Airline Restructuring in Canada
Third Interim Report

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Independent Transition Observer on Airline Restructuring
April 2002

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Executive Summary

This is the third interim report of the Independent Transition Observer on Airline Restructuring. This iteration is something of a departure and expansion from previous work, recognizing that "airline restructuring" has taken on a new and disturbing meaning in the context of the post-September 11th environment and the economic slowdown.

The process of restructuring began with a simple goal: a competitive, healthy airline industry, which meets the needs of Canadians. At this writing, the jury is still out. Parts of the airline industry are healthier than they were a few months ago, but there is still a long way to go. Some Canadians' needs are being met, but far from all.

Where do we go from here? Few people are happy with where we are, but it seems that even fewer agree on what the solutions might be. There are also different types of questions. Some are large and complex: should we re-regulate the entire airline industry? What happens if Air Canada needs a cash infusion to survive? Some are smaller, but no less complex: should we subsidize certain routes to assist economic development?

This report examines a number of options – both the tried and true and the innovative and risky. It uses input from across Canada, from leading aviation experts to those whose expertise begins and ends with getting on an airplane. It includes ideas and comments from pilots and baggage handlers, provincial governments, and community leaders. It looks at what some other countries have done, and what seems to be working, and what is less successful. It examines some of the innovations that are happening in this country at this moment, and where we are stagnating. It also reviews the gaps in our policies, knowledge and abilities that are stopping us from achieving a more resilient and reliable airline sector. The report attempts to provoke discussion, encourage debate and eventually, help us achieve resolution.

Communities

Air access has two roles for communities: first, to allow residents to travel, and second, to encourage economic growth and development. However, economic development isn't the job of airlines, and communities are struggling to fill that need. Their problem is compounded by a lack of aviation data that they would use to create business strategies, and the fact that they are now responsible for their local airports' viability.

There is evidence that some communities are beginning to find local solutions, rather than waiting for either Air Canada or the federal government to solve their access needs. This is a positive step, and ways to support local solutions should be explored.

Consumers

Customers were already dealing with changes to schedules, delays, bumping and poor service. But now there's more. With the imposition of the Air Travellers Security Charge, airline passengers may be called on not only to pay for their own safety, but also to ensure the safety of the CN Tower, Parliament Hill and other potential targets of terrorism from the sky. Not only that, but customers who want to (or must) use two tickets (on two carriers which don't interline) to get to where they're going may have to pay twice.

Business

Although all business in Canada is affected to some degree by the availability or lack of air access, the two sectors that are impacted the most are travel agents and the tourism industry. Travel agents are sandwiched between the carriers and customers, and must serve both groups. Part of their job is to keep customers well informed during a time of instability, a demanding task. As well, they still have to face declines in commissions paid and the increased use of Internet booking systems.

Tourism relies on competitively priced and easily accessed air service to compete for visitors. Unfortunately, issues around price and routing are usually out of tourism operators' control. Tourism travel is generally more seasonal and represents a lower-yield than business travel, the core market for Air Canada and other full service carriers.

Generally, business' main concern over the past few months has been trans-border commerce and the need to design Canada-U.S. programs that facilitate the movement of people and goods across our shared border – including air access.

Airlines

Air Canada is struggling to recover, but at times, its business decisions can become problems for stakeholders. There isn't a great deal of public good will for the carrier at this writing. Tango, its low fare brand, is expanding its routes, strongly supported by some as a new and needed product, accused by others as being a predatory "fighting brand". WestJet is a success story by virtually any measure. It has struck a chord with many travellers and had the right product and the right business strategy at the right time, and is continuing its expansion plans.

The demise of Canada 3000 (C3) has been blamed on many factors, including the launch of "Tango". However, its end cannot fairly be attributed to any single reason, but to many. These include the complexity of the merger of C3, CanJet and Royal Aviation, the serious drop in demand post-Sept. 11 as well as the impact of Tango.

Although the government offered a loan-guarantee, Canada 3000 was not able to come up with a business plan that met the government's requirements. Two attempts to reduce the size of its labour force, one through the Canadian Industrial Relations Board and the other through direction negotiations with unions, were not successful. The Competition Bureau seemed not to have received the necessary information in time to issue a "cease and desist" order against Tango.

Independent regional carriers may hold the key to the future of regional service. However, they have some serious challenges. Capitalization is difficult; especially as the entire airline industry is under a pall. Moreover, given the fierce nature of airline competition, investors may be unwilling to "bet" against Air Canada by investing in a small competitor. Independent carriers have a more difficult and expensive time to hook into a "network" – Air Canada has its designated carriers and partners, and those on the "outside" of the family are not assured of the same prorates or advantageous agreements.

Airline employees

Airline employees are sometimes seen as being a part of the problem – the cost of union labour is high and some say that the agreements are overly restrictive, protecting union jobs at the expense of a profitable and resilient airline. Staff is described as indifferent or even surly.

On the other hand, employees are the front line troops – on the receiving end of all the anger and frustration of customers. Air Canada employees are still in the midst of a difficult and complex merger process and trying to maintain their professionalism at work. While their internal issues are being sorted out, they are also faced with their company being reviled almost daily in the media. While it may not always be easy to deal with employees if you're a customer, it seems to be even more difficult to **be** an airline employee.

Data

The call for more detailed and timely data is virtually universal, with the unsurprising exception of carriers, who are reluctant to reveal potentially sensitive commercial information. However, the Aviation Data Forum held by the Minister in June 2001 and subsequent meetings with stakeholders have determined that if anything, the demand for data has grown over time, not lessened. Few stakeholders believe that "the greater good" is being upheld if carriers are protected. Many think that the interests of stakeholder groups and the potential benefit to Canadians outweigh airlines' concerns.

The government framework

An examination of Canada's air policy reveals a number of interesting phenomena.

First, even though the air sector is a federal responsibility, in practical terms both provinces and municipalities are very much involved, either to help shape their airline industry to further their own economic and policy goals or even through direct grants and subsidies to promote more access and/or increase airport viability.

Second, an examination of the provisions of Bill C-26 suggests that, at the very least, few people understand them. Many people, judging from the types of inquiries and complaints, expect that the government has much more power over a wider range of issues than it really does.

Finally, a review of the airline sector in other countries has shown that regardless of the differences in air policy between countries, many of the world's airlines look very much either like Air Canada or WestJet. Full service carriers seem to be struggling, while low-cost, low-fare carriers are profitable and growing. This leads to the conclusion that, at least for now, non-government factors, such as the economy, population, geography and how the airlines themselves operate, have a larger impact on the air service we get than government policy. Nonetheless, the government should examine all the options, not because they may or may not work in the short term, but for their broader and longer-term implications.

A number of options have been put forward for government action and will be considered for inclusion in the final recommendations of the Observer, in the next report. The Section "Issues and Options for the Future" and the Appendix, "Weighing the Options" review the concepts and examine the potential "pros and cons" of each.

The options most often cited are:

- Regulate the airline industry, controlling which carriers can fly which routes, at what capacity and at what fares
- Put into place an essential services program, to support communities which have lost scheduled service
- Liberalize air service provided by foreign carriers, with or without reciprocation
    - Cabotage
    - Foreign-owned domestic carriers
- Stimulate growth of the airline industry through programs that encourage expansion and investment, for example
    - Loan guarantees
    - Removal of barriers that prevent new entrants or expansion by smaller carriers
    - Increase foreign ownership percentage to 49%

- Reduce government-related costs to the airline industry, such as aviation fuel taxes, making profitability easier to achieve and potentially lowering the cost of air fares
- Stimulate the economy at large or travel in particular through (for example) tax reductions or other actions
- Include air access as part of its existing regional and economic development programs to better answer community based access requirements
- Provide data and other information/knowledge tools to stakeholders
- Create an integrated transportation policy framework that considers the changed environment, including the impact of trade agreements, international airline alliances and "common aviation areas" and re-defines the role of governments.

The impact the airline industry has on all of us is infinitely greater than the airline industry itself. It is relatively simple to describe what we need the airline industry to be, but overwhelmingly challenging to achieve it. We want an airline sector that is resilient in the bad times and can flourish in the good. It should provide a key part of the Canadian transportation network to foster economic opportunity. At the same time, it should bring our communities together, and link us to the world. It should be competitive, allowing maximum choice for consumers. Oh, yes, the airlines should make money, too, attracting investors back into an industry that has virtually become a pariah in the markets.

Introduction

This is the third interim report of the Independent Transition Observer on Airline Restructuring. This iteration is something of a departure and expansion from previous work, recognizing that "airline restructuring" has taken on a new and disturbing meaning in the context of the post-September 11th environment and the economic slowdown.

It has been an extraordinarily difficult time for everyone, marked by confusion, frustration and anger. As we struggle to shape the future of the airline industry, clarity, and reasoned debate has never been more important – or more challenging to achieve.

The process of restructuring began with a simple goal: a competitive, healthy airline industry which meets the needs of Canadians. At this writing, the jury is still out. Parts of the airline industry are healthier than they were a few months ago, but there is still a long way to go. Some Canadians' needs are being met, but not all.

Last fall, the picture was especially grim. Capacity had been cut. Canada 3000 failed. Air Canada was reeling. Happily, there have been signs of improvement. Both Air Canada and WestJet (which seemed to ride out the downturn very well) have announced that they will increase their domestic capacity for this summer. Conquest Vacations with Skyservice have accelerated their own new domestic expansion plans, as have some other carriers in Canada.

