

# **Submission to the Canada Transportation Act Review Panel**

**Submission by:**

**British Columbia Air Merger Consortium**

*chaired by*

Mr. Kevin Walker  
Immediate Past President

Council of Tourism Associations of British Columbia

*10 April 2001*

---

## Table Of Contents

<b>Table Of Contents</b>	<b>i</b>
<b>1.0 Introduction</b>	<b>1</b>
1.1 BC Air Merger Consortium	1
1.2 Initial Impacts on BC Tourism	1
1.3 Continuing Monitoring	2
1.4 Conclusion: Current Domestic Air Policy Does not Serve the Tourism Industry	2
<b>2.0 Importance of Tourism</b>	<b>4</b>
2.1 Importance of Tourism to B.C.	4
2.2 Importance of Air Transport to Tourism	4
<b>3.0 Recommendations</b>	<b>5</b>
3.1 Right of Establishment	5
3.2 Modified Sixth Freedom Rights.	6
3.3 Regulation of Average Air Fares	7
3.4 Price Competitive Foreign Carrier Access to Beyond the Gateway Markets	9
3.5 Improve Collection and Access to Data on the Airline Industry	10
<b>Appendix A: Executive Summary</b>	<b>12</b>
Airline Industry Restructuring Implications for B.C. Tourism	12
<b>Appendix B: Recommendation of the National Transportation Act Review Commission</b>	<b>24</b>
Competition in Transportation Policy and Legislation in Review Volume 1, National Transportation Act Review Commission (1993)	25
<b>Appendix C: Recommendation of the Royal Commission on National Passenger Transportation</b>	<b>26</b>
Directions: The Final Report of the Royal Commission on National Passenger Transportation (1992)	27

# Submission of the British Columbia Air Merger Consortium

## 1.0 Introduction

### 1.1 BC Air Merger Consortium

On August 9, 2000, the Council of Tourism Associations of BC (COTA) and Tourism British Columbia co-hosted an industry meeting at which a study on the effects of airline restructuring, commissioned by Tourism BC, was unveiled, and a consortium of industry stakeholders was assembled. The consortium consists of BC tourism organisations (including COTA, Tourism BC, Tourism Vancouver, Tourism Victoria, Tourism Whistler, Regional Destination Marketing Organizations, BC Yukon Hotels Association, BC Food Services and Restaurant Association) and the BC Chamber of Commerce who are concerned with the impacts that airline industry restructuring was having on tourism and businesses in British Columbia.

### 1.2 Initial Impacts on BC Tourism

COTA and Tourism BC had been hearing anecdotal evidence from the industry that serious negative impacts were being experienced. Accordingly, they commissioned a study by InterVISTAS Consulting with the intent of determining whether the anecdotal evidence was reflecting a true problem or not. A copy of that study is being provided to the Review Panel. Its executive summary is provided as **Appendix A**.

The study disclosed the following situation:

- There had been a 13% reduction of flights to BC from the rest of Canada. (net reduction after offsetting a 17% decrease in Air Canada flights by increases in flights by other carriers)
- Seat capacity on flights from elsewhere in Canada had been reduced by 7% (net).
- The number of flights from the Vancouver gateway to destinations within BC, had been reduced by 20% (net) and the number of seats by 8% (net).
- Overall, trans-border and international capacity had increased at Vancouver Airport during August 2000, while domestic capacity has declined.
- While nominal air fares increased only by the rate of inflation, average air fares in B.C. had increased by 11% for domestic leisure travel and 9% for US leisure travel.

The study observed that despite the passing of Bill C-26 into law, Canada has an inadequate regulatory framework for addressing the dominance of Air Canada.

Specifically, the bill does not address:

- increases in the average cost of air travel (caused by the lower number of discount seats available);

There is lack of a mechanism for timely disclosure of data to track the airfare, sales and seat capacity impacts of restructure. Such information is vital to assist the tourism industry in its own planning. ***This issue of lack of sufficient data for monitoring the effects of industry restructuring is highlighted.*** It is a major concern when the government undertakes a fundamental restructuring of an industry (air transport) upon which other, larger sectors of the economy (e.g., tourism) depend, without either a legislative capability to properly monitor effects or without committing departmental resources to undertake an adequate level of monitoring.

- Foreign carrier access to British Columbia markets is severely limited. Only 37% of Canada's bilateral air services agreements allow access for the foreign carrier(s) to British Columbia. There are carriers who have indicated an interest in serving BC, but the lack of route rights has been an impediment. As well, foreign carriers complain of being priced out of beyond-the-Vancouver-gateway markets, now that there is only one regional network carrier.

The study also noted that there is potential for further negative impacts. Air Canada will continue to dominate the Canadian market for years to come. Despite ambitious fleet plans, WestJet and charter carriers will not be sufficient to eliminate Air Canada's dominance. Fleet additions between 2000 and 2005 will still leave Air Canada with an overwhelmingly large share of the domestic market. As well, Air Canada has made clear its intention to reduce its workforce and further rationalise domestic services.

### **1.3 Continuing Monitoring**

The Consortium has continued to monitor developments in the industry, tracking the limited data that is available. Each update shows some change in the market, but overall, the reductions in service (flight frequency) and capacity (seats available) continue to be experienced, along with increased average air fares.

### **1.4 Conclusion: Current Domestic Air Policy Does not Serve the Tourism Industry**

After almost nine months of monitoring, the consortium has determined that the current legislative framework for Canada's airline industry is inadequate to meet the needs of BC's tourism industry. The consortium recognised the importance of this inadequacy to the growth of the tourism industry and the viability of many of its members. The importance is such that the BC tourism industry has found it necessary to commit considerable resources to a multi-year effort to monitor the effects of industry restructuring and to advocating policies which will protect the interest of tourism industry. In discussion with other industry groups across Canada, the issues are not impacting tourism in British

Columbia but all tourism in the country.

The current review of the National Transportation Act provides a timely opportunity to put forth some recommendations for changes to the legislation governing aviation policy. Our recommendations are provided in Section 3 of this submission, after commenting on the importance of tourism in Section 2. Recognising that public policy must reflect the values and concerns of Canadians, we supplement our submission with a separate confidential document with polling results on questions related to our recommendations.

---

## 2.0 Importance of Tourism

### 2.1 Importance of Tourism to B.C.

Tourism is perhaps the largest and most important sector of the economy that depends on air transport. In British Columbia, Tourism is one of the largest sectors of the economy, with 113,000 B.C. jobs in 1998 directly employed in tourism. B.C. tourism alone supports a far larger job base than the entire airline industry in Canada.

Tourism ranked fifth of all B.C. sectors in job growth, outranking all goods production sectors, including the resource industries.

Over the previous ten years, tourism employment grew by 31%, almost double the provincial average rate of job growth.

In 1997, tourism accounted for \$4.1 billion of B.C.'s gross domestic product. Industry revenue was roughly \$9 billion per year on visitor volumes of approximately 22 million. Over half of these were visitors from outside the province.

#### **B.C. tourism:**

- **113,000 direct jobs.**
- **31% job growth in 10 years.**
- **5<sup>th</sup> largest in job growth.**
- **larger employment base than any resource industry.**

### 2.2 Importance of Air Transport to Tourism

With just over half of the customers served by B.C.'s tourism industry arriving from outside the province, air transport is critical to the industry. Convenient air service increases the size of the accessible market. Air tourists also tend to be the highest tourism spenders. Air access is also critical in moving U.S. and overseas tourists out of the gateways and into other B.C. tourism markets and experiences.

