail to recall the key role played by regulation.

Safety is one of the best examples for showing how important the combination of solid legislation and the cooperation between government and industry are: Before 9/11, for instance, 350 passengers on average made it through an airport checkpoint while today it is less than 150 (IATA, 2013). Although we do know that the vast majority of

passengers and cargo poses no threat to safety at all, inefficient regulation has led to this yet unsolved challenge of slow passenger checks.

The absence of collaboration and poorly conceived regulation threatens the whole aviation industry and could therefore cause devastating effects on a world scale economy.

1.3 BRIEF HISTORY OF AVIATION REGULATION

In order to understand what the approach on regulation has been so far, particularly in the European Union, we have to go back to the 50s:

a) It was on December 7th of 1958 that 52 sovereign States gathered in Chicago to sign the Chicago Convention. This treaty established the International Civil Aviation Organization, an international agency within the United Nations that was empowered to regulate the air transport market. This act is considered to be the first piece of aviation legislation and a revolutionary one as well because its article 24 forbids the taxation on aviation fuel.

b) Until 1978 there was no real common aviation policy within the European Union. As it happened with the Sea, every State on its own had jurisdiction over its airspace. Article 80 of the nowadays amended Treaty of the European Union used to read as follows: "1.) The provisions of this title shall apply to transport by rail, road and inland waterway. 2.) The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, *may* lay down appropriate provisions for sea and air transport. They shall act after consulting the Committee of the Regions and the Economic and Social Committee."

c) In the time comprehended between 1978 and 1986 the general European Law principles were applied to aviation. Doctrines like free movement of people and goods strongly influenced aviation policy.

d) In 1999 a diplomatic meeting – commonly branded as the Montreal Convention – sanctioned a document known to be one of the most important attempts to internationally harmonize aviation regulation.

e) Most changes in regulation certainly occurred during the XXI century. As mentioned above, 9/11 pushed many safety regulations and this period also finally brought us the full liberalization of European skies, being now commonly known as the “single European sky”. Europe’s principal legal document on passenger rights was approved in 2004.

f) On March 13, 2013 the European Commission presented a draft resolution called “air passenger rights proposal” with the objective of clarifying grey areas of previous acts as well as introducing a suite of new passenger rights.

g) The European Parliament voted upon the European Commission’s proposal on February 5th this year. The content of this voting will be analyzed throughout this Thesis.

h) Negotiations between the Commission, Parliament and Council will keep on taking place after this year’s European elections.

i) The Transport, Telecommunications and Energy Council will be receiving all Member States in June in order to discuss the aforementioned proposals.

2. REGULATION

2.1 CURRENT SITUATION

Having come into force on February 5th, 2005, the EU's Passenger Rights Regulation 261/2004 – officially named “Regulation (EC) No. 261/2004 of the European Parliament and the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights and repealing Regulation (EEC) No 295/91 – is at present time in force. It is the legislative response of the European Union to cope with the harms caused by delayed or cancelled flights and denied boarding. This small piece of legislation is considered to be an innovative regulation because it establishes compensations for the passengers whenever their flights are cancelled, delayed or they are deprived of boarding – article 1 of the regulation –. A small graphic representation of the Regulation as it is nowadays in force can be found on the next page. Interested readers can find more detailed information on this matter on the summary of Regulation 261/2004 published by the European Commission on its “mobility and transport” webpage.

The monetary amount of the compensations is determined by the different combinations of the variables “time of delay” and “kilometers to destinations”. The air carriers will, by the same principle, also have to assist their passengers with different “non-monetary” contributions such as meal vouchers or hotel nights.

Although the European Union has progressively expanded the content of this ruling for the past 8 years, Brussels now considers that the time for non-legislative action such as guidelines or voluntary agreement has elapsed and there is a need for a greater reform. During the next passage we will examine the plan of action by the European Parliament and the European Commission to adjust the present regulation.

2.1.1 OVERVIEW OF REGULATION 261/2004

Denied Boarding (Article 4)

The article that will apply depends on the nature of the denial. Should the passenger voluntarily agree, he shall be treated in terms of article 8.

If the denied boarding goes against his will, all three paragraphs – 7, 8 and 9 –are applicable.

Flight Cancelled (Article 5)

In case a flight is cancelled, article 8 and 9a/c are automatically in force. Should rerouting be necessary, also 9b.

Compensation under article 7 only is valid if the cancellation is not due to extraordinary circumstances.

Flight Delayed (Article 6)

Depending on the time of the delay and the kilometers, article 8 or 9 will decide on this matter.

Article 7 (Compensations)

- a) 250€ for flights up to 1500 km
- b) 400€ for intra-community flights under 1500km and for the rest between 1500km and 3500km
- c) 600€ for the rest of the flights

Article 9 (Right to Care)

Passengers shall be offered, free of charge:

- a) Meals
- b) Accommodation + Transportation
- c) Two emails/SMS/Fax

Article 8 (Re-Routing)

Passengers shall be offered choice between:

- a) Reimbursement ticket price
- b) Alternative route on the same day
- c) Alternative route on later date chosen by passenger

Having analyzed the European approach, it is essential to take a closer look at other markets as well. Though the Australian and American situations will be analyzed throughout this Thesis, I intend to presently examine the emerging Asian market, which is slowly opening its borders.