However, challenges still remain. High yield business travel – Air Canada's key customer group in the past – hasn't rebounded. Capacity could be reduced again if anticipated demand isn't there. Airline passengers will be paying a new security fee that some believe will depress demand for low-fare and short haul air travel. Communities still have issues with the quality and quantity of regional service.

Government air policies have been blamed for the failure to create a competitive airline industry. Bill C-26 is intended to protect Canadians from monopoly pricing and predation, and help ensure a "level playing field" for competitors, but some have questioned if it is adequate in this post-September 11th environment. At least in the short term, the demise of Canada 3000 felt like a blow to the goal of "made in Canada" competitive solution, although a number of carriers have stepped in to fill the breach.

Blaming government is easy, but far too simplistic. The issues are deeper than that. Other nations are facing the same challenges as we are, even when, as in the case of Australia, federal policy is radically different. Swissair, Sabena and Ansett are some of the national carriers that have collapsed. Others, like Air Canada are still on their feet, but they are reeling, and more may fall before this downward cycle ends.

If there is a pattern it is that the WestJet style carriers world-wide are thriving, and full service carriers like Air Canada are struggling, virtually everywhere you look. Government ownership doesn't seem to make a difference either. State-owned carriers seem to have the same challenges as privately owned airlines. It seems that the high internal costs and complex processes of full-service carriers, the economic downturn and the lingering effects of the terrorist attacks have far more impact on airline health than any government policy, at least in the short term.

The impact the airline industry has on all of us is infinitely greater than the airline industry itself. It is relatively simple to describe what we need the airline industry to be, but overwhelmingly challenging to achieve it. We want an airline sector that can foster economic opportunity. At the same time, it should bring our communities together, and link us to the world. It should be competitive, allowing maximum choice for consumers. Oh, yes, the airlines should make money, too, attracting investors back into an industry that has virtually become a pariah in the markets.

My objectives, in writing this report are

- To examine the current state of the airline industry in Canada
- To assess the efficacy of current government tools (laws, regulations, policies) and identify gaps
- To review the advantages and disadvantages of major recommendations proposed by stakeholders
- To report the impacts of the events of the last six months on stakeholder groups
- To provide information to assist informed debate.

As always, I am indebted to the many people who took time to share their expertise, opinions and experiences with me, and to the many others who debated, provoked and helped shape the various views I've recounted here. My mandate as Independent Transition Observer on Airline Restructuring will be completed in six months, at which time I will release final recommendations. There are no quick fixes or easy answers. Resolution will only result from our combined efforts. I look forward to continuing to meet with Canadians and to work together to find meaningful recommendations for our future.

The last report will be prepared this coming summer, and include the Observer's final recommendations. If you wish to provide input, please contact Debra Ward at Box 30056, Station 250 Greenbank, Ottawa, ON K2H 1A3, tel: 613 274-0691, or toll free at 877 261-0787, fax 613 226 7166, email: transition.observer@rogers.com,

The Legacy of 9/11 and the Economic Slowdown

So much has been written and said about the aftermath of September 11th and the economic slowdown that it is difficult to avoid being facile, repetitive or both. The fact is that we cannot yet assess – or even come to grips – with what the lingering effects might be. This section reports on what has happened in the last months, and speculates on where we might end up.

The airline roller coaster, part one: the economic downturn

The airline industry enjoyed great growth during the mid and latter part of the 1990s, despite a slow start attributed to the Gulf War and recession. Once those problems were behind us, the hot new sector of high tech and the expanded opportunities of global trade put more people on more airplanes than ever before. Low fare alternatives such as WestJet in Canada and Southwest in the U.S. moved non-traditional passengers out of cars and buses and into airline seats. Towards the end of the nineties, it appeared that the airline industry had established itself as both mass transit mode and irreplaceable business tool. Then the rosy picture began to sour.

Clouds appeared on the horizon in 2001, with the dotcom and stock market free fall. High yield passengers – the bread and butter of full-service airlines – stopped buying those expensive airline tickets, and switched to low-fare travel or reduced airline travel significantly. At the same time that revenues slowed, fuel prices soared. It was a bad time for many carriers. In August, Air Canada, which had announced a loss for the previous quarter, released a recovery plan that included capacity and fleet reductions and labour downsizing. But even this belt-tightening left them unprepared for what lay ahead.

The airline roller coaster, part two: September 11th

Then it changed again, and this time, no existing crisis plan could cover the enormity of the use of commercial aircraft as weapons of mass destruction. Away from the carnage and grief, two more prosaic, but important events happened almost immediately: air travel demand shot down and insurance for carriers and airports shot up. In short order, most people wouldn't fly and there was a danger that airports would be forced to close, if their insurance couldn't be paid.

Fortunately, both here and in the United States, governments acted quickly to handle the insurance problem. However, people didn't start getting back onto planes for a while, and air carriers have yet to make up lost ground. Currently, air travel is still down from last year, but the rate of decline is slowing. For example, Air Canada's traffic declined by 17.9% in October, 8.4% in November and only 2.5% in

December, compared with the same period in 2000. And while traffic has increased, the high-yield passenger traffic hasn't yet rebounded. People are still not willing to pay as much as they did only two years ago.

Airline losses are huge. Air Canada posted a loss of $1.25 billion. Transat AT, the parent company of Air Transat has posted a loss of $99 million. WestJet continues to be Canada's major success story, and is expected to post a profit.

At the same time, costs have climbed – Canada's recent imposition of a security fee being only one example[1]. So, now we have an industry that is seeing a one-two-three punch: higher costs, lower yields AND fewer passengers. It is a wonder that any carrier can make money in this situation, and many of them are burning thousands of dollars every day in their efforts to keep flying.

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What Killed Canada 3000?

One of the saddest and most unexpected turns of event was the demise of Canada 3000. This airline had introduced a new type of service to Canada, moving from a charter carrier serving vacationers to a national scheduled airline, offering 100 domestic and international destinations. The carrier offered some similar services (meals, movies) as Air Canada, but at a lower price to consumers and with fewer restrictions. It had doubled its market share (albeit to only 9% of the total Canadian market), and seemed to be one of the "made in Canada" competitive solutions sought by the government.

When it failed, it seemed to highlight everything that had gone wrong with the airline industry in Canada. However, since then, it appears that at least some of its capacity is being replaced with either new charter service or low fare options provided by expansion of services by WestJet and Tango.

While some are tempted to lay the blame of C3's end solely on Air Canada and its Tango brand, the truth isn't that simple. Canada 3000 launched into an ambitious expansion program when it purchased Canjet and Royal Aviation. At the same time, its low fares were possible because the planes flew full – 85% load factors to break even, according to some. September 10th was their largest booking day. Then came September 11th. The bottom fell out of its demand. A month later, on October 11th, Tango, which seemed to be on many of the same routes as C3, started accepting bookings for its November 1st launch.

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[1] The security fee is as follows: $12.00 per one-way trip in Canada; $24 for round-trip travel within Canada; $12.00 for travel to the continental U.S. (the U.S. will charge its own fee on the return portion into Canada); $24.00 for travel to a destination outside Canada and the continental U.S.

Canada 3000 used all of the tools at its disposal. It applied to the Canadian Industrial Relations Board for permission to release part of its labour force. The application was rejected. It discussed a $75 million loan guarantee with the government, but could not produce a business plan that demonstrated how it was going to recover the funding. Last minute negotiations with one of its unions met with no success. Finally, the Competition Commissioner looked at Canada 3000's claim that Air Canada's Tango was anti-competitive, and agreed that it was a "fighting brand". The Competition Bureau was ready to issue a "cease and desist" order against Air Canada. However, it was too late by that point, and Canada 3000 ceased operations on November 9, 2001.

Canada 3000 was seen as a strong carrier, led by able management. It's possible that C3 would have been strong enough to overcome two out of the three challenges: its merger, the plunge in demand or competing with Tango, but it couldn't fight all three.

Government responses to the post-September 11th environment

Given the fact that at least some of C3's problems related to the post-September 11th environment, should the government have tried harder to save the airline? To put the question in its larger context, should the government have introduced a rescue package for carriers following September 11th as was done in the United States? Do these extraordinary times call for extraordinary measures?

Some extraordinary measures were taken. For example, the government indemnified essential aviation services against acts of terrorism as early as September 22nd, and introduced a $160 million fund to reimburse carriers for the time that all air services were grounded immediately following the attack.

However, Canada didn't go as far as the American government, whose recovery package included not only reimbursements for the time that airplanes were on the tarmac but also an additional $10 billion in loan guarantees Carriers are still very much on their own in this country, as they struggle to get back to normal loads and revenues. Was the government's response the right one?

Some have argued that Canadian carriers should have had the same kind of assistance as their American counterparts, even though the U.S. program has been reported to be very complex, with only one carrier securing a loan guarantee to date. However, that view is not universal. Others have argued, with equal vigour, that "propping up" companies is not the answer, and that the marketplace itself is the best route to recovery.

What Could the Government Do?

While the state of the economy seems to have a greater impact on airline service than government policy, the government can still act. No option should be rejected simply because some think "it won't work" or "it didn't work before". A few of the most frequently discussed options are listed below for consideration, and will be reviewed in more detail in the section "Issues and Options for the Future".