## 3.0 Recommendations

### 3.1 Right of Establishment

**Reason for Change:** Two previous commissions examined the issue of whether to allow increased competition from foreign carriers in Canada's domestic airline markets. Both the National Transportation Act Review Commission and the Royal Commission on National Passenger Transportation Policy were reluctant to recommend increased access while Canada had two competing national network carriers. However each anticipated that Canada's airline markets may evolve such that only a single national network would be serving the market. Both recommended that in such an eventuality, foreign carriers should be allowed to offer service in domestic Canadian markets. (The full text of the recommendations of these two commissions are provided in **Appendix B** and **Appendix C**.)

The market structure anticipated by both commissions has come to pass and their recommendations should now be implemented. Both were near identical in recommending that foreign carriers be granted the right to establish Canadian airlines.

**Recommendation:** We recommend that Section 55(1) of the Act be revised to change the definition of what constitutes a "Canadian" air carrier. Existing provisions regarding ownership and control should be replaced by a provision which defines a carrier as being Canadian if its place of incorporation and principle place of business are in Canada.

**Discussion:** This new definition of what constitutes a Canadian air carrier would then result in the carrier employing Canadian labour, abiding by Canadian labour law, using Canadian licensed aircraft, adhering to all Canadian safety standards, paying Canadian taxes, etc.

We are not recommending at this time that foreign carriers be granted cabotage rights. We do not anticipate that such rights would result in significant service offerings. More importantly, cabotage would not be as strong a generator of jobs as would the establishment of Canadian domiciled carriers.

This new definition of what constitutes a Canadian carrier should be applied in the Act to both domestic and international air services. In practice, it will not result in the designation of a foreign owned Canadian domiciled air carrier to an international service, as virtually all of Canada's existing bilateral air services agreements require that any carrier designated by Canada be substantially owned and controlled by residents of Canada. The issue of whether the Minister negotiates new air service agreements (bilateral or otherwise) which would allow the Minister to designate a foreign owned Canadian carrier is a matter for international air policy, which is the subject of another review. The Act, however, should not be a barrier to policy options and negotiating positions by the Minister.

Some may argue that Canada should move to our proposed right of establishment policy only if reciprocal rights are negotiated. We recommend that Canada should change the

Act immediately and unilaterally. Many commentators, including, we understand, some of the Review Panel's own researchers and commentators, have indicated that it is very unlikely that the U.S. will grant the right of establishment to non-US carriers or other investors. The question then becomes one of whether to wait for a remote chance of reciprocal rights which would produce a benefit to Canadian air carriers but deny Canadian citizens and our economy the much larger benefits of a competitive domestic airline market.

The B.C. tourism industry alone employs more Canadians than the entire Canadian airline industry. We urge that the much larger economic and social value of a competitive airline market be given the weight it deserves in your recommendations.

We also note that other progressive nations have adopted a view that the benefits to consumers and industry should outweigh the benefits to carriers in the development of transportation policy. Australia and New Zealand are two examples, each of which now have foreign owned domestic air carriers (and arguably a foreign controlled international carrier – Ansett International). Some may argue that British owned Virgin Blue in Australia may not survive its recent start of service. Such arguments are irrelevant. The Canada Transportation Act is based on using competition as the primary means to achieve the objectives declared in Section 5: "... those objectives are most likely to be achieved when all carriers are able to compete, both within and the various modes of transportation ...". This is at variance with the need to determine in advance whether in fact there will be new foreign owned domestic air carriers established, or whether such carriers will be long lived. The Act should enable the best conditions for the emergence of competition and not require a predetermination as to whether actual entry will take place. Such predetermination would be speculative at best.

Finally, we note that air transportation is the only mode of transportation in Canada which excludes foreign ownership and control of a carrier. In our opinion, this contradicts the objective of Section 5 that national transportation policy rely, in part, on competition between the modes of transport.

### **3.2 Modified Sixth Freedom Rights.**

**Reason for Change:** In his testimony to the House of Commons Standing Committee on Transport, the Commissioner of Competition advocated that foreign air carriers be granted what he termed *modified sixth freedom rights*. Sixth freedom traffic is that which moves from a city in Country A to a city in country B via a hub in Country C. (E.g., Boston to Taipei via Vancouver.) Modified sixth freedom traffic rights would allow movement of traffic between two cities in Canada via a foreign hub. (E.g., Regina to Montreal via Minneapolis.)

Currently such service is prohibited by the Canada-US bilateral air services agreement. As well, there is some ambiguity in Section 55(1) of the act as to whether a modified sixth freedom service would constitute a domestic service, and thus could not be served by a foreign air carrier.

Allowing modified sixth freedom services would create the opportunity for passengers and shippers between two Canadian points to have a choice of service, injecting competition as is preferred by Section 5 of the Act.

**Recommendation.** It is recommended that Section 55(1) of the Act be modified to make clear that service between two points in Canada via a foreign airport does not require holding a domestic license. As well, it is recommended that the Review Panel recommend to the Minister that he negotiate a change to the Canada-US bilateral air services agreement which would remove the prohibition on modified sixth freedom services.

**Discussion.** In making this recommendation, we recognise that modified sixth freedom service, while potentially offering a low price, have lower service quality attributes. They are indirect and would involve two customs and immigration inspections in each direction. These services will appeal largely to the most price sensitive passengers. Tourists are such passengers. They generally are very price sensitive. Modified sixth freedom services would enhance the development and maintenance of domestic tourism – a market segment which could choose US, Mexican or other foreign destinations if domestic air travel is too expensive.

We also note that ability of US carriers to carry some modified sixth freedom traffic may be an enabler of new transborder air services. There are a number of unserved routes which are only marginally unprofitable. A small amount of incremental traffic could make the difference in terms of new transborder services to communities currently unserved.

A question is whether the US would be willing to negotiate for reciprocal modified sixth freedom traffic rights. We believe that the prospects for this may be good. US carriers would serve to benefit from such rights and thus might see it in their vested interests to support such a granting of rights.

### 3.3 Regulation of Average Air Fares

**Reasons for changes:** The tourism industry is very price sensitive. There is significant competition between different tourism destinations, both regionally as well as intercontinentally. A major pricing concern is in markets beyond the major gateways. While gateways will have some degree of competition, either from foreign carriers or from charter carriers, beyond the gateway markets are vulnerable to unreasonable fares due to lack of competition.

Section 66 of the Act provides powers to the Agency to provide orders to an air carrier regarding unreasonable air fares. This provision is of great importance to Canada's tourism industry in the vulnerable beyond-the-gateway markets. The provision is intended to deal with cases of abuse of market power without introducing onerous regulation. We support both of these goals: market power must not be abused and the Canadian airline industry must not be subject to onerous regulation.

However, we do not believe that the specifics of Section 66 are as effective as they should

be. Our concerns lie in four areas.

First, except for a transitional period, the agency cannot act on its own initiative. Given the complexity of air fares, we believe that it is highly desirable for a professional group (the Agency) to develop skills and be provided with the resources to understand and monitor air fares and yields. We thus recommend that the transitional provisions contained in Bill C-26 empowering the Agency to act on its own initiative be made permanent.