To illustrate this matter, I shall analyze the historical evolution and status quo of Japanese aviation regulation.

During the postwar period, Japan established a thoroughly regulated airline industry. This was evidenced by Japan's Civil Aeronautics Law, which required that airline companies obtain government licenses in order to enter the market, resulting in little to no competition between carriers. A further motivation for regulation was the physical capacity constraints at major airports. This situation gave the Ministry of Transport considerable control over all aviation matters.

When, in the 1970s, the USA deregulated its aviation industry and urged for similar measures overseas, aiming for an international open skies market, Japan's policymakers started recognizing that a shift towards a deregulatory approach was inevitable; though still believing that American-style deregulation was not best suited for Japan due to the physical limitations of their primary airports (Alexander, 1996). Thus, infrastructure expansion became the number one priority to overcome capacity constraints.

In the second half of the 1980s, the introduction of international and domestic competition further started to deconstruct the nation's regulatory policies, loosening the bindings towards liberalization. In recent years, one can still observe the shift towards liberalization and the development of aviation relations between Japan and other countries. Consequently, Japan has cooperated with the ASEAN (Association of Southeast Asian Nations) towards a more deregulated sky in Southeast Asia, and has even signed various open skies treaties, for instance with the US (2010) and Switzerland (2014) among others.

To recapitulate, Japan's current situation is not nearly the open aviation market that prevails in the United States, yet the efforts have been made over the past 20 years to slowly reduce former levels of regulation in order to remain competitive given the global trends in airline deregulation.

Further information on the Asian-Pacific aviation market will follow throughout the next chapters.

2.2 UPCOMING REFORM

In order to accurately evaluate the impact of the future reform in the third chapter of this Thesis, we need to split the forthcoming measures into two different sections, relatively to the subjects affected by them.

Numerous of the following rights are overlapping, since they definitively could at the same time be regarded as some kind of drawback for the air carrier and an advantage for the passenger – think for example of the concept of “compensation” as something that affects both the demand as well as the supply of the air transport market –. However, for the purpose of simplification I have decided to break up this symbiosis into two different parts.

On the one hand we will analyze procedures dealing essentially with the demand side of the aviation product – the passengers– and on the other hand we will undertake an evaluation of those actions altering the suppliers of air transport industry – mainly the airlines –.

In both cases the reader needs to understand that the European Parliament and the European Commission agreed upon the great majority of the points mentioned in this Thesis, and merely differ in small thresholds of those reforms.

Hence, it is therefore accurate to believe that the future reform of Regulation 261/2004 will look very similar to the drafting I bring up in the following lines.

2.2.1 Restructuring Passenger Rights

On this section I will try to concisely list in a comprehensive way the different passenger rights that the European Parliament, together with the European Commission, is planning to introduce or reform in next to no time. Though some of the forthcoming entitlements are created ex-novo, most of them simply consist of enlarging already existing rights catalogued in Regulation No 262/2004.

The most relevant passenger rights that will be affected by the new reform are, among other (European MEMO 13/206):

a) Information on cancelled / delayed flight

At present time and although it has become a general practice for most air carriers, it is not mandatory for the airline to inform the passenger on the delay itself but only on his rights. The proposal intends to make the information, never later than 30 minutes after the expected departure time, of circumstances like the nature of the disturbance or the expected new departure time a formal requirement.

b) Rearranged flight

To match the definition of a rescheduled flight, the rearranging of the trip must be within the two previous weeks before the original departure time. At the moment, under regulation 261/2004 it is not clear whether a passenger whose flight has been rescheduled owns the same rights as those of travelers with a cancelled or delayed flight. Therefore Brussels intends to unambiguously align both circumstances.

c) Misspelt names

One of the less intrusive changes the European Union will introduce is the right of a passenger to request, without being charged, that his misspelt name be changed up to 48 hours before departure.

d) No boarding denial based on a missing outbound ticket

It has become more and more popular to refuse the boarding of those returning passengers that did not take the outbound ticket – the departure ticket – of the same returning air carrier. The proposal intends to outlaw this situation.

e) Mismanaged baggage

Small, manageable musical instruments will soon be allowed into the passenger cabin. For larger instruments the air carrier will be coerced to clearly state under what circumstances the latter will be transported.

Overall, there will be a new general transparency policy on the haulage of baggage, including more exhaustive information on the terms and conditions belongings are stocked and allowed on the plane.

In order to undercut the strict deadlines of baggage claiming new, faster forms will be introduced, allowing the passenger to rapidly submit a complaint.

f) Reimbursement in case of tarmac delay

A tarmac delay refers to the situation of a plane being stuck at the tarmac, the area located between the gates and the runways. Should this condition last for more than 5 hours, the passenger has the right to fully be refunded the ticket price as if his flight had been cancelled as well as disembark if the tarmac delay should have happened after the boarding.

g) Triple choice

It is well known that in law we use the brocard “pacta sunt servanda”. This basic principle in Civil Law stresses the fact that private contracts – such as the one between the passenger and the airline – and its clauses are binding between both parties. Therefore, failing to fulfill them derives in a bond rupture.