The government could:

- Regulate the airline industry, controlling which carriers can fly which routes, at what capacity and at what fares
- Subsidize fares and/or routes
- Liberalize air service provided by foreign carriers, with or without reciprocation
    - Cabotage
    - Foreign-owned domestic carriers
- Stimulate growth of the airline industry through programs that encourage expansion and investment, for example
    - Loan guarantees
    - Removal of barriers that prevent new entrants or expansion by smaller carriers
    - Increase foreign ownership percentage to 49%
- Reduce government-related costs to the airline industry, making profitability easier to achieve
- Stimulate the economy at large or travel in particular through (for example) tax reductions or other actions
- Include air access as part of its existing regional and economic development programs
- Provide data and other information/knowledge tools to stakeholders
- Create an integrated transportation policy framework that considers the changed environment, including the impact of trade agreements, international airline alliances and "common aviation areas" and defines the role of governments.

Ultimately, **what** the government chooses to do will be determined by **why** it is doing it: Is it to protect our made-in-Canada airline industry? To strengthen ties between Canadian communities and citizens? To encourage regional development? To allow people freedom of choice? These questions must be answered before new policy is created.

How safe is safe?

The horror of September 11th's attack clearly showed that the unthinkable could happen anywhere – it could happen here. Our security systems couldn't deal with suicidal terrorists, and the days following September 11th were filled with ideas to seal up any gaps in the system. The gaps have been sealed with a new security program as announced in the December 10th federal budget. And it is to be paid for by passengers.

The new program provides $2.2 billion over the next five years to make air travel more secure in accordance with rigorous new national Transport Canada standards.

> To ensure that these standards are met, the Government will create a new federal air security authority. Measures will include:
>
> - Armed undercover police officers on Canadian carriers
> - Better-trained personnel to screen passengers and carry-on baggage
> - New state-of-the-art explosive detection systems at Canada's airports
> - Enhanced policing in airports
> - Permanent modifications to aircraft cockpit doors to make them more secure and
> - Enhanced security zones at aircraft handling facilities and on tarmacs.

The new security systems, and in particular, the additional cost to travellers has led to a number of concerns. While the measures taken in Canada are similar to those in the United States, the additional cost here is far higher, at $12.00 per one-way trip in North America, and $24.00 internationally. The one-way trip for an American traveller is $2.50US. The concerns expressed by stakeholders in Canada are:

- The unfairness of burdening a certain segment of the Canadian public with a security measure that benefits all of us.
- The negative impact these high fees could have in a time of economic downturn on all travel intentions. Most vulnerable are short-haul and low-fare travel, where price sensitivity is highest. Ironically, by this action the government may reduce travel demand with one hand at the same time that it is working to increase it with the other
- The fee will go into general revenues, not a separate "security" fund. This has led some to consider the security fee simply another tax on consumers
- There seems to be, at this point, no risk assessment attached to the fee and to the measures. How long will passengers pay? What are the risks that they are being protected from? How long will these risks last?

A number of suggestions have been offered to fine-tune and improve this program, including:

- That the costs be shared between taxpayers and passengers, as the risks, and benefits are already shared
- That the fee be re-configured as a percentage of the ticket price and therefore be fairer to consumers purchasing low-fare or short-haul tickets
- That a risk assessment program be established to ensure that the security measures are on track with real-world events, and that adjustments are made accordingly.

What the future may hold

While trying to predict the future is nothing more than educated guessing, some trends are emerging. These could have long lasting impacts on Canada's airline industry, and are worth noting.

- As people's fear of terrorism diminishes over time, the major factor in the airline industry's recovery will be the condition of the economy
- It appears that other carriers are picking up some of Canada 3000's business. Air Canada has taken some of it, of course, but so has WestJet. Charter business seems to be recovering as well. Skyservice, Air Transat and others have announced that they will start to fill the charter gap left by C3.
- Some industry watchers believe that the Tango brand itself is slowing new and competitive scheduled services from entering the market. According to them, new carriers can't wait for the Competition Bureau to assess "anti-competitive" practices under the current procedures, and new or expanding airlines may not be willing or able to compete with Tango. Some have suggested that this is a significant enough problem to further discourage potential investors from entering the market
- Although there are signs that the economy is beginning to recover, the slowdown is far from over. Most analysts see an economic recovery coming in the latter half of 2002. The airline industry may take a longer period to feel the effects, although a number of analysts are becoming cautiously optimistic that some may see (are predicting?) airlines begin to rebound later this year. However, the high-yield business that is so important to carriers like Air Canada is not rebounding as quickly. Some think it will never return to pre 2001 levels
- Some are predicting that short-haul traffic, such as Ottawa-Toronto or Edmonton-Calgary will see either a long term or permanent decline in demand as it becomes increasing time-efficient and less costly to use alternate modes like rail or road. The two reasons most often cited are long waits at airports and the new security fee
- Some industry watchers believe the airline industry will recover, but will never be the same. Carriers may find that they need a new way of doing business if they hope to be profitable and stable.

The Airline Industry Today

"…despite putting in billions and billions and billions of dollars, the net return to owners from being in the entire airline industry, if you owned it all, and if you put up all this money, is less than zero…So I now have this 800 [telephone] number, and if I ever get the urge to buy an airline stock I dial this number. And I say my name is Warren, and I'm an "air-o-holic," and then this guy talks me down on the other end [of the line]…." Warren Buffett, Berkshire Hathaway [2]

What's Happening in Canada

One of the most critical issues we face is Air Canada's staggering losses and debt load. Because of Air Canada's importance to this country's transportation network, its financial woes are our problem as well. We have to decide quickly what steps should be taken, if any, to protect Canadians.

There are marketplace solutions. Air Canada could restructure its debt, and go through an extensive and fundamental overhaul. It could emerge in stronger condition, but may look like a very different carrier than it does today. Some see Air Canada's role for Canada as too important, and its current state too perilous. One person said "We're putting too many eggs in Air Canada's basket". A number of suggestions for government action have been proposed, some of which would radically change the shape of Canada's airline industry. The suggestions that have been proposed to mitigate our reliance on Air Canada include:

- Relaxing limits to foreign carriers
- Re-regulating the entire industry, including other carriers
- Assuming control over a "new" Air Canada
- Bailing the carrier out, with strict rules around its future operation
- Allowing Canadian carriers to pick up "the slack", and introduce programs to speed the natural process, but allow a new market-based solution to emerge.

For inter-continental travel, Canada is served by a number of major international carriers. However, their convenience is in direct proportion to how closely you live to our international gateway cities. It's easy to get onto a Star Alliance carrier such as United Airlines or Lufthansa via Air Canada, given AC's large domestic network, but it's more complicated (and likely more expensive) if you want to use American Airlines or Cathay Pacific, or any other carrier outside the Star umbrella. Internationally, carriers generally reduce capacity or even eliminate service very quickly if the economics aren't right. Virgin Airlines announced Toronto-London service with huge

[2] PBS Home Video entitled "**WARREN BUFFET *talks business***", 1995

fanfare. (No one will quickly forget the sight of Sir Richard Branson in full hockey regalia). However, Virgin left our market in short order, and with considerably more silence.

The good news right now for consumers and communities is that Air Canada and WestJet are both competing for the same low fare market. Through Tango, AC is offering low-fare, no-restrictions travel to a growing number of Canadian cities. WestJet has been on the same course for years. For the most part, it seems that they are not paralleling each other's routes completely, as AC did with CAI. Although there is overlap, it appears that different networks may be developed. Even better, smaller communities will be benefiting from WestJet or Tango flights. Some areas will be seeing 737 jet service for the first time in years or possibly for the first time ever.

However, there are some differences between WestJet and Tango. WestJet is not only a low-fare operator; it is a low-cost operator that is extremely well capitalized. Tango employs higher priced labour, and is part of an expensive airline in financial turmoil. Perhaps, as some have claimed, Tango will "cannibalize" Air Canada yield. On the other hand, Tango may benefit from the extensive Air Canada network.

Some have questioned the lifespan of Tango. Unlike WestJet, which is and always was in the low-fare business, Tango is a brand created to meet demand. Will it be a permanent part of our airline industry, or will it disappear if Air Canada no longer needs it? Certainly, the demand for low-fare unrestricted tickets seems to be the only growing market segment. The next few months will determine if low-fare airline service will become the wave of the future, or as it was stereotyped in the past, a niche carrier for visiting grannies.

How Do Carriers Compare?

Air Canada

Concerns about Air Canada's financial losses and what they might mean for Canadians have been addressed at the beginning of this section. Even though this is the critical concern, there are other issues to be faced as well. Air Canada is our only national full service airline and historically, our national flag carrier. It carries a lot of baggage, and has become a lightening rod for everything people think is wrong with Canada's airline industry. So much has been said that it is difficult to separate fact from fiction. However, if we are to pass judgement on a private corporation, it is vital that we have the facts needed to do so fairly.