Second, the provisions of Section 66 only empower the Agency to review specific air fares. As we indicated in the previous paragraph, air fares are complex. A carrier may "offer" a low fare but make little capacity available at that fare, resulting in a subtle but powerful means of exploiting market power. It is our recommendation that Section 66 be modified to make clear that the Agency may and should examine the *average* air fare paid in the market in question.

Third, and related to our previous point, Section 66 does not make clear that the Agency may examine and make orders regarding the capacity offered at various air fares. A low air fare may be offered, but if few seats are available for sale, the carrier can achieve a significant increase in revenues, exploiting its market power. It is our recommendation that Section 66 be revised such that in examining and making orders regarding the average air fare in a market, the Agency may make orders regarding capacity to be made available *during a scheduling season*. Note that we do not believe that a carrier should be ordered to offer specific levels of capacity at any specific air fare on any specific flight. It should have the flexibility to manage its capacity to deal with peak demands -- but within a season, it must make adequate capacity available at lower fares so as not to exploit market power.

Fourth, Section 66 applies to monopoly routes operated by a carrier or affiliated carriers. The act is unclear as to whether it would apply to routes which are not strictly a pure monopoly but which are dominated by a carrier and its affiliates. We envision routes developing in the next few years where small regional carriers will operate point to point services with very small capacity. On such routes, there will be a concern that although not strictly a monopoly, the dominant carrier may exercise significant market power, especially with regard to network traffic, that is traffic originating outside the immediate region. The latter type of traffic is especially important for the tourism industry at locations beyond the major gateways which receive competing service by foreign carriers.

**Recommendation:** We recommend that Section 66 of the Act be revised to a) continue the ability of the Agency to examine air fares on its own initiative, b) examine average air fares in markets, c) be empowered to make orders regarding either average air fares or capacity offered at the lowest air fare, and d) conduct examinations and make orders in markets which are dominated by a major air carrier and its affiliates, even if not strictly a monopoly.

**Discussion:** Some may consider it paradoxical to advocate both increased competition from foreign carriers, as well as fine tuning regulations regarding unreasonable fares. In

our view both of these are consistent. Section 5 of the Act embraces competition within markets as the most likely means to achieve the national goals for transportation policy. Our recommendation for foreign air carrier right of establishment is fully consistent with this. However, actual competition cannot be insured and the Act needs powers to prevent abuse of monopoly or dominance powers in such cases.

### **3.4 Price Competitive Foreign Carrier Access to Beyond the Gateway Markets**

**Reasons for Changes:** Historically, the interline fare setting process reserved beyond-the-gateway access to a national market for its national air carrier. This was accomplished by means of the *interline proviso* which provided a disproportionate share of an interline fare for the carrier on the domestic route segment. These provisos are not set by an international agreement, but rather have been specified by national carriers. For example, on a Tokyo-Paris-Marseilles ticket, the French carrier would specify the fare sharing proviso for the Paris-Marseilles segment which a Japanese carrier could access. A consequence was that national carriers had a significant advantage in carrying traffic from behind their gateways to foreign markets. While national and foreign carrier may compete equally in gateway-to-gateway markets, beyond the gateway markets were dominated by the domestic carrier through provisos which were unfavourable to the foreign carrier.

Over the past two decades while the unfavourable domestic proviso continued, carriers formed alliances which provided alliance partners with more favourable provisos. In Canada, where we had competing domestic network carriers, this afforded many beyond the gateway communities with competitive access to the services of foreign carriers. This had a favourable pricing effect for the development of tourism and other travel to beyond the gateway communities, and it also tended to raise the visibility in foreign markets of opportunities in Canada's beyond the gateway regions.

Since the merger of Air Canada and Canadian Airlines, the new Air Canada has cancelled the favourable provisos which Canadian Airlines had provided to its foreign alliance partners (oneWorld and other bilateral alliances). These foreign carriers, unless they are part of an Air Canada alliance, are now only able to obtain access to beyond the gateway markets in Canada by the historical (unfavourable) interline provisos which are unfavourable to foreign carriers. In one well publicised case, British Airways witnessed its proviso for access for Toronto-Ottawa increase from the range of \$300 to over \$1000.

**Recommendation.** Bill C-26 modified the Canada Transportation Act to allow the Governor in Council to define predatory acts, which the Competition Bureau and the Competition Tribunal would then enforce under section 78(2) of the Competition Act. We recommend that the Governor-in-Council add to the list of predatory actions which are enforceable under 78(2) of the Competition Act. The addition should define as predatory the act of charging foreign carriers domestic provisos which are in excess of those charged to foreign carriers with which a dominant Canadian carrier has a code sharing alliance or an alliance which involves the joint establishment of prices and/or capacity.

### 3.5 Improve Collection and Access to Data on the Airline Industry

**Reason for Changes:** While Canada has never had the level of data collection on the airline industry enjoyed by the United States, the National Transportation Act of 1987 eliminated significant elements of data collection on Canadian air services. The result is that as we enter the era of a domestic airline market dominated by a single carrier and its affiliates, consumers, public interest researchers and dependent industries such as tourism have limited ability to monitor developments. This is a serious gap in public policy toward this industry. As well, the lack of timely and meaningful data makes it more difficult for potential carriers to evaluate opportunities.

Even simple data, such as average fares or load factors on routes are not available. The lack of data in Canada is a serious problem, made more so by restructuring into a dominant air carrier.

There are several sources of the problem. First, not all carriers are required to report data. This results in an incomplete picture of what is happening. As well, it makes it difficult to publicly report data, as the Statistics Canada Act prohibits reporting of data when there are fewer than three participants in a market (unless directed to by legislation). It also disadvantages Air Canada, as its competitors do not incur the costs of reporting data, while potentially benefiting commercially from data reported by Air Canada.

Second, because the Canada Transportation Act does not require the reporting of data, the Statistics Canada Act makes it difficult to access data. Legislation which requires data dissemination enables Statistics Canada to make data available to the public.

Third, there are no effective penalties for timely reporting of data by carriers. Discussions with Statistics Canada personnel indicate that their serious delays in reporting the limited airline data made available in Canada is due to laggard reporting by carriers.

**Recommendation:** The Canada Transportation Act should introduce a new provision to require the *collection and reporting* of an adequate set of data by carriers so as to allow users to monitor the airline industry and to enable commercial assessment of potential air services. This data must include:

- Capacity, passenger traffic, load factors (computed from the previous two), and average fares (or alternatively total revenue) by carrier by route.
- A ticket sample of all routes in Canada must be collected and made available. The data collection should include carrier, origin and destination, specific flight segments, and fare paid. Because of the commercially sensitive nature of this information, this data can be made available with a lag, such as two years.
- The requirement to provide data needs to be extended to a much more comprehensive set of air carriers than at present. There should be no exceptions for carriers providing charter services. We recommend that it apply to any air carrier

providing commercial air service with annual revenues greater than \$20 million. This level will allow capturing most important data while freeing the small specialist carriers in Northern and other services from what to them would be a burdensome requirement.

