

Fueling Discontent: Falling Oil Prices Spark Airline Surcharge Debate

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By **Amon Cohen**

Crude oil prices plummeted from \$115 per barrel in June to around \$85 in late October. Motorists on both sides of the Atlantic have benefited from lower prices at the gasoline pump—dipping below \$3 per gallon in some U.S. states—so naturally it follows that airlines reduced their passenger fuel surcharges too, right? After all, they introduced (and have subsequently raised) surcharges as oil prices went up.

Wrong, it would appear. *Travel Procurement* found evidence of only a handful of carriers making reductions in recent months, most of them in Japan, where the government regulates surcharges. Otherwise, fuel surcharges seem to defy the laws of both physics and economics that dictate what goes up can come down. In fact, as increasing numbers of corporate travel professionals are observing, surcharges seem to defy any logic at all. The rationale by which they are calculated is opaque at best and apparently nonexistent at worst. Worse still, their very existence is difficult to justify. Indeed, there seem to be compelling reasons why fuel surcharges should now be scrapped entirely, especially as carriers exclude from negotiated corporate discounts that element of the total ticket price.

There are so many criticisms to be leveled at airlines on this issue that it is hard to know where to begin. At the most basic level, Paul Wait, chief executive of the United Kingdom's Guild of Travel Management Companies, asked, "as fuel prices are coming down, why isn't that flowing through to lower surcharges?"

Good question, and one that *Travel Procurement* posed to five major carriers. American Airlines and Delta Air Lines didn't answer at all, whereas United Airlines merely replied: "We don't give forward-looking comments on fare action."

An official at IAG, parent of both British Airways and Iberia, said: "That is not something we comment on. We are monitoring the situation."

Only Lufthansa was prepared to talk, for which it deserves credit, even if many may not like its answers. "We don't have a fuel surcharge anymore," said a spokesman. "Since the beginning of the year, it has been an international surcharge, which covers all costs that are not controllable from our side, such as air traffic control. Our latest forecast for our 2014 fuel bill is €6.7 billion (US\$8.5 billion), which is only a slight decrease, because we pay in euros and the euro has been falling. Our hedging policy has also slowed down the effect of decreasing oil prices."

(Large airlines typically practice some level of fuel hedging, which is making advance purchases of fuel at a fixed price for future delivery.)

Yet at the same time Lufthansa is linking the surcharge to uncontrollable costs, there is a discretionary, market-based element to the pricing. Asked if Lufthansa will lower its "international surcharge" should its fuel costs (as opposed to the global fuel price) fall significantly, the spokesperson said: "There are a lot of factors. Certainly, there is the fuel cost, but there is also the competition and the market. We have surcharges which are suitable for market conditions comparable with other airlines. You have to look at our final fares [i.e. total ticket prices], and they are decreasing slightly." The spokesperson added that revenue per available seat kilometer (a measure of unit revenue) is down 3.6 percent for Lufthansa in 2014, and yield (a measure of fare paid) also is down, leading to lower profits. The official added that airlines also like surcharges because they can be adjusted much more easily than net fares, which Lufthansa tries to increase only once per year.

Whatever the underlying reasoning from the airline perspective, there is no doubt that surcharges can be, to put it diplomatically, incoherent. BCD Travel consulting wing Advito has been comparing total ticket prices with fuel surcharges and found the surcharge on some routes exceeds an airline's entire fuel costs for those flights. Remember that, in theory, the surcharge should only cover the increase in fuel costs airlines have experienced since introducing them around a decade ago.

On a Berlin-Rome flight operated by one carrier flying an Airbus A320, for example, Advito calculated the total cost of jet fuel per flight at €5,159, based on a very high assumed oil price of \$120 per barrel. Even at that price, the airline earns more from the surcharges it collects than its total fuel cost as soon as the load factor exceeds 68 percent. According to Advito, the airline's average load factor in April 2014 was 83.9 percent.