Brussels will enlarge the passengers’ rights when their plane has suffered a long delay or a cancelation. For now the passengers’ choice was reduced to either receive an alternative mode of transport or to be offered the possibility to rebook at their best convenience. Reimbursement will soon be the third pillar and the re-routing option will also be broaden: should the air carrier not be able to provide the rearranging on its own services within 12 hours, they will be compelled to offer the alternative through competing airlines or via a substitute transport modes.

h) Right to care

One of the structures that will most drastically be reformed is the section containing the non-monetary compensations for passengers. The so-called “right to care” comprehends a series of measures aimed to help the passenger at very spot such as free meals or free of charge hotel nights.

According to the new proposal, this right will be dependent on the sole variable of time – two hours –, independently of the distance to destination.

In case of the already mentioned tarmac delay, after just one hour the airline will have to provide its passengers with basic assets like water and toilet access.

i) Right to obtain complaint handling

Novel deadlines are comprehended in the new proposal: while the passenger has up to three months after the departure time to hand in the complaint, the air carrier has to reply within one week.

External ways for complaint – mainly civil courts and national enforcement bodies – will additionally be available for all passengers, regardless of the fact that they previously presented the aforesaid complaint at the airline. The European Parliament has also suggested that the Commission define a common complaint sheet for the whole European Union.

2.2.2 Interventions on the supplier side

The other side of the coin is represented by those instruments that *directly* interfere with the supplier's behavior. All the upcoming measures openly confront the free managing style of air carriers. The new regulation contemplates a sanctions section, for the European Union considers that up to now penalty policies have been inconsistent and do not represent worthy incentives.

These sorts of procedures, however, do not solely intrude the air carrier's sphere; their impact is much larger than that. Other agents in the aviation industry such as airports also see themselves affected by this new ruling.

The most relevant processes affecting the suppliers of the aviation industry consist of the following points (European MEMO 13/206):

a) Supervision and cooperation

One of the goals of the new regulation is to supply all National Enforcement Bodies – those agencies responsible for monitoring the application and enforcement of passenger rights – with a common address partner, the European Commission, to facilitate communication and cooperation among the organizations. They will no longer be mere “complaint – replying” agencies but take an active role in monitoring airline policies to prevent malpractices from happening. Strengthening oversight of air carriers by national and European authorities will be one of the important steps the European institutions are willing to take. Material means as well as technical expertise will also be stipulated for them from the European funds.

b) Bankruptcy

Although article 8 of the current regulation ensures that all passengers receive the chance for rerouting, experience has shown that this right has often not been provided, especially when it comes to the case of cancellation due to the insolvency of the airline. With the aim of minimizing the damages caused to passengers, national authorities will be requested to thoroughly audit and gather information on the financial records of the air carrier as well as putting their activities on ice if possible threats to economic stability is detected.

Member States will also be encouraged to promote new insurance instruments with the aim of protecting the passenger’s capital in case of bankruptcy. This last measure will closely be followed by the European Commission, who at the same time already has settled an appointment – two years after the adoption of the new regulation – to review its execution and efficiency. The European Parliament, however, even has come to propose that airlines be obligated to take an insolvency indemnity insurance policy.

c) *Policy for price transparency*

Although Price Transparency is regulated by “Regulation 1008/2008 of 24 September 2008 on common rules for the operation of air services in the Community” and is technically not part of the new Regulation, it is considered to be a cornerstone of passenger rights protection.

As a matter of fact, Price Transparency is one of the various examples of market intervention we will find along this Thesis. Enhancing competition within the European Union’s airlines meant liberalizing the aviation market by assuring the freedom of all air carrier companies to unreservedly set up their prices. Nevertheless, as it usually happens in modern economies, this freedom had some unmistakably established limits, like consumer protection.

Price Transparency is a policy that guarantees that both the seller and the buyer know the price and quantities for a given stock – in this case the flight –, thus allowing the passengers to obtain perfect information about the aviation market and ultimately making his transport mode choice based on that knowledge.

At Member State level measures have already been taken. In Spain, for instance, there is a law for the protection of market competition – Ley 15/2007 de 3 de junio, de Defensa de la Competencia –. It is the intention of the European Commission to further improve this area by coordinating action under all Member States and more effectively monitor the operator’s pricing policy.

d) *Liability of the Air Carrier*

The following passage truly describes one of the core challenges the aviation industry will have to face once the new regulation is approved. I feel that at this moment it is in order to take a brief recess to explain the concept of “liability”, a fundamental term in Law that might not be known to all readers.

In Law, a person or a company – relevant for this Thesis are the air carriers – is legally liable when they can be held accountable according to a certain regulation. Liability means, therefore, “being responsible”. In what cases and up to what extent the air carrier is held liable has to be formally regulated by law.