In my view, Air Canada has several issues to deal with:

- The initial promise of an improved carrier and better service to Canadians following the acquisition of Canadian Airlines started to fade by summer of

2000, a time that was hallmarked by delays, confusion and problems for travellers. Air Canada wasn't the only carrier experiencing these problems. In fact, the airline industry globally was a mess that summer. To AC's credit, it attempted to deal with the issues quickly, with the "Air Canada 180 day promise". Subsequently, the airline released its "Customer Service Plan", which deals with some of these concerns. However, from anecdotal reports and in reviewing the report of the Air Travel Complaints Commissioner, there is still a distance to go to restore both customers' and Canadians' confidence in the carrier

- Air Canada must now re-earn customers' trust, rather than simply keep it. This is a difficult task, since they have little or no margin for error. A recent example was the proposed changes to Aeroplan. The airline backtracked on some of the new restrictions, but not before once again angering customers and getting negative publicity
- The cultural differences between Air Canada and Canadian Airlines were quite profound. For those customers who were loyal Canadian Airline users, Air Canada hasn't measured up
- Air Canada has historically responded to new competition by price matching. In the past, this has been more of an issue between airlines. However, what was once acceptable "standard operating procedure" has become a "David and Goliath" battle, with Air Canada in the role of the unfriendly giant
- Communities and consumers feel that they have little influence on Air Canada's decisions, yet must live with, and find ways to deal with, the consequences of those decisions, good or bad. Air Canada must work under unique restrictions and regulations, such as compliance with the Official Languages Act, the commitment to routes until January 2003, etc., giving it less flexibility than other Canadian carriers
- The merger with Canadian Airlines is far from completed, even though the issue has not been top of mind in recent months.

Tango

Tango, using Air Canada employees and Air Canada re-assigned equipment, offers low-fare unrestricted travel. Cities, which have recently lost C3 service, or have been served only by prop aircraft seem to be welcoming Tango as an alternative way of getting low-fare air service. Tango has recently announced its expansion to 21 Canadian cities. Travellers can get Aeroplan points for Tango travel, and use them on Star Alliance carriers. This is seen to be as anti-competitive by some industry watchers.

The brand was deemed anti-competitive against Canada 3000, albeit the ruling was too late to help C3. Some critics have alleged that Tango is "a fighting brand" because the input costs it saves per flight (compared with the cost to run a regular Air Canada flight) are not as significant as the savings offered on fares. Another criticism is that Air Canada is "cannibalizing" its own demand, simply moving Air Canada customers off AC onto Tango.

Air Canada Regional

Air Canada Regional is a single carrier serving small and mid-sized Canadian communities. It was created by the amalgamation of Air BC, Air Ontario, Air Nova and Canadian Regional Air Lines. ACR feeds into Air Canada's network (and Star Alliance) and provides all the benefits that are offered by the mainline carrier.

There are a number of criticisms pointed at this member of Air Canada's family. Most often cited as issues are high fares and the type of equipment on a route, which is usually prop service. (Although regional jet service may be re-instated in some markets later.)

At the same time, ACR is the backbone of regional, networked air travel and offers over 3000 flights a week connecting people to domestic and international destinations through its AC links. It also moves business people and tourists to many smaller regions in the country. In this regard, ACR is seen as an essential part of the Canadian transportation network, and provides Air Canada with valuable "behind the gateway" feed.

Because the carrier serves a number of small communities, it is vulnerable to many of the same challenges as independent regional carriers. These include competition from low-fare jet service serving regional markets, the use of private corporate jets rather than commercial services and competition from other modes.

The amalgamation of the component carriers could be of benefit to both the carrier and consumers, given the regional airline's greater flexibility and more cohesion. The "new" ACR will be watched with interest over the next few months.

LowCostCo

Although not yet launched, this Air Canada-owned carrier is already controversial. Running as a separate entity, it is intended to have lower costs, and provide lower fares, than Air Canada mainline. Some have already called it "anti-competitive". As it is impossible to assess something that doesn't yet exist, a full examination of the implications of this carrier will have to wait. However, some of the elements that people will be watching for will be its routes compared with those of WestJet, its fleet size and whether it will interline or code share with Air Canada mainline.

WestJet

WestJet is a bright spot in an otherwise gloomy picture. It weathered high fuel prices, the economic downturn and September 11^{th}, continued its expansion plans and is continuing to show a profit. Investors tend to agree: share value has doubled since September 11^{th}.

WestJet was styled to get people out of their cars and into WestJet planes. But, what started out as an airline catering to "visiting friends and relatives (VFR)" traffic, has become a major force in Canada's skies. It has expanded to many communities of all sizes in Canada, with its own self contained network. In some communities, it has as much as 50% of the market – a true competitor for Air Canada. In recent months, it has taken some steps that can put it well on the way to entrenching it as a national domestic carrier. For example, it introduced long-haul flights with fewer connections required and is now on the Sabre Computer Reservation System (CRS) making ticket purchases easier. Further expansion into more Canadian communities is expected, including a planned moved into Toronto.

WestJet has built, and continues to build, great customer loyalty. It has a focussed strategic plan, and it stays the course, now entering smaller markets that haven't seen jet service in years, if ever. It is also very clear on communicating what a traveller could expect on one of its flights, and works to exceed that expectation – successfully more often than not.

WestJet is known for keepings its costs low, and passing savings on to its "guests". As a result, it has the ability to fly into small markets and make money with Boeing 737 aircraft on routes that have been considered "marginal" using traditional air service.

Independent Regional Carriers in Canada

Although Air Canada has grabbed most of the media attention, it would be a mistake to discount the size or importance of regional service, and the current and future role of independent regional airlines.

There is a lot of regional flying in Canada, unsurprising for a country of this size. Air Canada, through Air Canada Regional, or in affiliation with independent regional carriers, offers 3172 scheduled flights a week[3]. Independent regional carriers offer 1852 scheduled flights a week.[4] In addition, remote communities also receive non-scheduled service.

[3] Status as of November 1, 2001, source: Transport Canada
[4] -Ibid

Some regional carriers have served their communities for decades. Some have had agreements with Air Canada or Canadian Airlines over the years, offering points, being part of the CRS, and so forth. Some were "orphaned" following the merger, and could no longer offer the benefits of network travel.

These carriers have played an integral role in Canada's growth as a country. From the historic role of bush pilots who helped open our north, to today's role of providing the daily needs of medivac, mail and even food to remote communities, the regional carriers have drawn an indelible line across our country. The independent carriers are not responsible to a distant head office. The owners and operators live in the communities they serve. Their continuation and growth is essential to thousands of Canadians.

These carriers have articulated a number of challenges: financing is difficult if not impossible; they feel that Air Canada can shut them down simply by having the deep pockets to wait them out.

AC partners or designated carriers have an automatic advantage over independent regional carriers as they can easily provide services such as interlining, network destinations, prorated fares and easy access on CRS systems. Independent carriers find these services expensive and complex, given their limited resources.

The effects of September 11th, higher costs and lower revenues, are every bit as acute for regional carriers, but many of them have fewer resources to fight their way out of the hole into profitability. Some of them, many using prop aircraft, may soon face the additional competition of WestJet's or Tango's low-fare jets which are being deployed in smaller markets across Canada.

Many owners have reported that the difficulty obtaining financing is the biggest challenge they face, followed by Air Canada's dominance. Even the idea of forcing Air Canada to give up capacity to these carriers wouldn't solve the overweening challenge of capitalization.

Air Canada will be able to vacate routes beginning next January. Many are of the view that this can open the door to new opportunities for independent airlines, but only if the can get the financing they need to expand.

What's happening worldwide

Few knowledgeable industry-watchers were surprised that the airline industry turned from profitability to red ink in 2001, although some may have been shocked by the speed of events. It has long been known that traditional airlines are expensive to operate, have few avoidable costs and rely on other sectors of the economy to drive demand.

A deregulated airline industry is still a relatively new phenomenon. Designed to increase competition, consumer choice and efficiency, deregulation has also left carriers vulnerable to economic and social upheaval. And heave they did, after September 11th. While the industry seems to be settling in to a new norm, it has suffered, and recovery will be slow. Seemingly unshakable carriers, like Swissair are gone, and some others have become virtually charity cases. The only bright spots are the low-fare carriers, still making money, still expanding.

In the United States, a kind of balance has been achieved, with most of the major operators controlling their own "fortress" hub and spoke systems. Few challenge each other directly at their centres of strength. If a new entrant comes in, established carriers respond quickly, lowering prices, and (in cases of predation) dumping capacity, in order to retain market share. Carriers are further buttressed by membership in international alliances. Alliances work as virtual global airlines, with various members responsible for certain routes.

General airline types in North America

Full service carriers. Traditionally rely on high-yield traveller demand for core revenue. Offer enhanced services such as frequent flyer points, high frequencies, business class travel, etc. Costs, including fleet, labour, etc, tend to be high. Most are highly networked and serve national and international destinations and are members of global alliances. Many were "national carriers" prior to deregulation. In other regions of the world, many are still partially or totally owned by government. Most have been harmed by the events of 2001 and many are expected to show continuing losses. Examples include Air Canada, United Airlines, British Airways, etc.

Low-fare carriers. In North America, they fly domestic routes only. Keep costs and prices low by offering good, basic service. No interlining with other carriers, minimal services on board, no meals, no reserved seating, etc. These carriers have shown growth even after the economic downturn and September 11th. Also tend to utilize secondary airports and to stimulate travel through pricing. Examples include WestJet and Southwest.

Charter carriers. These carriers focus on vacation travel routes. Generally, tickets are purchased by tour operators as part of an overall holiday package, and re-sold to consumers. However, charters can sell single tickets and Canadian destinations if they wish. Examples include Air Transat.

Regional carriers. May be affiliated with major carrier or independent. Offer services to smaller and remote communities on regional jets or prop aircraft. Canadian examples include Bearskin Air, Hawkair and Air Creebec. Some are fully owned subsidiaries of major carriers: for example, Air Canada Regional is fully owned by Air Canada.