**Discussion:** The United States considered significantly reducing its data reporting and dissemination requirements in the early 1980s when it was sunsetting its Civil Aeronautics Board. It is interesting to note that it was Bob Crandall, President of American Airlines, who was the strongest advocate of retaining data reporting requirements. His support was based on the simple fact that American would benefit more from access to market data than it would give up in terms of competitors having access to American Airlines traffic and other data by route. In this spirit, we strongly support the requirement that a broader set of carriers must report data than at present, so that Air Canada will also gain from the increased data reporting requirement.

We also note that in 2003, Air Canada will be allowed to drop service to some communities in Canada, subject to the consultation provisions in the Act. Some service rationalisation by Air Canada must be anticipated as it integrates its network and pursues its best commercial opportunities. Thus a number of communities will need to rely on replacement service from other carriers. Commercial evaluation of service is hindered by the current lack of data. An improved data reporting and dissemination policy will facilitate development of replacement service.

## Appendix A: Executive Summary

### Airline Industry Restructuring Implications for B.C. Tourism

On 21 December 1999, the Federal Minister of Transport announced that the Federal Government would allow Air Canada (AC) to acquire Canadian Airlines International (CAI). This ended several months of industry restructuring battles that were fought in the financial markets, the policy environment and the courts. However, for users of air transport and the tourism industry, this is only the beginning of *a multi-year process* of industry restructuring. A dominant airline with control of roughly 80% of domestic seat capacity and 90% of revenues at the time of merger has the potential to exercise market power. There are some benefits that could accrue from a large Canadian carrier emerging as a major force in the world airline industry, but a dominant carrier in domestic markets could potentially act to the detriment of the consumers and industries, such as tourism, that depend on air transportation.

Considering the critical role air transport plays in B.C. tourism, it is important to understand what is happening as a result of airline industry restructuring and what the implications will be for the tourism industry. There is much anecdotal evidence of the impacts, but the tourism industry must weigh factual evidence. In addition, it must look beyond the initial effects, both positive and negative, and anticipate further impacts. Some policy decisions governing Canada's airline industry are yet to be made (such as a new international air access policy); therefore, an opportunity exists for the tourism industry to influence some dimensions of the outcome.

The purpose of the report is to address these issues and to provide information to the B.C. tourism industry and government policy makers to assist them in responding to the effects of airline industry restructuring.

#### *The Merger and Market Structure*

As the merger begins, Air Canada has a dominant position in the Canadian airline industry. It has a fleet of 436 aircraft (283 of which are jets) versus 75 aircraft (70 of which are jets in service) operated by WestJet (WJ) and the charter carriers. Even with the ambitious fleet expansion plans by WJ and the charter carriers, AC will remain dominant for some time. The current fleet plans of the independent carriers for 2005, for example, will see a doubling to almost 150 aircraft, but this will still be a fraction of AC's size.

Air Canada's offer to purchase CAI was contingent upon a number of requirements. These included: no interference from AMR Corp. (the parent company of American Airlines), approval from government and regulatory agencies, no opposition from the Commissioner of Competition, access to non-public CAI financial information, and consented arrangements that provide for the resignation and appointment of directors of CAI. All of these requirements were eventually met, in part because AC agreed to a number of formal

undertakings with the Commissioner of Competition to facilitate market entry and foster competition.

One significant undertaking was the divestiture of Canadian Regional Airlines (CRAL). CRAL's fleet of roughly 50 aircraft, many of which are regional jets, could offer both (a) significant competition in domestic markets, and (b) foreign carrier price competitive access beyond the gateways. While an independent CRAL would not replicate the Air Canada network in terms of scope and frequency, it might be able to provide a competitive choice for a number of Canadian communities.

The Federal Government introduced legislation (Bill C-26) to deal with some of the concerns associated with a dominant air carrier. It gives the Canada Transportation Agency (CTA) powers to regulate individual airfares (but only on complaint after 2002), and gives the Competition Bureau new temporary cease and desist powers to prevent anti-competitive actions by a dominant air carrier.

However, there are still some important gaps in terms of dealing with the effects of a dominant air carrier. These gaps include:

- The CTA has no powers to control the number of seats offered at various fare levels. Hence, even if the CTA prevents increases in discount airfares, a dominant carrier could reduce availability of discounted seats. Average prices would rise and the price sensitive tourism markets could be severely impacted.
- Foreign air carriers and other investors continue to be severely limited in their ability to invest in Canadian air carriers, thus constraining the potential for competition in domestic markets. As well, U.S. and other foreign air carriers continue to be excluded from Canadian domestic routes by the so-called *cabotage* prohibition.<sup>1</sup>
- Foreign air carriers competing with Air Canada have no mechanism by which they can ensure that they can access to beyond-the-gateway markets in Canada at charges reasonably similar to what they could obtain in 1998 and earlier.
- Canada's bilateral air services agreements continue to be generally restrictive. For example, the Vancouver International Airport Authority reports that only one-third of Canada's agreements allows foreign air carriers access to Vancouver. The federal Minister of Transport has indicated that he is unwilling to revise Canada's International Air Policy before 2002.

### ***Initial Impact of the Merger on Air Capacity***

*Capacity inbound to B.C.* This study used data from the June 1 schedule of the Official Airline Guide (OAG) to measure the impact of the merger on airline capacity in individual airline markets in B.C. While the OAG database is not without its limitations, it is the most up to date, comprehensive and consistent source of data on airline services. **Table 0-1** summarises capacity impacts on routes to B.C. Major findings from this analysis include:

---

<sup>1</sup> *Cabotage* is the right granted to a foreign carrier to operate within another nation's domestic market.

- The AC family has reduced the number of inbound domestic flights to the province by 17%. Seat capacity has been reduced by 10%.
- This has been offset by 9% growth in flights (6% in seats) by other domestic carriers, resulting in *an overall 13% reduction in domestic flights to B.C. (7% in seats)*.
- AC has expanded transborder service to the U.S. for an overall increase of 5% in flights and 3% in seats.
- Asian seat capacity has increased by 9% for AC but has declined by 2% for foreign air carriers for an overall increase of 4%.
- European seat capacity increased by 10% for AC, 6% by the Canadian charter carriers but declined by 1% for foreign carriers for an overall increase of 4%.

Table 0-1: Air Capacity Inbound to B.C. (Excluding Intra-B.C.) August 1999 vs. 2000

By Sector:		British Columbia					
		Frequency			Seat Capacity		
		Aug-99	Aug-00	% change	Aug-99	Aug-00	% change
<b>Domestic</b>	AC family	3,451	2,856	-17.2%	338,414	303,320	-10.4%
	Other Domestic	679	752	8.5%	98,969	105,756	6.1%
	<b>TOTAL</b>	<b>4,130</b>	<b>3,608</b>	<b>-12.6%</b>	<b>440,470</b>	<b>409,076</b>	<b>-6.5%</b>
<b>Transborder</b>	AC family	960	1,007	4.9%	86,584	88,937	2.7%
	Other Domestic	88	100	13.6%	12,016	11,360	-5.5%
	U.S. Carriers	2,334	2,496	6.9%	205,281	217,986	6.2%
	Overseas Carriers	31	49	58.1%	11,997	16,101	34.2%
	<b>TOTAL</b>	<b>3,413</b>	<b>3,652</b>	<b>7.0%</b>	<b>315,878</b>	<b>334,384</b>	<b>5.9%</b>
<b>Other International</b>	AC family	317	341	7.6%	87,125	95,379	9.5%
	Asia-Pacific						
	Europe						
	Misc. International						
	Other Domestic	140	147	5.0%	40,332	46,241	14.7%
	Overseas Carriers	317	303	-4.4%	115,715	113,336	-2.1%