The fact that air carriers are to compensate passengers if they fail to deliver their product within the deadlines established by the current regulation finds its exception when the cancellation occurs due to extraordinary circumstances which could not have been avoided even if all reasonable measures had been taken.

At present times, Regulation 261/2004 has included the extension of the air line’s liability in article 5.3, stating that “An operating air carrier shall not be obliged to pay compensation in accordance with Article 7 – the one regulating the right for compensation –, if it can prove that the cancellation is caused by extraordinary circumstances which could not have been avoided even if all reasonable measures had been taken.”

As you can see, the term “extraordinary circumstances” is of utmost importance, for under those situations air carriers are not required to pay any kind of compensation. This, which at first sight seems very sensible, turns out to be problematic once we realize that the expression itself is not clearly defined.

This is an example of the so-called “undefined – or undetermined – legal concepts”. Limiting or even excluding the liability of operating air carriers as we have come to regulate it today is a direct consequence of the 1999 Montreal Convention, which firstly introduced this idea. Since it is obvious that there is no such thing as a mega-regulation – in the sense of contemplating each and every aspect of an industry – most of our legislation contains undefined legal concepts, which will

afterwards, on a case-by-case basis, narrowly be sharpened by the Tribunals.

In fact, Regulation 261/2004 already sets some guidelines as to how the term “extraordinary circumstances” should be interpreted. Political instability, meteorological conditions incompatible with the operation of the flight concerned or security risks are some of the circumstances listed by the Preamble of this regulation.

The Commission (Press release 13/2011) now has proposed to sharpen the definition by adding events like storms, operational problems or strikes as well as listing the technical failures that would exclude the airline’s liability. The European Parliament, however, strongly suggested that technical problems almost never be an exemption. Moreover, the legislative body has decided to take a more radical approach (European IP 14/119) and strongly motions for a closed, exhaustive list of possible “extraordinary circumstances”, whereas the European Commission would rather have an open catalogue for they believe that not all possible future events can be foreseen.

Additionally, both institutions, though disagreeing on the exact number of days, have agreed to limit the nights passengers receive in case their flight is cancelled due to extraordinary circumstances.

e) Keeping the passenger informed

As a complement to the issues mentioned above on the obligation air carriers have to keep their passengers informed, airports will be forced to open contact points to update passengers on their flight’s status as well as on their rights.

f) *Contingency plans*

Iberia's last strike has left us with images of hundreds of passengers being left stranded at Madrid's largest airport. To keep this from happening again, airports together with air carriers will have to prepare emergency plans to take care of those passengers affected by mass disruptions.

g) *Luggage policy*

The liability limits included in the Montreal Convention allow air carriers to compensate for lost or damaged equipment with less than its real value. This last rule shall be reformed to protect those passengers with reduced mobility – from now on PRMs –.

Under the new proposal, such passengers will be entitled to declare, without been charged, the actual value of the mobility equipment at the check-in point so that the potential compensation be established for the full amount.

There will be a general police for zero tolerance against unreasoned denial of baggage. Other than for security reasons or technical specificities of the aircraft, the airline shall not refuse any luggage. To ensure that this rule be observed, national authorities will be responsible for the enforcement of compensation rules for mishandled or lost equipment.

h) *Right to care of PRMs*

In order to achieve the universal right of PRMs to be able to enjoy the same possibilities to travel as the rest of the citizens, their right to care will have no financial limit or of any kind.

i) Compensation

Last but not least, one of the most important sections of the current Regulation 261/2004, the one on compensations, will also be reformed. The delay thresholds will be extended from three to five hours for all intra-European Union flights and short international flights. For the remaining flights it will be sometime between nine to twelve hours.

Compensation right is also going to apply to those situations where the passenger has either missed the connection flight, had his flight rescheduled while having been notified with less than two weeks in advance or was denied boarding. In those cases, the operator of the first flight will be the one having to respond to all damages.

The amounts fixed for compensation will probably be reviewed and extended and new rights will be approved.

3. IMPACT ANALYSIS

3.1 LEADING QUESTION

Now that the different European reforms have been catalogued, it is time to evaluate the impact they might have on the airline industry. One of the first conclusions we can easily draw from what has been mentioned so far is that aviation is a heavily regulated sector and extremely consumer protecting.

Although at first sight this might look like an ideal situation, I believe that the plan of action the European institutions have taken might possibly have some drawbacks for the suppliers of the product and ultimately on the air passengers as well.

This third section of the Thesis will precisely deal with the question of whether the future revision of Regulation 261/2004 is appropriate or harmful for the industry.

3.2 A WELL-DESIGNED REGULATION

The first thing that has to become clear is what I, as the author of this Thesis, consider to be a good regulation. The concepts “good” or “bad” are simply adjectives; they are indeed very ambiguous and vague; depending ultimately on how each individual, depending on its socioeconomic background, perceives things to be.

Coming up with a definition for the ideal regulation is not to be taken slightly. By doing so, we design a quality standard to which the current situation can be contrasted upon.

This is the reason why I would like to suggest the definition of a well-designed regulation be a compound of policy and regulatory settings that encourage rather than restrict aviation’s economic contribution.