The Government Framework

"Transportation is essential to our well-being. Canadians need a reliable, safe and sustainable transportation system to connect our communities, and to connect us with our trading partners. Transport Canada works to help ensure that Canadians have the best transportation system — not by owning and operating the system as in the past, but by developing and administering policies, regulations and programs for a safe, efficient and environmentally friendly transportation system; contributing to Canada's economic growth and social development; and, protecting the physical environment". Transport Canada, 2001-2002 Estimates, A Report on Plans and Priorities

One of the issues that has been discussed in recent months is the role of government in the airline industry. How effective are current policies and regulations in today's environment? What is the framework that guides government decisions? What is transportation policy for? This section looks at the role of transportation policy, how air policy compares to other modes and examines the efficacy of some of the key provisions in Bill C-26 and in the Air Canada undertakings.

There is a distinction between national policy and transportation policy. As defined by the MacPherson commission report in 1961, "national policy refers to the broadest goals: achieving a national identity and unity, economic development but accompanied by concepts of equality and justice, social welfare, and so on. Transportation may play a role in reaching these objectives, but the focus of national transportation policy is the health and performance of the national transportation system"[5].

Canadian air policy vs. other countries

Many people have referred to air policy in other countries. How, for example, Australia seems to have similar challenges as Canada, but responds with a far more liberalized policy. Or, what the American are doing that we might not be. Given all the comparisons being made, it is informative to examine some of these policies and see which countries, if any, are further ahead than we are, and what lessons we can learn from them.

It appears that despite the very different national policies that exist, the outcomes and challenges are scarily similar. It seems that government policies, regardless of what they are, have far less of an effect on the airline industry than factors such as the health of economy, how the airline industry functions as a sector and so on. This has enormous implications for those who look to the federal government to "fix" the airline industry. Issues that all countries have in common include

- Shift from protected "national carriers" to market competition
- Service to small and remote communities

[5] *Vision and Balance*, Report of the Canada Transportation Act Review Panel, June 2001

- Security and safety
- Government spending vs. user-pay
- Balancing consumer protection with a free-market environment (e.g. anti-monopoly/predation legislation, consumer protection, airline mergers).

The next few pages review some key Canadian policies and contrast them with their equivalents in Australia, the United States and Europe. Whenever possible, outcomes are also reviewed.

Currently, some key Canadian transportation policies favour:

- Allowing market pressures to be the primary force in shaping transportation
- Shifting to a user-pay system (airports, NavCanada, security, etc.)
- Keeping government responsible for oversight and regulations on safety and security issues
- Keeping Canadian carriers Canadian-owned and controlled (foreign ownership maximum is 25%)
- Allowing any Canadian carrier to fly anywhere in Canada
- Allowing an “open skies” agreement with the United States: American carriers can fly to any Canadian destination. Canadian carriers have the same ability to fly to any American city as well
- Negotiating international agreements (e.g. bilaterals) on a reciprocal basis only, providing Canadian airlines with similar opportunities in other countries as are given to foreign carriers here
- Providing ownership/support of remote airports.

Unlike some other countries, Canada does not currently support or provide:

- Transport Canada funding to directly support the cost of maintaining scheduled air service to communities. However, other departments may be providing support on an ad hoc basis, based on regional needs.
- Support or financial programs that are designed specifically to encourage or develop new air services
- Multi-lateral air agreements
- Detailed aviation data for use by stakeholder groups.

Some provisions were re-tooled post September 11th. Government:

- Provided an indemnity for third-party war and terrorism liabilities for essential aviation service operators in Canada
- Introduced a wide range of new measures to enhance the security of operations at Canada's airports

- Allocated $160 million to compensate Canadian air carriers and specialty air operators for losses resulting from the closure of Canada's airspace following the terrorist attacks in the United States on September 11, 2001
- Introduced legislation to remove the 15 per cent limit on individual ownership of shares in Air Canada
- Created a new Canadian Air Transport Security Authority responsible for the provision of key air security services. The Authority will be a federal entity and will report to the Minister of Transport
- Introduced revisions to the Competition Act to enhance its ability to react to anti-competitive behaviour.

The Australian Example

Government policy
Foreigners can own 100% of domestic carriers, if the company involved set up an Australian head office and its aircraft are registered with that country. As well, international carriers can fly to any regional Australian city, without reciprocation. However, this does not include the major four - Sydney, Melbourne, Brisbane and Perth. International carriers can have foreign ownership of up to 49%. As a result, Ansett was owned 49% by foreigners (Air New Zealand and Singapore Air) and Richard Branson introduced "Virgin Blue" as a foreign owned, domestic carrier.

Australian airline industry
Subsequent to a major shake up in Australian airline sector (the demise of Ansett, which handled 40% of the domestic market, and Qantas' purchase of Impulse, an Australian-owned domestic carrier) Virgin now serves 26 city-pairs, and is now running a "national" service. Qantas may also purchase what remains of Ansett, despite the reservations of the competition watchdog, giving that former national flag carrier greater dominance. Meanwhile, an Australian-owned company may buy a controlling stake in Virgin Blue. According to one Australian airline-watcher, Qantas has 80% of the market, Virgin Blue, 10% and "Ansett II", 10%.

In response to the turmoil, the federal government introduced a temporary "Rapid Recovery Scheme", to keep routes active in regional areas. However, that pool of funding is drying up, and some routes have not recovered to financially viable levels, leaving the continuing problem of regional service on the front burner.

The Australian government uses a number of programs to support air service, including:

- Remote Air Service Subsidy for remote and isolated communities requiring basic services: fresh food, mail, educational materials, medical supplies, and the carriage of passengers, spending about $10.4 million (Australian) over five years. This subsidy does not appear to apply to rural communities.
- Other forms of assistance that are indirect, such as some reductions in taxes and charges.
- An attempt to create the "right business environment" which could encourage air service demand. The goal is to achieve a dynamic economy featuring low interest rates, low unemployment and lower business taxes. This aim is supported by a number of business and community support programs that are outside of the Department of Transport's purview.

Even prior to the collapse of Ansett, at least one state (the equivalent of our provinces) created its own "Ministerial Task Force on Regional Air Service" to deal with longer term issues. Although its current focus is on keeping a basic level of service, its ultimate goal is to overcome the challenge of maintaining services on financially unviable routes.

The American Example

Government policy

Foreigners cannot own American airlines. According to the Department of Transportation, "Only 'citizens of the United States' may operate aircraft in domestic air services and may provide international scheduled and non-scheduled air services as U.S. air carriers". The term "citizen of the United States" is defined by statute to be: (a) an individual who is a U.S citizen; (b) a partnership in which each member is a U.S. citizen or (c) a U.S. corporation of which the president and at least two/thirds of the board of directors are U.S. citizens, and at least 75% of the voting interest in the corporation is owned or controlled by U.S. citizens."

U.S airline industry

Major carriers dominate their own "fortress" hubs, and control as much as 80% of the traffic out of these areas. The U.S. industry is a combination of a few major international players, which deploy out of their own hubs (e.g. American Airlines, United Airline, Continental, etc.), low fare carriers such as Southwest and regional carriers (some independent, some affiliated with majors). Some major carriers, such as Pan Am, have gone bankrupt over the years. Others have been seeking merger (e.g. United and USAir), despite opposition from some members of Congress. Some have estimated the percentage of start up failures to be as high as 97%. Many unions have scope clauses that limit American carrier ownership of non-American airlines.

The U.S. government uses a number of programs to support air service, notably:
Essential Services. This program provides funding for "a minimum level of service" to connect a community to a hub, as specified through the program. The appropriation has varied from year to year, and was reduced to $25.9 million in 1997. Finally, the sunset clauses were removed, and in 1998, $50 million annual funding was realized through the Rural Air Services Survival Act. Air carriers are invited to submit a proposal for subsidized service, and the provider is selected based on several criteria. Generally, two to four daily flights using 19-seaters are subsidized to one hub. Communities that are "within a reasonable drive" of a major hub airport are not eligible (within 70 driving miles, or about 110 kilometres). Twenty-six communities in Alaska and 78 in the continental U.S. are currently subsidized. Anecdotally, some of these services are not well used, as travellers ignore the hub-spoke connection in favour of a low-fare carrier in their region.

As well, a recovery program was instituted post-September 11th to assist carriers. Carriers were eligible for $5 billion in relief relating directly to the short-term effects of September 11th. An additional $10 billion is available on an "as needed" basis for loan guarantees. Airlines must submit their recovery plans to a federal Task Force to access these funds.

There are also a number of federal rural development programs available to assist in diversifying and increasing economic opportunities in rural or remote regions.

An advocacy organization "Regional Aviation Partners" has been created, and represents regional airline companies, aircraft manufacturers, and city, county, and state governments, airports, chambers of commerce, business organizations and hospitality organizations. Its goal is to represent all facets of regional aviation and the interests of small, rural, underserved communities that were negatively impacted by deregulation of the airline industry in 1978.

The European Union Example

Government policy (from 1992)
This agreement between member states continues the liberalization process and allows for cross-border airline mergers and takeovers and also permits airlines from one member state to set up operating subsidiaries in other member states. While bilateral agreements still exist between member and non-member states, this may soon change. On January 31st of this year, the Advocate General of the European court found that bilateral open skies agreements were contrary to EU "community law". Though non-binding, the Advocate General's findings are usually endorsed by the court. A court ruling is expected in mid-2002. This approval would allow the EU to pursue a multi-lateral approach to open skies agreements. Member states may continue to regulate access to domestic routes, but only without discrimination on grounds of nationality of ownership and air carrier identity.