Plenty more evidence suggests fuel prices are not objectively tied to costs. "Joint ventures are allowed to set fares together, but they don't buy their fuel together. What a coincidence then that their surcharges match," said Olivier Benoit, area practice leader for Advito. Benoit also pointed out that Lufthansa's "international surcharge," though supposedly meant to cover more than fuel, did not rise when the name was changed from "fuel surcharge." He also noted that one particular European airline imposes a higher surcharge on short-haul flights for business-class tickets than for economy, even though the seats and seat pitches in both classes are identical.

It's also a challenge to discover the rules on which airlines claim to base their surcharges. "At the time airlines introduced their surcharges, they published the rules behind them," said Benoit. "Ten years later, they mostly don't publish the rules anymore, or make it very hard for the surcharge to come down, such as saying they will only reduce it if oil falls below \$60 per barrel. Airlines are now managing the surcharge like a fare. It's a great excuse to make some money."

Jörg Martin, chairman of the aviation committees of GBTA Europe and German travel managers' association VDR and also managing director of CTC Corporate Travel Consulting, agreed. "Airlines are charging the surcharge as they want without any relation to the market price trend for fuel," he said. "We have many examples of this kind of nonsense. There is no logic, which makes it very difficult for buyers to negotiate."

This last point by Martin goes to the heart of the second major grievance about surcharges, which is whether they should exist at all. The notion of a surcharge might imply a limited duration, yet surcharges have been in place since oil prices spiked in 2003. Subsequently, airlines found ways to trade profitably with the crude oil price well above the \$30 per gallon that once was thought to be the highest level they could sustain.

Is there still a case for isolating this one essential cost of doing business from the others that airlines incur? GTMC's Wait thinks not. "Surely it's time to price fuel costs back into the fare," he said. "An aircraft can't go anywhere unless you put some fuel in it."

According to Advito's analysis of all tickets bought by clients in 13 major European markets, the YQ ticket box for surcharges as a percentage of total ticket price has climbed from 11.4 percent in February 2009 to 16.4 percent in 2014. In many cases, it is much higher. Advito showed *Travel Procurement* an example of a New York JFK-Frankfurt ticket for \$797.70, in which the net fare accounted for only \$111. It is far from an academic issue for travel buyers, given that airlines refuse to negotiate on the total ticket price—only on the net fare.

Once again, inconsistency is rife, and other rules always seemingly work in the carriers' favor. "They say YQ is not part of the fare when assessing rebates, yet they follow ticketing rules such as making the YQ charge nonrefundable when the ticket is nonrefundable," said Benoit. Airlines, in other words, are refusing to refund fuel they charge as a specified item, even if their passengers haven't consumed it.

If buyers feel aggrieved about surcharges, how can they fight back? At a collective level, Martin said VDR and GBTA Europe are raising the issue with the German government and European Commission, but perhaps stronger and more urgent advocacy is required across a wider section of the travel industry. At an individual level, Martin feels clients have little power to achieve the goal of persuading airlines to negotiate on total ticket price rather than the net fare alone. "Only the really big clients have a chance to negotiate these kinds of changes," he said. "Even those with €300 million air spend aren't able to negotiate."

However, some travel managers at least want to try. "This is an overlooked area," said Mikael Saari, global sourcing lead for Ikea. "So far we haven't brought it up because we haven't had the data. In our current travel management company request for proposals, one parameter is whether the travel management company can give me data not just for net fares but also for taxes and surcharges because I need to analyze that. However, I am not 100 percent sure I will succeed in getting that data, and even if I do, will the airlines respond? But I am going to bring this issue up in our next airline RFP."

Benoit suggested buyers ask airlines directly for a breakdown of YQ charges. If they can obtain sufficiently detailed data, buyers can show airlines how their total ticket price compares with competitors and push for deeper fare discounts to compensate for those elements of the total price that remain off-limits. For many buyers, it is surely time to get in airlines' faces over an issue the carriers have had all their own way for too long.

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