In my opinion, our current regulation is poorly designed and I further believe that the upcoming European reform that will take place this year might additionally threaten the industry’s financial sustainability. My intention is to bring evidence on these matters during the next sections.

3.3 IMPACT ANALYSIS

Tony Tyler, Director General and CEO of the International Air Transportation Association identified the industry's two main goals as setting focus on the global harmonization of regulations and on finding an equitable approach for air passenger rights (IATA, 2013). Let us now analyze how regulation may fulfill both requirements and impact the aviation industry.

3.3.1 Harmonized regulation

In today's global economy, where competition within the air transport market is so fierce, incentives for delivering the service on time are more than certain. The large number of producers assures that airlines get enough motivations to fully satisfy their customer's needs in order to obtain benefits. It should therefore be commercial pressure what ensures that airlines get their passengers on time and without incidents and not government intervention.

In case of an incident like inevitable occasional delays or cancellations, the same commercial discipline encourages the airline to provide accordance assistance.

It is obvious that there are areas where regulation should definitively play a key role – think for example of security –, but the problem is that nowadays we have over fifty countries with specific regulation on aviation. This lack of harmonization has led to confusion for both passengers and airlines.

I strongly believe that aviation laws should be based on internationally adopted principles rather than on a national level so that legal uncertainty and instability do not hinder the sector.

The positive side of this discussion is that the solution to harmonize legislations already exists and is called “Convention for the Unification of Certain Rules for International Carriage by air” – commonly known as the Montreal Convention –.

This regulation is an International Treaty which aims to unify the different regulations on aviation around the world. Its content both satisfies the passengers – because they obtain accurate mechanisms to secure their rights – as well as the industry – for air carriers would know with certainty up to what extend they are to be held liable–.

It should be the industry's top priority to get a global ratification of the Montreal Convention as soon as possible.

At present time, and almost fifteen years after it came in force, only half of the International Civil Aviation Organization's Member States have ratified the resolution. Although important actors of the aviation industry like the United States of America, the People's Republic of China or the European Union are among the 103 out of 190 ICAO contracting-states who joined the Convention, significant representatives of the Asian emerging markets like Thailand, Indonesia or Vietnam are yet to ratify. A world power like the Russian Federation neither is part of the Convention.

As a result of this scenery we nowadays have a real patchwork of liability regimes that fosters uncertainty in determining what regulation applies to a specific passenger.

3.3.2 Passenger Rights

During this passage I will particularly focus on the impact of the future reform of Regulation 261/2004. As I have already mentioned, achieving a balanced catalogue of passenger rights – ideally on a global scale – is of utmost importance and at the same time a very difficult task to be carried out.

The European Union has made a strong attempt to properly find a way out by considerably restructuring their aviation regulation. I already advanced that, thought well-intentioned; this new set of rules most likely won't help the sector's growth.

These next lines will separate those measures that will probably have a positive outcome on the industry from those which might not.

a) Instruments that will encourage progress

The most constructive decision the European Union is willing to take consists of curtailing the limits of the airlines' liability when it comes to providing care and assistance to passengers in case of delay or cancellation due to extraordinary circumstances. As already explained, such boundaries nowadays do practically not exist although it seems

more than reasonable that airlines should not be held indefinitely accountable for events totally beyond their control – think for example of Iceland’s volcanic ash cloud in 2010 –. These situations endanger the financial sustainability of the air carriers and shall soon no longer be in force – the only exception will be those cases where the passenger suffers from any kind of reduced mobility or needs special medical treatment; is either pregnant or an unaccompanied child –.

Subsequently, limiting the accommodation nights to a maximum of three days will as well lighten their responsibility. This last compensation rule will not apply to small-scale regional aircrafts – those with small aircrafts of not more than 80 seats and providing short distance services of less than 250 km – like the Canarian airline “Binter Canarias”, for such measures could be totally disproportionate with these air carriers’ financial revenues.

b) Endangering measures

The following measures are considered to harm the aviation industry’s growth.

One of the most threatening ideas Europe has proposed consists of regulating the compensation for delays occurring during connecting flights by letting the whole burden for compensation fall merely on the operator of the first flight.

Hence, there I am seriously concerned with the fact that regional operators might be strongly discouraged from offering connecting flights to long-haul destinations. The economic effects of this consequence go far beyond just disturbing the passenger: it means that the industry will probably not entertain certain routes and potential emerging markets – which definitively are in desperate need of these kind of itineraries – will be hindered from boosting.

Other measures envisioned in the future reform consist of a wide-ranging policy for supervision of the air carrier's industry. Not only is their financial status to be constantly monitored, but their general performing as well.

In my opinion this might scare future airlines from entering the market – thus sinking the competition within the industry – and at the same time it may result in a constant obstacle in the industry's daily managing.

When talking about compensation thresholds, the legislative institution of the European Union intends to fix the compensation for delays at three hours. However, this last thought might not be in the passengers' best interest hence I assume that equaling the compensation deadlines for delays and those for cancellation at three hours will prompt the later because the air carrier will most likely not be motivated to deliver the product with delay but simply cancel it.