<i>TOTAL</i>	<i>774</i>	<i>791</i>	<i>2.2%</i>	<i>243,172</i>	<i>254,956</i>	<i>4.8%</i>
AC family	240	248	3.3%	68,378	74,772	9.4%
Other Domestic	0	0	-	0	0	-
Overseas Carriers	199	188	-5.5%	74,227	72,836	-1.9%
<i>TOTAL</i>	<i>439</i>	<i>436</i>	<i>-0.7%</i>	<i>142,605</i>	<i>147,608</i>	<i>3.5%</i>
AC family	77	93	20.8%	18,747	20,607	9.9%
Other Domestic	122	118	-3.3%	36,722	39,017	6.2%
Overseas Carriers	106	106	0.0%	37,288	36,900	-1.0%
<i>TOTAL</i>	<i>305</i>	<i>317</i>	<i>3.9%</i>	<i>92,757</i>	<i>96,524</i>	<i>4.1%</i>
AC family	0	0	-	0	0	-
Other Domestic	18	29	61.1%	3,610	7,224	100.1%
Overseas Carriers	12	9	-25.0%	4,200	3,600	-14.3%
<i>TOTAL</i>	<i>30</i>	<i>38</i>	<i>26.7%</i>	<i>7,810</i>	<i>10,824</i>	<i>38.6%</i>
<b>TOTAL<sup>3</sup></b>	<b>8,317</b>	<b>8,051</b>	<b>-3.2%</b>	<b>996,433</b>	<b>998,416</b>	<b>0.2%</b>

Source: Official Airline Guide OAG-MAX February and August 1999 and January-June 2000 data disks, YVR Flight Information Display System (FIDS), Canada 3000 Flight Schedule. 1) "Other Domestic" denotes other Canadian airlines. 2) Caution: Frequency and capacity data totals may not include all charter operations by Royal Airlines, Air Transat and foreign charter carriers. 3) See notes to Air Capacity Tables in Appendix G for additional discussion on methodology, limitations and interpretation of data.

*Capacity within B.C.* **Table 0-2** summarises the impact on capacity for service within B.C. As can be seen, there has been a major reduction in beyond-the-gateway capacity by AC.

*Impact on air capacity from YVR to B.C. Tourism Regions.* **Table 0-3** summarises air capacity changes from YVR to the B.C. tourism regions.

**Table 0-2: Air Capacity for YVR Routes Intra-British Columbia (August 2000)**

By Carrier Group:	British Columbia					
	Frequency			Seat Capacity		
	Aug-99	Aug-00	% change	Aug-99	Aug-00	% change
<b>AC family Carriers</b>	4,369	2,820	-35.5%	159,350	127,033	-20.3%
<b>Other Domestic Carriers<sup>1</sup></b>	854	1,387	62.4%	29,272	46,885	60.2%
<b>TOTAL</b>	<b>5,223</b>	<b>4,207</b>	<b>-19.5%</b>	<b>188,622</b>	<b>173,918</b>	<b>-7.8%</b>

Source: OAG MAX August 1999 and August 2000 data disk.

**Figure 0-1** provides a summary of the capacity changes inbound to B.C. and for intra B.C. routes from YVR.

**Figure 0-1 Summary of Capacity Changes Inbound to B.C. and YVR Intra B.C. Routes (August 1999 vs. August 2000)**

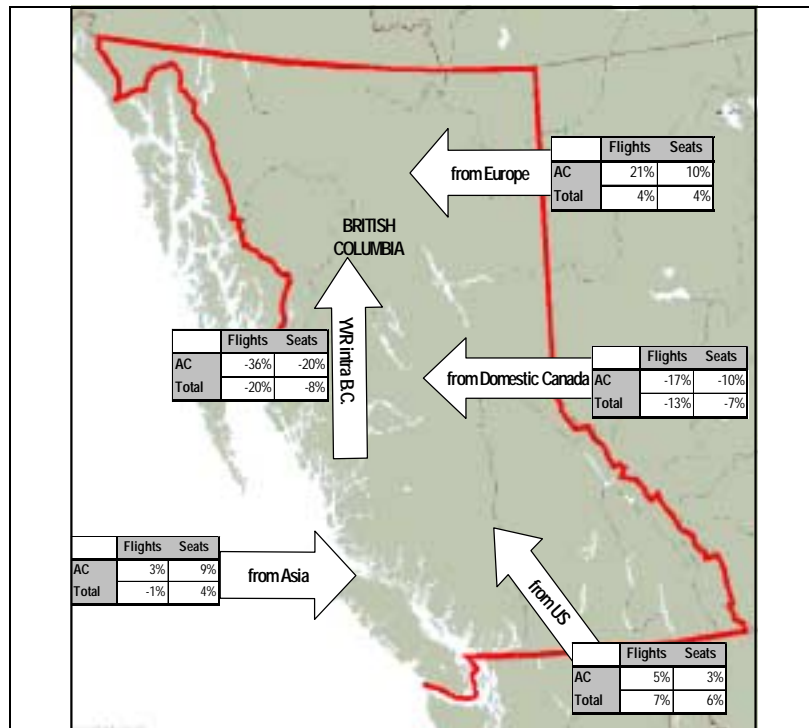


Table 0-3: Air Capacity Changes From YVR to the B.C. Tourism Regions (1999 vs. 2000)