A member state may impose a public service obligation in respect of scheduled services to an airport in a peripheral or development region or on a thin route to a regional airport, if the route is vital to the economic development of the region and if adequate services would not otherwise exist. Exclusivity may be conferred for three years on any carrier that agrees to start a service on most such routes where there is none, but this right must be offered by public tender throughout the EC.

No capacity limitations may be applied between member states, although the Commission may authorize stabilizing measures if this leads to serious financial damage for the scheduled carriers of a member state.

European airline industry
While some of the effects of liberalization are beginning to be felt, the European airline community hasn't yet experienced its full effect. Following September 11th, some airlines have either collapsed or are currently on state "life support" including Swissair and Sabena.

A few are 100% privately owned, such as BA, but most still have some state ownership provisions (e.g. Air France, Alitalia, TAP, etc.)

Some low fare carriers, notably Ryanair, which is serving 50 communities in 12 countries, are making major inroads into European markets.

Anecdotally, some member states subsidize services to remote communities. However, given the existing rail and road systems, these programs appear to be quite small, and tied into regional and rural recovery/development programs

The Provisions of C-26

July 2000, Bill C-26 returned some powers to the government, which were intended, in government's own words "…*to ensure an orderly restructuring of Canada's airline industry, with the least possible disruption to communities, the travelling public and to airline employees. In addition to the safety tenet, the legislation flowed from* ***five basic principles: protection from price gouging, protection of service to small communities, the fair treatment of employees, the fostering of competition, and the maintenance of Canadian ownership and control. The legislation includes measures respecting major airline mergers and acquisitions, revised exit notice provisions, expanded oversight of domestic prices, new powers in the area of anti-competitive behaviour by airlines, and expanded responsibility for Air Canada to ensure the provision of services to the public in both official languages. In terms of the airline industry, domestic issues will continue to focus on consumer choice and protection, service to small communities, and adequate access to airport infrastructure by new entrants*** *(emphasis mine)*. " Transport Canada, 2001-2002 Estimates, A Report on Plans and Priorities.

However, these powers do not turn back the clock to a government-controlled airline industry. The airline industry remains, for the most part, a demand-driven service, and cannot be used directly by government to further economic or social policy ends.

Anti-Competitive Behaviour (Competition Bureau)

Bill C-26 introduced amendments to sections of the Competition Act to prohibit the abuse of a dominant market position, as it applies to the operation of a domestic airline service. The statute defines "anti-competitive acts". As well, the Commissioner of Competition can issue a temporary "cease and desist order" when an inquiry has been commenced and the Commissioner has reason to believe that competition will be harmed or a competitor eliminated if the order is not made.

The anti-competitive statute and undertakings have come under criticism in recent months. Despite the "cease and desist" ability, many have complained that the system cannot respond quickly enough. WestJet's claim of predation against Air Canada has yet to be adjudicated by the Competition Tribunal. For its part, Air Canada believes that the anti-competition provisions unfairly restrict its ability to compete with other carriers by putting lower-fare inventory into the marketplace.

Some of the key measures to protect Canadians and Canadian carriers from Air Canada's dominance are included in a series of "undertakings" between Air Canada and the government. Some of these are:

- Air Canada agreed to surrender 42 departure/arrival slots in Toronto

- Air Canada must provide Aeroplan points to existing carriers and new entrants (for carriers with revenues of less than $250 million annually).
- Air Canada must interline or offer joint fares with any Canadian carrier, providing the carrier meets reasonable industry standards, and that these fares be clearly displayed
- Air Canada must surrender a certain percentage of airport facilities where AC ticketing/check in positions exceeds 60%
- Travel agents' "overrides"(i.e. bonuses) on domestic Air Canada tickets can no longer be based on revenue performance or market share for domestic services, but on international and transborder share instead.

Issues that have arisen include:

- Travel agents have reported that the override program has had at least one unintended consequence. In order for agents to achieve a higher level of income on domestic sales, they must sell Air Canada internationally, potentially impacting sales of other international carriers that serve Canada. The bonus is critical to the survival of some travel agencies, as the "base" commission is very low – and some say do not even cover the cost of ticket issuance. It is in their self-interest to maximize their sales of Air Canada internationally, but it might not always be in the best interest of the consumer
- Many have voiced a concern that the trying to determine "avoidable costs", the current standard being used, is not practical. They have said that the formula is too complicated, arbitrary and that it would be very difficult to extract the appropriate accurate information from the dominant carrier in a timely way. A final criticism, since addressed, was the lack of financial damages if a carrier were found guilty of anti-competitive practices, leading some to speculate that without significant financial penalty, there would be little in the Act to ensure compliance.

Recently two amendments have been tabled to address perceived inadequacies in the present *Competition Act* with respect to the airline industry

- Closing the gap that can occur after the expiry of temporary cease and desist orders issued by the Commissioner against a competitor, by permitting extensions of temporary orders until the Commissioner has received the relevant information to determine whether to file an application with the Tribunal; and
- Permitting the Tribunal to assess an administrative monetary penalty against an airline, when it has issued an order under the abuse of dominance section of the *Act*, to a maximum of $15 million.

Government viewed these measures as necessary, given the instability in the airline industry post September 11th. The effectiveness of these changes will be monitored and reported on in the next report of the Observer.

Effectiveness

Despite these changes, there is still some concern within the aviation and stakeholder communities that the new amendments do not go far enough. This is still a "complaints-driven" process, and the paperwork must be done before action can be taken. Some call this an onerous burden for a smaller carrier that perceives itself to be "under attack" by the dominant carrier.

There is also the problem of what does and does not constitute predatory behaviour. It is not necessarily predatory to compete head-to-head. Air Canada believes it is not acting anti-competitively if it simply matches prices with a competitor on a route, even if the competitor pulls out of that route as a result – it simply won the contest.

The impact of Air Canada's competitive presence in the marketplace is far subtler than merely a matter of price according to some of the other carriers. Even though the undertakings require Air Canada to provide some perks, such as Aeroplan and interline agreements to other carriers, they, unlike Air Canada or AC-owned carriers, have to pay for these add-ons and manage them, raising the cost of the ticket and the administrative burden for small airlines.

Some people have identified gaps between what the undertakings were intended to do, versus what they are actually doing. The problems noted include:

- If a small carrier wishes to have interline services with Air Canada, it must become a member of IATA (International Air Transport Association), which could be expensive and burdensome
- In the Aeroplan contract, there is a requirement for AC to conduct a safety audit of the participating airline, at that carrier's expense. In some of the carriers' view, this is an unnecessary burden as safety audits are already conducted by Transport Canada and are part of the criteria for issuing an Operating Certificate
- The processes of filing a complaint, appearing before the Tribunal, etc. favour the dominant carrier which already has a legal department, researchers, etc., rather than the smaller carrier which must find the resources to take, and support, its actions.

Finally, the most controversial element not addressed by current legislation is Air Canada's ability to establish low-fare competitors in the marketplace. Many have claimed that Tango is a "fighting" brand, there simply to punish the competition. Some saw that brand as the "final straw" in Canada 3000's demise. Air Canada's western low-cost carrier, yet to be launched, is also seen by some as a direct assault against WestJet and perhaps regional independent carriers as well. Since its inception, Tango has changed some of its routes, and according to some travel agents, routinely cancelled flights – putting their passengers on Air Canada mainline instead. These passengers obviously enjoy the benefit of paying for low-fare, minimal service, but reaping the reward of full-service, once the switch is made. They are not likely to complain. In a recent radio interview, one travel agent claimed that some people are intentionally booking Tango in the hope that the flight would be cancelled and they could move up to Air Canada.

Air Canada appears equally unhappy with the requirements, although from a totally different perspective. Air Canada sees these new products as an important way to attract passengers who want low-fare options at a lower cost to the carrier. The airline sees the introduction as leading to positive competition for travellers while helping the airline return to profitability. As any other business, Air Canada's ability to brand, set prices and deliver services based on current consumer needs is critical to its future. However, some analysts believe that Tango, which offers low-fares but still has many of the high costs of Air Canada, cannot be sustained for the longer term.

Our need to resolve these challenges is particularly acute. Many carriers have reported that Air Canada's competitive strategies, legal or not, are the single most critical factor that chills investment and expansion by smaller carriers. Air Canada is unsure itself of the rules of the game, and claims that its inability to respond to the demands of the marketplace harms not only the company, but also consumers who want greater choice.

What is Anti-Competitive by Law?

(*a*) Operating capacity on a route or routes at fares that do not cover the avoidable cost of providing the service, that is all costs that could be avoided if the service is not provided,

(*b*) Increasing capacity on a route or routes at fares that do not cover the avoidable cost of providing the service, that is all costs that could be avoided if the service is not provided,

(*c*) Use of a low-cost second-brand carrier in a manner described in paragraphs (*a*) and (*b*) above,

(*d*) Pre-empting airport facilities or services required for the operation of a competing carrier,

(*e*) Pre-empting take-off and landing slots required for the operation of a competing carrier, to the extent not governed by regulation,

(*f*) Refusing to make available on usual trade terms, unused or surplus airport facilities or services required for the operation of a competing carrier,

(*g*) Using commission overrides or other inducements to travel agents to sell only or primarily the flights of the offering carrier for the purpose of eliminating or disciplining a competitor or impeding entry into or expansion of a competitor in a market,

(*h*) Using the offer of more than the usual awards in a frequent flyer program, for the purpose of eliminating or disciplining a competitor or impeding entry into or expansion of a competitor in a market.