If the threshold, however, was set at a higher level – let us say four hours – there are more reasons to rely on the fact that the industry would have a strong incentive not to cancel the flight but simply deliver a service behind schedule. Thus they would not have to pay any kind of compensation.

Behind this reasoning there is the strong belief that cancelation is by far the worst outcome for passengers, for in that case they have to rely on the availability of other transport options.

The European Parliament has also proposed to impose on air carriers the obligation of taking insurance policies for the case of bankruptcy. This event will obviously increase the airline's cost and for sure this extra charge will be trespassed to the ticket price.

The rest of the above mentioned measures, though well intentioned, will possibly as well increase the ticket price. New information points, new complaint sheets or contingency planning are expensive matters ought to be carried solely by the industry.

3.4 OVERBOOKING

The problem of denied boarding due to overbooking as one of the main reasons for denied boarding (Garrow, Kressner and Mumbower, 2011) has been addressed in many different ways by the rest of the countries. Selling more tickets than there are seats available is not illegal. In fact, it is an instrument often carried out by air carriers to compensate for potential absentees. Different from the already mentioned European policy, where large compensations put pressure on the air carriers, both the American and the Australian aviation market have come up with distinct measures for tackling the problem.

The United States Department of Transportation, in its published “Consumer Guide for Air Travel 2014”, has opted for a mixed regulation: The consequences for the denied boarding due to overselling depend on whether the passenger agreed or not on not entering the plane.

American airlines are forced by law to seek out people who are voluntarily willing to give up their seats for compensation before bumping anyone involuntarily. Nor the form or the actual terms of such reparation are however regulated by the government. They depend solely on the negotiation between the passenger and the air carrier. The bargaining may include free meals or vouchers for future flights; the content of the compensation is essentially boundless. It is the free market on its own what solves the situation.

Nevertheless, if passengers are bumped against their will, the American legislation entitles them to denied boarding compensation. Similar to the terms already adopted in Europe, the amount of the aforementioned compensation is established by a combination of the variables “price of the ticket” and “length of the delay”. If the airline

delivers a substitute transportation that is scheduled to arrive within one hour to the original arrival time, no compensation will be mandatory.

Should it, however, be sometime between one hour and two, the airline has to pay an amount equal to 200% of the original one-way fare to the final destination with a \$650 maximum. Finally, if the substitute transportation is scheduled to get to the destination more than two hours later, the compensation doubles: 400% of the one-way fare with a limit of \$1300.

I consider the American approach of dealing with overbooking to be beneficial for both the industry and the customers, for its flexibility addresses directly the heterogeneity of the passengers' needs (Laurens Behrens, 2013). Through the use of the multinomial logit model, literature has shown that business travelers are more willing to pay to reduce journey time than leisure travelers (Se-Yeon & Kwang-Eui, 2013).

Thus, urgent travelers will be able to get on the plane whereas those who are less concerned about getting to their destination on time may reach a mutually accepted compensation.

A new Canadian law entered in force on September, 2013 and entitles passengers who due to overbooking voluntarily decided not to enter the plane to claim upon receiving cash instead of travel vouchers on a one-to-three exchange rate (let us say \$300 cash equal \$900 travel vouchers). In case of involuntary bumping, cash compensation will be applicable based on the sole variable of the length of the delay (\$200 for less than 2 hours; \$400 if it is between 2 and 6 hours and \$800 for all delays of more than 6 hours).

The more radical approach has been taken by the Commonwealth of Australia. Surprisingly – even for myself, I have to admit – there is no specific air passenger rights legislation in Australia. Nor do guidelines exist. They totally rely on the free market and the fierce competition to safeguard passenger rights. Each participating airline in the Australian Airline Customer Advocate scheme is required to provide its own Customer Charter containing the airline's Conditions of Carriage. The terms and circumstances in case of delay or cancellation will therefore be set, on an individual basis, by each airline. Depending on whether the passenger decides to travel with Qantas, Jetstar, Virgin Australia or Tiger Airways, their set of rights will fluctuate. Up to

what extent I consider such a liberalization to be beneficial will be analyzed during the fourth chapter of this Thesis.

3.4 TAXATION

This last section will cover one last and important aspect of aviation regulation: taxation.

One of the most heated debates aviation taxation has ever had to witness was motivated by the decision adopted on 2008 by the European Union to include the aviation sector into the EU Emissions Trading System; the Union's cornerstone policy to reduce industrial greenhouse gas emissions in a cost-effective way.

Instead of imposing a certain pollution control – commonly known as command-and-control regulations –, market-based instruments like the European approach are regulations that encourage private polluting activities to implement changes that are positive not only to meet the policy goals, but to the own firms as well because they will be able to achieve their aims at a very low cost.

The main difference between these instruments and the control-and-command policies is that market-based policies normalize the incremental amount of money that firms spend to reduce pollution and not the maximum pollution level itself. This standardization of the marginal cost (the additional resources spend to lower pollution) creates an incentive for firms to lower their emissions, because in the end this results in a benefit for themselves (Stavins, 1998).