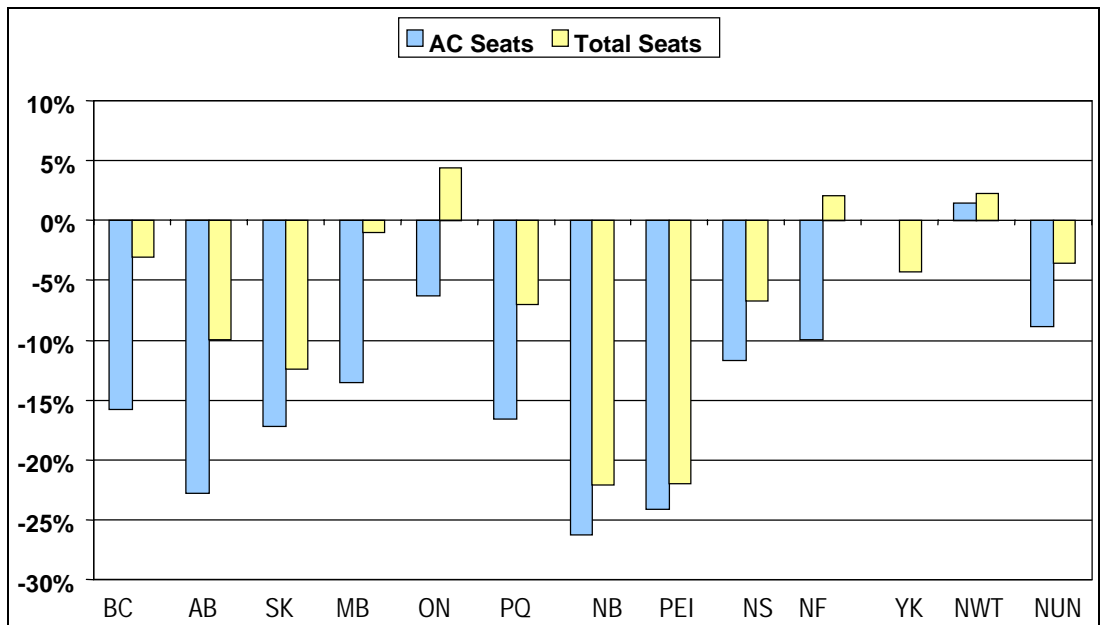
		Frequency			Seat Capacity		
		1999	2000	% Change	1999	2000	% Change
<b>Region A The Islands</b>	AC family	25,495	17,132	-32.80%	827,769	713,414	-13.81%
	Other Domestic	4,165	8,550	105.28%	63,094	184,386	192.24%
	<i>Total</i>	<i>29,660</i>	<i>25,682</i>	<i>-13.41%</i>	<i>890,863</i>	<i>897,800</i>	<i>0.78%</i>
<b>Region B Vancouver, Coast &amp; Mountains</b>	AC family	0	0	-	0	0	-
	Other Domestic	1,801	1,774	-1.50%	32,418	26,610	-17.92%
	<i>Total</i>	<i>1,801</i>	<i>1,774</i>	<i>-1.50%</i>	<i>32,418</i>	<i>26,610</i>	<i>-17.92%</i>
<b>Region C Thompson Okanagan</b>	AC family	10,232	7,350	-28.17%	373,120	293,442	-21.35%
	Other Domestic	1,532	1,370	-10.57%	123,511	163,964	32.75%
	<i>Total</i>	<i>11,764</i>	<i>8,720</i>	<i>-25.88%</i>	<i>496,631</i>	<i>457,406</i>	<i>-7.90%</i>
<b>Region D B.C. Rockies</b>	AC family	2,775	1,978	-28.72%	103,353	80,296	-22.31%
	Other Domestic	80	0	-100.00%	846	0	-100.00%
	<i>Total</i>	<i>2,855</i>	<i>1,978</i>	<i>-30.72%</i>	<i>104,199</i>	<i>80,296</i>	<i>-22.94%</i>
<b>Region E: Cariboo Country</b>	AC family	1,275	1,102	-13.57%	43,442	39,035	-10.14%
	Other Domestic	544	604	11.03%	10,050	11,476	14.19%
	<i>Total</i>	<i>1,819</i>	<i>1,706</i>	<i>-6.21%</i>	<i>53,492</i>	<i>50,511</i>	<i>-5.57%</i>
<b>Region F: Northern B.C.</b>	AC family	11,111	7,261	-34.65%	535,879	379,726	-29.14%
	Other Domestic	285	679	138.25%	34,770	81,928	135.63%
	<i>Total</i>	<i>11,396</i>	<i>7,940</i>	<i>-30.33%</i>	<i>570,649</i>	<i>461,654</i>	<i>-19.10%</i>
<b>TOTAL</b>		<b>59,295</b>	<b>47,800</b>	<b>-19.4%</b>	<b>2,148,252</b>	<b>1,974,277</b>	<b>-8.1%</b>

Notes: Source: Official Airline Guide OAG-MAX February and August 1999 and January-June 2000 data disks, YVR Flight Information Display System (FIDS), Canada 3000 Flight Schedule. 1) "Other Domestic" denotes other Canadian airlines. 2) See notes to Air Capacity Tables in Appendix G for additional discussion on methodology, limitations and interpretation of data.

### *Comparison of Impacts on B.C. to Impacts in Rest of Canada*

An analysis of August 2000 vs. August 1999 air capacity changes in each of the Canadian provinces/territories and among the other major gateways was conducted to provide a broader perspective on impacts to the B.C. tourism sector. **Figure 0-2** shows the relative impacts.<sup>2</sup> As can be seen, Ontario has fared quite well relative to the other provinces. B.C. has experienced a large drop in capacity offered by AC, but due to WestJet, Pacific Coastal and others, B.C. has had a lower total (AC and others combined) impact.

**Figure 0-2: Change in AC and Total Domestic Seats Among the Canadian Provinces (August 1999 vs. August 2000)**



Source: The Impact of Airline Restructuring in Canada upon Tourism in the Provinces and Territories, June 2000.

### *Initial Impact of the Merger on Airfares*

*Airfares.* The study also looked at preliminary information on airline fares in B.C. Sources include databases from Air Tariff Publishing Corporation and Sabre computer reservation system, and average fare data from the Bank Settlement Plan of the International Air Transport Association. Major findings include:

- *There are no significant increases in published airfares taking place.* Preliminary evidence gathered in the review of select city pair markets is consistent with this conclusion. On average, full/discounted economy airfares increased 3% over the previous year. Other fare levels increased at various rates, remained the same or

<sup>2</sup> There are some differences in how capacity to/from/within provinces is treated in the figure that shows impacts on all provinces, versus how capacity was measured in the previous tables, hence they cannot be directly compared.

declined.

- *A new discount program has been introduced.* In a recent development, the AC family announced the introduction of new lower fare levels to and from 75 small communities in Canada. The average discount is 38% off the current lowest year round published fare. The new discounts will apply to more than 700 routes, representing 30% of the carriers' markets in Canada. While it is early to assess the impact of the fare reductions, it is known that this is a previously existing fare program, but which is now being expanded to include a range of smaller communities that were previously excluded. Although only 30% of the AC market is included in the program, fare reductions are applicable to routes involving a number of B.C. destinations. In comparison to the previously available fare levels between these city pairs, the discounts are significant. What is required to provide an assessment but is unknown at this time, is whether meaningful numbers of seats will be available at these fares. This is of particular concern given the reduction in capacity on a number of intra-B.C. routes.

**Key strategies to deal with fare concerns will be:**

- **continued monitoring of average fares.**
- **active pursuit of alternate, sources of detailed average airfare data.**
- **obtain quantitative feedback from inbound tour operator community.**

- *The average airfare paid has increased.* The preliminary information indicates that average airfares from B.C. to Canadian destinations have increased by 5% for the business traveller and 11% for the leisure traveller between 1999 and 2000. Not only is this higher than the nominal increases in fares, B.C. average fares have increased more than the Canada-wide average airfares.
- *The number of discount airfares may have been reduced.* January-May 2000 data on average fares purchased in Canada provide an indication of the direction that ticket sales have taken for travel in Canada. Average fares for pleasure travel have risen at roughly three times the rate that full fares have risen. While there are a number of reasons why average air fares may have increased significantly greater than nominal airfares, the report indicates that the evidence is suggestive that the driver of increased average airfare levels is decreased availability of tickets at discounted fares. Nevertheless, it is not possible to definitively assert that the availability of discount fares has been reduced. Given the importance of this topic to the tourism industry, it will be essential to establish an effective tracking mechanism to monitor changes.
- *Competition brings average fares down.* In markets with significant competition, such as Vancouver-Kelowna, there are substantial fare savings taking place.