Protection from price gouging on monopoly routes within Canada (Canadian Transportation Agency)

Current legislation to protect consumers from gouging does just that and no more. It does nothing to address the cost of tickets generally, only those sold on monopoly routes. It doesn't help individuals get lower fares that may be available on other routes because of the presence of airlines such as Westjet. On complaint or for a limited period of time on its own motion, it allows government to disallow, roll back or refund any "unreasonable" fares or rates on monopoly routes or to add fares or rates if they are absent on monopoly routes but available on similar competitive routes operated by the carrier within Canada.

Of 41 domestic pricing complaints received by the Canadian Transportation Agency, since July 5, 2000, 9 were withdrawn by the complainants, 15 are still in progress and 17 resulted in rulings. Of these, 12 were dismissed as they were not in the Agency's jurisdiction, (3 were pre-July 5, 2000 and 9 were not "monopoly" carriers: i.e. not the only person providing service between the two points within the meaning of section 66 of the Act). Of the five remaining, three were found in favour of the carrier (fare or rate published or offered was not unreasonable and/or range of fares offered was not inadequate) and two were found in favour of the complainant (fare published or offered was unreasonable and/or range of fares offered was inadequate)

The two reports that have been issued by the Air Travel Complaints Commissioner suggest that airfares are a minor part of the complaints his office has received, accounting for 4.3% of complaints received between July and December 2000 and 3.4% of those received between January and June 2001.

This leads to two questions: how effective is the CTA in dealing with price gouging, and how important is this role? Views differ. For example, the Public Interest Advocacy Centre's recent paper on the airline industry advocated a broadening of the CTA's powers, including the authority to review the actual cost of all air fares in Canada and to approve or change pricing for different classes of tickets, among other expanded powers, saying *"The adherence to a failed liberalized market orthodoxy and ineffective means of redress has left passengers as little more than paying pawns in the system*."[6] The Canada Transportation Act review panel, on the other side of the spectrum, recommended that the powers be removed entirely, saying "*The Panel is concerned that the Agency has been saddled with exceedingly complex responsibilities that are difficult to fulfil in a timely and effective manner...Price regulation is a costly and slow process and one that is especially ill-suited to an industry characterized by frequent and rapid price changes*."[7]

[6] *High Hopes and Low Standards! The Life and Times of Airline Travel in Canada*, Andrew Reddick, PIAC, 2001

[7] *Vision and Balance*, Report of the Canada Transportation Act Review Panel, June 2001

Effectiveness

Along with very different prescriptions as outlined above, some general comments and observations note the following possible limitations to our current legislation

- Detailed information from the airlines must be requested each time, making the assessment process slow and cumbersome
- The CTA may require more resources to ably monitor the airline industry and rule in a timely way
- The concept of "reasonable" vs. "unreasonable" is still being developed, and there are no transparent guidelines as to what these are
- There is a potential conflict or area of confusion between the CTA and the Competition Bureau, which monitors and has powers concerning predatory practices, not high prices
- There is some confusion about whether certain protections fall under provincial jurisdiction through "consumer protection acts" or are a responsibility of the federal government though the CTA or another department.

MONOPOLY FARES

Under C-26, section 66 of the Canada Transportation Act is replaced with:

Unreasonable fares or rates

(1) If, on complaint in writing to the Agency by any person, the Agency finds that a licensee, including affiliated licensees, is the only person providing a domestic service between two points and that a fare, cargo rate or increase in a fare or cargo rate published or offered in respect of the service is unreasonable, the Agency may, by order,

(*a*) Disallow the fare, rate or increase

(*b*) Direct the licensee to amend its tariff by reducing the fare, rate or increase by the amounts and for the periods that the Agency considers reasonable in the circumstances; or

(*c*) Direct the licensee, if practicable, to refund amounts specified by the Agency, with interest calculated in the prescribed manner, to persons determined by the Agency to have been overcharged by the licensee.

Complaint of inadequate range of fares or rates

(2) If, on complaint in writing to the Agency by any person, the Agency finds that a licensee, including affiliated licensees, is the only person providing a domestic service between two points and that it is offering an inadequate range of fares or cargo rates in respect of that service, the Agency may, by order, direct the licensee, for a period that the Agency considers reasonable in the circumstances, to publish and apply in respect of that service one or more additional fares or cargo rates that the Agency considers reasonable in the circumstances.

Relevant information

(3) When making a finding under subsection (1) or (2) that a fare, cargo rate or increase in a fare or cargo rate published or offered in respect of a domestic service between two points is unreasonable or that a licensee is offering an inadequate range of fares or cargo rates in respect of a domestic service between two points, the Agency shall consider

(*a*) Historical data respecting fares or cargo rates applicable to domestic services between those two points

(*b*) Fares or cargo rates applicable to similar domestic services offered by the licensee and one or more other licensees using similar aircraft, including terms and conditions of carriage and, in the case of fares, the number of seats available at those fares;

(*b*.1) The competition from other modes of transportation, if the finding is in respect of a cargo rate, an increase in a cargo rate or a range of cargo rates; and

(*c*) Any other information that may be provided by the licensee, including information that the licensee provides under section 83.

Alternative Domestic Services

(4) The Agency may find that a licensee is the only person providing a domestic service between two points if every alternative domestic service between those points is, in the opinion of the Agency, unreasonable, taking into consideration the number of stops, the number of seats offered, the frequency of service, the flight connections and the total travel time.

Protection of service to small communities (Canadian Transportation Agency)

This piece of the legislation ensures that no one loses domestic service without notification. However, there are larger issues that the provision does not cover, such as

- The impact of loss of service on communities
- The challenge of developing and financing regional access strategies
- Challenges and opportunities for new entrants

Following the merger, Air Canada agreed to continue to serve all Canadian communities that were served by AC, Canadian Airlines Ltd or their regional affiliates until January 4, 2003. As well, new provisions were added to the Canada Transportation Act, which require air carriers to give 120 days notice before discontinuing year-round non-stop scheduled air services between two points in Canada where the proposed discontinuance of service will result in a significant reduction of weekly passenger-carrying capacity between those two points.

It is expected that the full impact of this legislation will not be felt until Air Canada begins to vacate routes in 2003. However, for the purposes of comparison, here are the rulings to date.

Exit provisions

To date, post, July 5, 2000, the Canadian Transportation Agency received 30 discontinuance complaints. Twenty-six dealt with situations where the notice requirements before exiting did not apply. For example, the complaints concerned points where more than one other carrier was providing service. Three complaints were withdrawn and one resulted in an Agency ruling that dismissed the complaint. As well, a number of carriers requested a reduction of notice period or exemption from giving notice. Of these 14 cases, the Agency required some form of notification in eleven cases and exemptions were granted in three. It should be noted that these are based on common-sense approaches to the real world, for example in the case of bankruptcy or when one carrier was taken over by another. It is expected that these new powers will be tested more rigorously once Air Canada itself can exit routes.

Effectiveness

The Canada Transportation Act Review Panel noted a concern that the 120-day exit provision might not allow time for needed consultations and recommended that the period of notification of termination of service be extended to 180 days.[8]

The CTA Review Panel also expressed a view, echoed by many that Air Canada's ability to exit routes may well open the door to new opportunities for other carriers and communities.

EXIT PROVISIONS

Under C-26, sub-section 64(2) and (3) of the Canada Transportation Act is replaced with:

Notice of discontinuance of certain services
(1.1) If a licensee proposes to discontinue its year-round non-stop scheduled air service between two points in Canada and that discontinuance would result in a reduction, as compared to the week before the proposal is to take effect, of at least 50% of the weekly passenger-carrying capacity of all licensees operating year-round non-stop scheduled air services between those two points, the licensee shall give notice of the proposal in the prescribed form and manner to the prescribed persons.

Discussion with elected officials
(1.2) A licensee shall, as soon as practicable after giving notice under subsection (1) or (1.1), provide an opportunity for elected officials of the municipal or local government of the community of the point or points, as the case may be, to meet and discuss with the licensee the impact of the proposed discontinuance or reduction.

Notice period
(2) A licensee shall not implement a proposal referred to in subsection (1) or (1.1) until the expiry of 120 days, or 30 days if the service referred to in that subsection has been in operation for less than one year, after the notice is given or until the expiry of any shorter period that the Agency may, on application by the licensee, specify by order.

Considerations re whether exemption to be granted
(3) In considering whether to specify a shorter period under subsection (2), the Agency shall have regard to
(*a*) The adequacy of alternative modes of public transportation available at or in the vicinity of the point referred to in subsection (1) or between the points referred to in subsection (1.1)
(*b*) Other means by which air service to the point or between the points is or is likely to be provided;
(*c*) Whether the licensee has complied with subsection (1.2); and
(*d*) The particular circumstances of the licensee.

Definition of `"non-stop scheduled air service''
(4) In this section, `"non-stop scheduled air service'' means an air service operated between two points without any stops in accordance with a published timetable or on a regular basis.

[8] *Vision and Balance*, -Ibid

Tariffs (Canadian Transportation Agency)

Tariffs are the conditions under which a carrier provides its services. Unfortunately, it appears unlikely that many passengers know what those rules are in any detail.