The EU Emissions Trading System is a very good example of tradable permits, also known as “cap-and-trade” strategy. This type of market-based instrument relies on the government to set a maximum level of pollution that may be emitted by the industry. The established limit is distributed, in the form of emission permits rights, among the firms. Since the number of allocated permits corresponds precisely to the previously set up emission limit, if a firm wants to additionally pollute, they will be forced to buy permits from the rest of the firms that do not require all of their permits.

It therefore pays off to pollute less, because your remittent licenses can afterwards be sold. As W. David Montgomery states, the buyer is being punished for polluting while

the seller gets a reward (Montgomery, 1972). Firms will as a result try to reduce their emission as much as possible, resulting in a better social welfare.

As a result of this European regulation, emissions stemming from all flights from, to and within the European Economic Area – this organization embraces the 28 member states of the European Union plus Norway, Liechtenstein and Iceland – are encompassed in the existing scheme by which airlines that exceeded their previously allocated polluting limit have to buy tradable permits to further emit carbon dioxide.

The requirements to buy permits are proportional to the entire length of the voyage, not just to the track that actually takes place on European airspace.

Because of this reason, non-European airlines as well many governments were strongly opposing the pioneering legislation.

Coherent with this outrage, three United States' airlines – the nowadays merged United Airlines and Continental Airlines together with American Airlines – jointly with their trade association, Air Transport Association of America, challenged the legality of the European aviation trading system on 2011.

Their lawsuit was mainly founded on the grounds that the procedure used by the European Union to bring airlines into their trading system is a serious breach of the Chicago Convention because, as already mentioned, this treaty prohibits any kind of taxation on aviation fuel – article 24 –.

They also argued that it goes against the general principle in international law of countries' sovereignty over their airspace.

On December 21, 2011 the European Court of Justice, however, upheld the legislation by stating that the extension of the European Emissions Trading System to aviation does not infringe the sovereignty principle because it only applies to those flights that either departure or land on European territory.

Neither does the Tribunal identify any kind of breach against the Chicago Convention, for the judges do not consider the trading system as a tax – because the price of the tradable permits is not established by the government but exclusively by the market –.

After the Tribunal ruling, more pressure was put on the European Union when the position of the aforementioned airlines was endorsed by more than twenty governments – including leading G-20 member states like the United States of America, the People’s Republic of China or the Republic of India –.

This international tension led to an agreement by the International Civil Aviation Organization Assembly in October 2013 to reach a global market-based approach on aviation’s emissions by 2016 and then apply it on 2020.

Subsequently, the European Trading System was amended so that, until 2016, it only encompasses emissions from flights between aerodromes within the European Economic Area. Flights between an aerodrome in the EEA and an airport in a third country or territory are not be encompassed

In my opinion, issues like global warming, where the impact of aviation externalities are likely to be felt in places that might not have caused the activity that led to the negative side effect, cannot be solved in the same way as the rest of externalities (Kaul, Grunberg and Stern,1999).. I agree with Nordhaus, on the idea that what makes these goods diverse from other economic issues is that there is no national, workable mechanism for resolving these issues efficiently and effectively (Nordhaus, 2005).

Moreover, the state sovereignty principle, one of the most important principles in international law stemming from the 1648 Treaty of Westphalia, ensures that all states have the right to retain supreme power within their borders and, what is more important and I consider it to be the core root of the problem, without any external authority interference (Douglas, 2012).

Therefore, unanimity at an international level nowadays is troublesome because of the tremendous heterogeneity among all States. Some countries like the United States of America or the People’s Republic of China might be more attached to their autonomy and therefore more reluctant to give up their sovereignty while others –Singapore or Libya regarding to oil – are so dependent on the production of certain “externality-causing” goods that it makes sense to believe that they will be unenthusiastic about discussing certain issues (Nordhaus, 2005).

For all these reasons I believe that the market-based mechanism taken by the European Union to tackle emissions caused by aviation is a good model for the international community, even though I have to admit that it was a unilateral breach of the 1997 Kyoto Protocol Climate Pact, by which countries agreed to address emissions from aviation jointly through the UN's aviation body, the International Civil Aviation Organization

I deliver my opinion having taken into account the advantages and drawbacks of the policy. The price we will have to pay is an inevitable increase of the air transport ticket prices. The European Union itself, on its updated "*Q&A on historic aviation emissions and the inclusion of aviation in the EU's Emission Trading System*", has estimated the rise to be somewhere between 1.8€ and 12€, depending on the distance of the flight

But I strongly believe that the problem of global warming needs to be addressed urgently and aviation strongly contributes to this problem for it accounts for roughly 3% of the European Union's total greenhouse gas emissions.

4. EMPIRICAL SUPPORT

From what I have presented so far, from my point of view it would not be wrong to say that one feasible solution for relieving the heavily regulated industry of aviation could be a broader global liberalization of the air transport market and leave the role of the State to merely ensure undistorted competition, security and, to the aforementioned extend, environmental protection.

During this last passage I intend to bring up some empirical studies found in the literature that support the theory of aviation industry working better under a liberalized market.