InterVISTAS cautions against relying solely on preliminary and anecdotal information. At this early stage, the best approach for gathering solid evidence for trends in yields would be (a) to continue the monitoring of average airfares sales in Canada; (b) active pursuit of alternate data sources for inbound average airfare data; and (c) gather qualitative and quantitative information from the travel agents and tour operators community to combine with data available from other sources, and (d) to urge the Federal Government to collect and report on changes to fares, average fares and capacity at various discounted fare levels.

### ***Future Changes***

Airline industry restructuring is an ongoing process whose effects will continue to take place for the next few years. Some observations that can be made include:

**The Canadian market is, and will likely continue to be, dominated by the AC family in terms of fleet and capacity for the next several years.**

- In spite of the presence of other carriers, the Canadian market is, and will be, dominated by the AC family in terms of fleet and capacity for the next several years. Competitive offsets from charter carriers and WestJet will not be sufficient to eliminate Air Canada's dominance.
- As AC completes alliances with Delta and potentially with US Airways, and as it pursues a strategy of seeking growth in transborder and other international markets, tourism access to the Vancouver gateway may continue to improve.
- Competition from airlines outside of Canada to beyond-the-gateway markets in B.C. may be insufficient due to limited price competitive access, and due to Air Canada's strategic alliances dominating some key international markets (e.g. Vancouver – Germany).
- A sale of Canadian Regional Airlines (CRAL) may provide important medium term benefits in providing competitive beyond-the-gateway access to U.S. and international carriers. A sale, however, would result in a period of adjustment as AC scrambles to deal with the loss of CRAL's capacity (roughly 50 aircraft), and as an independent CRAL establishes itself in the market.

### ***Preliminary Assessment of Impacts on B.C. Tourism***

- *VFR (28% of B.C. non-resident visitors)*. The visiting friends and relatives market is generally very sensitive to prices. VFR travel to Vancouver is likely to remain competitive. For beyond-the-Vancouver-gateway markets, the news is not good. There are significant reductions in capacity and there may be reduced access to the lowest fares. A few communities will benefit from offsetting service by WJ and Pacific Coastal.

- *Leisure (56% of B.C. non-resident visitors).* Leisure visitors to B.C. are generally somewhat less price sensitive than VFR but much more price sensitive than various forms of business travel. Impacts are similar to those for VFR travel: competitive for the Vancouver gateway but potentially negative for beyond-the-gateway markets, except where WJ and others can provide significant offsetting capacity.
- *Conference/Business Meetings (16% of B.C. non-resident visitors).* These travellers are much less sensitive to price and much more sensitive to service quality and convenience. The Vancouver gateway will have increased connectivity to U.S., overseas and domestic markets, offset somewhat by higher average fares in domestic markets.

Beyond-the-gateway markets will have mixed effects, but likely negative overall. On the positive side, Victoria and Kelowna have benefited from seasonal non-stop service to Toronto and there may be additional U.S. market penetration from new AC alliances with Delta and possibly US Airways. On the negative side, most communities will experience reduced capacity, higher average fares, and loss of code sharing connectivity with U.S. and overseas carriers.

### ***Policy and Action***

A number of actions to mitigate negative impacts on B.C. tourism and to maximise positive impacts from new opportunities were considered. These initiatives can include strategies to:

- Monitor industry developments so negative impacts can be pinpointed in a timely manner.
- Encourage AC to maintain or expand service, especially in beyond-the-gateway markets.
- Ensure that government agencies have powers which can prevent dominant air carrier abuses in a timely manner.
- Create the best conditions for continued expansion of airlines that provide competing services in domestic markets.
- Create an airline network alternative that will provide a competitive choice for tourists and for air carriers (Canadian and foreign) desiring access to beyond-the-gateway markets.
- Increase foreign carrier access to beyond-the-gateway markets at competitive prices.

Below, some details on potential initiatives are provided.

### ***Monitor Industry Developments***

1. Data on key measures of airline industry performance should be collected and reported on a timely basis. This should include information on average fares in major market segments (intra-province, domestic transcontinental service, gateway to regional community services, transborder services, overseas services by national market); capacity and frequency in individual markets; market shares of individual carriers (measured in revenues, capacity offered, passengers carried); and load factors.
2. The tourism industry should be provided with regular reports on developments in the airline industry.

#### *Encourage AC Maintenance or Expansion of Service*

Because of Air Canada's current and future dominance of the Canadian aviation marketplace, B.C. tourism will depend on this carrier for the majority of inbound air tourism. Accordingly, AC should be supported in its efforts to expand air services to B.C. This leads to the following initiatives that could be considered:

3. AC's efforts to seek additional open skies agreements should be supported by the industry and enabled by government.
4. The B.C. tourism industry should meet regularly with AC staff to exchange marketing concepts and develop methods to support each other's marketing and sales efforts.
5. AC should be encouraged to maintain a senior executive in B.C. Currently AC has no Vice President level manager located in B.C. Although there are indications that Air Canada may establish the headquarters of its proposed discount carrier in Vancouver, it is important that the mainline carrier has senior representation in B.C. and an internal voice for the opportunity of the Vancouver gateway and the B.C. market opportunity.

The B.C. tourism industry must ensure that AC recognises the B.C. gateway and tourism opportunities. AC is cultivating Toronto as a mega-hub, and, with its corporate headquarters in Montreal, has a strong eastern focus in general. As well, much of the senior staff of Canadian Airlines, which had developed a deep understanding of the B.C. market potential, have left the air carrier.

#### *Prevent Abuse by Dominant Carrier*

Even with passage of Bill C-26, some believe that the Canadian Transportation Agency will have only weak regulatory oversight powers. A specific concern is its inability to regulate average prices. As well, after a two year initial period, the agency will only be able to investigate prices upon complaint, and the new ombudsperson-commissioner of the Canadian Transportation Agency will have no enforcement powers. Some specific actions, which might be considered, are:

6. Make competitively priced beyond-the-gateway seats on regional AC family flights available to foreign air carriers.

7. Provide the CTA ombudsperson with real powers.
8. Increase the powers of the CTA to monitor and limit increases in average fares.

The Minister of Transport has commenced the required four year review of the Canada Transportation Act. The panel has a reporting date of 1 July 2001. This review process will be an excellent opportunity to put forth revisions to the CTA which will mitigate any negative impacts of airline industry consolidation. As well, there may be opportunity for (or opportunity should be created by) the tourism industry to put forth its views to the Parliamentary Standing Committees on transport. Of special importance is the need to ensure that in the future, the interests of the tourism industry are explicitly taken into consideration by the Government and its Agencies when dealing with airline industry issues. Australia, for example, explicitly considers tourism interests in its regulatory proceedings.

*Best Conditions for Continued Expansion of Air Canada and Independent Carriers*

In the long term, B.C. tourism growth will depend on the success of all of Canada's air carriers (AC and independent carriers) in providing competitive access to B.C. communities. This leads to actions that focus, in part, on lowering the costs for these carriers and potentially lower prices for inbound tourists.

9. Reduce or eliminate fuel taxes (provincial and federal domestic) on air carriers.
10. Revise the Federal Airports Policy to limit present and future ground rent payments by airports to the Federal Government.
11. Expand the Federal Airport Capital Assistance Program to increase support for the capital programs at regional airports.

*Network airline alternative*

12. An independent CRAL could provide important competitive access to beyond-the-gateway tourism markets.

If Canadian Regional Airlines (CRAL) is successfully sold, then many Canadian communities would have competitive service from an independent network carrier. It would not replicate the extent or frequency of the Air Canada network, and there would be challenges faced by an independent CRAL. If successful, it would be likely to form code sharing alliances with important U.S. and foreign airlines, creating conditions for competitive price access to a number of B.C. tourism destinations.

13. Cabotage access for U.S. and/or other foreign carriers would grant U.S. carriers the privilege of marketing purely domestic air services in Canada.

Cabotage is considered by some to be a controversial policy action to take. In part, this is because the stereotypical view is that there could be implications for transferring some Canadian jobs to locations in the U.S. However, there are several forms that cabotage could take, and some would generate new jobs in Canada. The

text describes several cabotage variants which might be considered:

- *Modified Sixth Freedom Cabotage.*
- *Right of Establishment Cabotage.*

*Domestic Code Share Cabotage.*

*Pure Cabotage.*

14. Air Canada itself has indicated it would support cabotage rights provided that privileges are reciprocal. Until recently, reciprocal cabotage rights with the U.S. seemed a remote possibility due in part to the way in which the cabotage prohibition is enshrined in U.S. legislation. The recent proposal to merge United and US Airways, however, could prompt the U.S. Congress to authorise cabotage rights for non-U.S. carriers, something which already has found some support within Congress. As well, U.K. carriers, such as Virgin, could be interested in establishing Canadian domestic operations, providing an alternative avenue for reciprocal cabotage rights. Virgin is launching domestic service in Australia this summer with the brand name of Virgin Blue. Australia has a significantly smaller domestic market than Canada, and is already served by two financially healthy domestic carriers.

*Foreign carrier access*

15. There should be an immediate start of a federal international air policy review, rather than a delay of the review to 2001, and an acceleration of implementing changes in this policy from 2002 to 2001.
16. Ensure that the needs of the B.C. tourism industry for increased access for air carriers (Canadian and foreign) to B.C. are made known in that policy review.
17. Obtain open skies regimes with as many countries as possible.
18. Support an early move away from the cumbersome, expensive and time consuming bilateral air services agreement negotiating process. This would be replaced with multilateral agreements. A significant medium term opportunity is to expand the coverage of the GATS agreement to include air traffic rights.

Complete the Canada-U.S. open skies agreement to include 5<sup>th</sup> freedom rights.<sup>3</sup>

---

<sup>3</sup> The latter initiative requires some comment. The 1995 Canada-U.S. open skies agreement gives U.S. carriers the right to fly to/from Canada, but not beyond Canada. 5<sup>th</sup> freedom rights, the ability of U.S. carriers to fly beyond Canada to overseas destinations, could result in new services by U.S. carriers, or increased service by overseas carriers due to increased gateway traffic to their flights via third-country-code-sharing by U.S. carriers. Just as importantly, AC could benefit from 5<sup>th</sup> freedom rights. If it exercised these rights and flew from Canada to a U.S. and then beyond, new overseas destinations (perhaps in Latin America or deeper into Asia) could be connected to Vancouver.

## **Appendix B: Recommendation of the National Transportation Act Review Commission**

**Competition in Transportation Policy and Legislation in Review  
Volume 1, National Transportation Act Review Commission (1993)**

**RECOMMENDATION NO. 17**

---

**We recommend that, should restructuring in the domestic airline market result in a primary carrier monopoly, the federal Cabinet give policy directions to the Agency under section 23 of the NTA, 1987 to license the granting of traffic rights within Canada to foreign carriers, or to permit foreign carriers to establish operations within Canada.**

---

*International Protectionism*

Despite deregulation in the U.S., airlines worldwide remain highly regulated. International air travel is governed by bilateral agreements between countries, foreign ownership is strictly limited, many airlines are either state-owned or subsidised and fares and routes are often set by governments. Airlines for their part are seeking to expand their foreign markets through networks, alliances and mergers with other airlines.

The airline industry is changing. As carriers form international alliances and global networks, the central importance of a national airline is passing away. The government has indicated that it is willing to liberalise its bilateral arrangements with the U.S. The future of competitive domestic air travel in Canada may well lie in policies that help Canadian carriers compete in the new international markets, but such policies should never be adopted at the expense of the Canadian traveller.

Certain restrictions in the Air Transportation Regulations delay possible use by air carriers of other carriers' seating space or aircraft in servicing proposed alliance routes economically.

## **Appendix C: Recommendation of the Royal Commission on National Passenger Transportation**

## **Directions: The Final Report of the Royal Commission on National Passenger Transportation (1992)**

Excerpt from Chapter 11: Applying the Principles to Air Carriers

### **Recommendations: OWNERSHIP AND CONTROL (p. 248)**

Although there are no national restrictions on ownership for the other transportation modes, air carriers are protected from foreign ownership and control under the *National Transportation Act, 1987*. This protection is consistent with the Chicago Convention, which sets the requirements of the world's bilateral air agreements. Under the Chicago Convention, there must be substantial national ownership and effective control of an airline designated as national. For an airline to be a national Canadian air carrier, substantial ownership and effective control must be held by Canadians—citizens, permanent residents, a government or government agent, and entities in which Canadians own and control at least 75 percent of the voting interests or “such lesser percentage as the Governor in Council may by regulation specify.”

If a Canadian air carrier that flies international routes were, by virtue of foreign investment, no longer owned and under effective control by Canadians, its designation as a national airline under the relevant bilateral agreements could be challenged. This challenge could come from the remaining Canadian air carriers, the other country party to the bilateral agreement, or from carriers in competition with the newly controlled airline. Under the existing international rules, this challenge would probably succeed.

Foreign control may also affect the ability of the government to ensure the availability of domestic service in emergency situations. The *Emergencies Act* provides the Canadian government with the power to requisition the use of any equipment, which includes aircraft on Canadian territory, in times of a declared emergency. Other governments have similar laws. A foreign government might act on prior knowledge, however, and order aircraft owned, or even operated, by its nationals, to be returned to its territory (in a manner similar to the control over shipping demonstrated in the days preceding World War II).

Restricting foreign ownership and control may reduce choices to the consumer. This would be of particular concern if a situation arises where only one domestic carrier remains viable. We recognize that there are instances when a relaxation in foreign ownership controls may be necessary to preserve domestic competition (we return to this later). For the most part, though, we believe existing restrictions on foreign ownership and control of Canadian air carriers are appropriate, given the current bilateral air agreement regime.

(...)

(from p. 252)

The federal government should be prepared, however, to prevent a situation that would require a return to economic regulation, which would be the likely outcome if only one major Canadian air carrier emerges. At the time of writing, discussions were under way regarding a potential merger between Air Canada and Canadian Airlines International. The presence of only one major airline in the domestic market is inadvisable. While we are concerned with the survival of the airline companies, our overriding policy consideration is to maintain competition between at least two air carriers. We believe that Canadian travellers will be best served if there are two or more competing carriers in Canadian skies. Maintaining competition should be the overriding policy consideration.

Therefore, we **recommend** that:

- 11.6** If faced with a potential reduction to only one major Canadian air carrier, the federal government exercise its authority under sections 67, 72 and 73 of the *National Transport Act, 1987* to override limitations on foreign ownership and control for the explicit purpose of, and to the extent required for, ensuring competition in the domestic market.