First of all it is my intention to examine the influence of deregulated markets on the suppliers of the industry to later analyze if that positive effect is perceived by the passengers as well.

a) Influence of deregulated markets on the aviation industry

Among the different examples one could choose from the air transport market, I consider the phenomenon of Low-Cost Carriers – from now on LCC – and airlines - within - airlines – AWAs – a particularly good case study.

On October 24, 1978 the United States House of Representatives passed the Airline Deregulation Act, a law which formally deregulated the American airspace. Trigger of this new ruling were two airlines, Western Pacific Airlines in the American state of California and the Texan Southwest Airlines, which successfully had been operating unregulated flights between both enormous states at a very low cost. This new law was followed by the entrance of countless LCCs into the American airline market.

The model of LCCs is nowadays a global trend (Dobruszkes, 2006) and has already started to expand to the Asian-Pacific market (The Economist, 2014) – this year another twelve such airlines will join the

47 already existing ones in the Asia-Pacific region (Pearson, Merkert, 2013)–. Regarded as a threat to the conventional airline models (Taneja, 2010), multiple network airlines have created their own low-cost subsidiaries following the model of other industries like the automobile one.

Commonly known as airlines-within-airlines, this new branch of the industry was mainly born to compete against the intensifying penetration of the independent LCCs.

At present time, there are roughly 30 AWAs operating around the world and over 200, yet exponentially increasing, LCCs. If we observe the precedence of those LCCs, we will notice that the vast majority of them operate in deregulated markets – one third of those companies are European (and almost all the rest are operating in the Asia-Pacific market –. Countries like Australia or Singapore have even refused to pass any kind of punitive legislation for they totally trust the market to put pressure on the air carriers and ensure a high quality and care service.

Opposing this scenery, the highly intervened market of People's Republic of China, with strict regulations on ownership rights representing entry barriers, only has a single LCC despite their massive potential demand.

Although it is true that many airlines following these models of airlines within airlines have failed in the past – mainly due to reasons like an unbalanced growth in regards to the demand, excessive control from their parent-airline, poorly designed strategy, shared administration or simply inefficient managing (Gillen and Gados, 2011) – the two-way relationship between LCC expansion versus liberalization simply cannot be denied.

It is undisputable that the fast growth of LCCs leads to competition and reduces fares, which fosters air traffic tremendously – mainly

between short-distance trips of an estimated three hours range for the LCC business model maximizes the utilization of their aircraft by keeping them in the air the longest possible time with approximately two returns per day –. Moreover, the aviation industry was forced to develop and adapt for it was now driven by the market rather than by regulation and hence firms had to create new strategies, find new potential markets, reduce costs and try to gain market share.

It now has become clear that deregulation nurtured the industry and connectivity (Hoon, Zhang and Xiaowen, 2010) but we still have to examine whether a deregulated environment also positively affects the demand side of the aviation product.

b) *Passengers profit from deregulation*

During this last passage we will analyze if passengers benefit from a liberalized air transport market beyond the substantial and already mentioned fact of a sensitive price reduction in the ticket. The first thing that previous economic literature has shown is that the emerging competition fostered by the entrance of LCCs has led to product heterogeneity and thus increased the demand range: Some papers have proven that socioeconomic facts like the age of the different consumers considerably affect the willingness to pay. Younger customers, for example, are less concerned with on-board comfort and therefore are not willing to pay for that service (Balcombe, Fraser and Harris, 2008).

Another aspect that was altered by deregulation was the ownership structure of international airlines: a large number of formerly state-owned companies have been progressively privatized. An investigation has shown that this change of managing also resulted in an increased satisfaction level of passengers; demonstrating the open secret of private airlines being more performance and efficiency oriented than pure public sector air carriers (López-Bonilla, 2008).

5. CONCLUSION

This Thesis focused on the interaction between regulation and the airline industry. It shows that, in many ways, a competitive airline market is self-regulating and commercial discipline is the most effective guardian of air passenger rights.

Aviation is possibly the most heavily regulated consumer-oriented industry in the world and during this essay I have proposed some measures to alleviate this concern. A global liberalization of the market combined with an internationally agreed upon Charta of air passenger rights would mean a huge step towards upgrading the aviation industry.

The third passage showed us how some of the well-meant efforts of the European institutions to secure those rights may result, for the above mentioned reasons, in a serious loss of connectivity as well as in a ticket price increase. We could argue that the reform of Regulation 261/2004 is a “missed opportunity”.

Empirical studies and the situation of different markets around the world is contemplated in the fourth chapter, proving prove that air traffic develops most comfortably in deregulated environments because only liberalized markets allow for competition and connectivity growth in the industry. The role of the State should therefore, in my opinion, be to merely ensure fair competition, promote efficient safety regulations and protect the environment through market-based instruments.

The second cornerstone to a balanced approach of the problem is to achieve harmonized regulation. The actual patchwork of liability regimes only generates needless and complicated confusion among suppliers and consumers.

Therefore I strongly believe that liberalization and harmonization will lead to enormous benefits for both the aviation industry and the passengers.

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