The air carrier's tariff contains all its fares, rates, charges, and terms and conditions of carriage. A ticket is proof of payment and only contains some of the information that appears in a tariff. The tariffs cover a number of things such as: limits or restrictions on the weight or size of baggage, compensation for lost, delayed or damaged luggage, compensation for denied boarding (bumping), and the carrier's rules concerning the carriage of persons with disabilities or minors. The tariffs must be published by law, but in practical terms, they are long and complex and not readily accessed by the public. Carriers are required, by law, to make their tariff or portions of their tariff available upon request.

The Canadian Transportation Agency can deal with two types of tariff complaints: first, if the carrier has failed to apply the terms and conditions of carriage, and second, if the conditions themselves are unreasonable. These complaints can concern travel within Canada, or international travel to or from Canada provided by Canadian or foreign carriers.

If the Agency finds that a carrier failed to apply its terms and conditions of carriage, the carrier will be ordered to do so. Under some circumstances, it could also be ordered to compensate the passengers or shippers. The Agency could also fine the carrier if the Agency found that the carrier had not applied its tariff.

If the Agency finds that a term or condition of carriage is unreasonable or unduly discriminatory, it may disallow the term or condition in question, and may substitute a different term or condition in its place.

From July 5, 2000 to December 31, 2001, the CTA received 12 complaints concerning a carrier’s failure to respect its domestic tariff. Five complaints are still active; staff resolved six and one required a ruling (dismissed due to bankruptcy). There were 34 complaints that the terms and conditions of the tariff were unreasonable or unduly discriminatory. Eleven are active. Twenty-three were disposed of by the agency, staff resolved 17 and there were six agency rulings – all dismissals.

There were 36 international tariff consumer complaints. Ten are active, staff has resolved 23 and there were three agency rulings – all dismissals.

Effectiveness

- The CTA has new powers to ensure that carriers have terms and conditions that are reasonable and non-discriminatory. Action is complaints-driven
- It appears that public recourse is of limited use as the provisions of the tariffs are not well known
- Although hard data is lacking, it appears that issues brought to the attention of the CTA might be articulated more clearly and resolved more forthrightly if the tariffs themselves were better known and understood by travellers
- The tariffs are complex legal documents. It is uncertain whether a majority of travellers would realistically be able to use the tariff as a tool to protect themselves or to understand if or when the carrier has failed to respect the tariff. Moreover, terms under the tariff change between carriers, adding to the confusion.

The issues around tariffs are quite significant, starting with the notion that few airline passengers know that the tariff exists. Perhaps some do not even read the "terms and conditions" that accompany their ticket. The carriers create their own tariffs – in effect laying out the conditions of how much we pay, and what we get for it. Essentially, from the passengers' point of view, the contract between passenger and carrier may be incomplete. The passenger may not have a clear idea of what s/he has just purchased. Without knowledge, there is little opportunity to assess, dispute and redress, if necessary, the terms of carriage.

This issue is being recognized globally, and some carriers are beginning to develop tariff documents that are more accessible and easier to understand. This is an action that carriers can take independent of government to improve their relationships with customers.

Contents of Tariffs

Every tariff shall contain

(*a*) The name of the issuing air carrier and the name, title and full address of the officer or agent issuing the tariff;
(*b*) The tariff number, and the title that describes the tariff contents;
(*c*) The dates of publication, coming into effect and expiration of the tariff, if it is to expire on a specific date;
(*d*) A description of the points or areas from and to which or between which the tariff applies;
(*e*) In the case of a joint tariff, a list of all participating air carriers
(*f*) A table of contents showing the exact location where information under general headings is to be found;
(*g*) Where applicable, an index of all goods for which commodity tolls are specified, with reference to each item or page of the tariff in which any of the goods are shown
(*h*) An index of points from, to or between which tolls apply, showing the province or territory in which the points are located
(*I*) A list of the airports, aerodromes or other facilities used with respect to each point shown in the tariff;
(*j*) Where applicable, information respecting prepayment requirements and restrictions and information respecting non-acceptance and non-delivery of goods, unless reference is given to another tariff number in which that information is contained
(*k*) A full explanation of all abbreviations, notes, reference marks, symbols and technical terms used in the tariff and, where a reference mark or symbol is used on a page, an explanation of it on that page or a reference thereon to the page on which the explanation is given;
(*l*) The terms and conditions governing the tariff, generally, stated in such a way that it is clear as to how the terms and conditions apply to the tolls named in the tariff;
(*m*) Any special terms and conditions that apply to a particular toll and, where the toll appears on a page, a reference on that page to the page on which those terms and conditions appear;
(*n*) The terms and conditions of carriage, clearly stating the air carrier's policy in respect of at least the following matters, namely,
(I) The carriage of persons with disabilities,
(ii) Acceptance of children,
(iii) Compensation for denial of boarding as a result of overbooking,
(iv) Passenger re-routing,
(v) Failure to operate the service or failure to operate on schedule,
(vi) Refunds for services purchased but not used, whether in whole or in part, either as a result of the client's unwillingness or inability to continue or the air carrier's inability to provide the service for any reason,
(vii) Ticket reservation, cancellation, confirmation, validity and loss,
(viii) Refusal to transport passengers or goods,
(ix) Method of calculation of charges not specifically set out in the tariff,
(x) Limits of liability respecting passengers and goods,
(xi) Exclusions from liability respecting passengers and goods, and
(xii) Procedures to be followed, and time limitations, respecting claims;
(*o*) The tolls, shown in Canadian currency, together with the names of the points from, to or between which the tolls apply, arranged in a simple and systematic manner with, in the case of commodity tolls, goods clearly identified;
(*p*) The routings related to the tolls unless reference is made in the tariff to another tariff in which the routings appear; and
(*q*) The official descriptive title of each type of passenger fare, together with any name or abbreviation thereof.

Official Languages

While Air Canada's ability to serve customers in both official languages may first seem to be a customer relations issue, it goes well beyond that: it is an obligation under law.

The "Air Canada Public Participation Act" requires the airline to adhere to the "Official Languages Act". The carrier is obliged to provide services in both official languages:

- At airports used by at least one million passengers a year
- On all flights that take off from and/or land in the National Capital Region, Montréal, and Moncton
- On domestic flights within Québec, Ontario, and New Brunswick, and on flights between two or three of those provinces
- At other airports or on other routes where demand for services in the second official language is at least 5%.

Benefits of having bilingual air service are quite clear, and include:

- Enhanced customer service
- Added safety in emergencies on board a flight or at airports
- Promotion of both the French and English elements of Canadian culture: a boon for tourism and for our national identity as a bilingual nation.

Broadly, official languages issues have tended to fall into the following categories:

- Signage
- Baggage check-in and ticketing
- Announcements
- Self-service kiosks
- Identification of bilingual agents and service at counters
- Identification of complaints procedures.

While this has been an ongoing obligation for Air Canada, no other airline in Canada has the same legal requirement, although many offer bilingual services based on demand. Under the terms of the merger, Air Canada must extend its official languages obligations to all designated flights, including those that were formerly Canadian Airlines or Canadian Regional Airlines Ltd. (CRAL). The airline's deadline for compliance has been extended to January 2004 for former Canadian Airlines routes

However, there are questions as to how successfully Air Canada has fulfilled its current obligations to date. Air Canada's ability to implement a bilingual strategy has been a matter of some concern, both to the Commissioner of Official Languages and to the Standing Joint Committee on Official Languages in the past. Both the Commissioner of Official Languages and the Standing Joint Committee on Official Languages have noted, with concern, Air Canada's difficulties in implementing a concerted bilingual strategy in view of repeated complaints of the years and its inability to deal with them effectively. For example, problems have been noted particularly by francophone communities such as les Iles de la Madeleine, which are served now by Air Nova, and hub through Halifax.

Air Canada, although committed to its program of bilingualism, has noted some specific challenges that have hampered implementation. For example, Air Canada has stated that some of the staff of Canadian Airlines Ltd. and CRAL are unilingual anglophones, and this resulted in a dilution of Air Canada's bilingual capability. Other labour-related issues such as mixing crews and seniority were identified as barriers. As well, there was some question as to whether passengers are given enough information to understand Air Canada's obligations and assess or comment on the level and quality of bilingual services they receive. Air Canada also noted that it is the only carrier required to adhere to the provisions of the Official Languages Act, and that it might be advisable to require the same level of commitment from other carriers as well.

However, there might be a light at the end of this tunnel. In a recent appearance before the Standing Joint Committee, Robert Milton was forthright and enthusiastic about the airline's commitment to official bilingualism. At the same time, the Office of the Commissioner of Official Languages has been working with Air Canada officials for some months to develop strategies for many of the issues that have caused difficulties in the past. Air Canada has implemented a number of programs to deal with this, including offering language-training programs to employees.

It appears that there is willingness on the part of the Commissioner of Official Languages, the airline and the unions to work together to handle complaints and allow Air Canada to implement a detailed and effective bilingual strategy. While there is a great deal of work to be done, I believe the desire to solve the issues is genuine, and that Air Canada will be able to report more success over time.

Stakeholders' Views

If I had to encapsulate the views of individuals over the last few months in two words, they would be "frustration and resignation". Frustration, because few feel that they are getting the air service they had been promised prior to the merger of Air Canada and Canadian, and resignation, because even fewer see a clear path out of our current difficulties.

The horror of September 11th is receding and people across Canada are left dealing with its aftermath, and the ongoing challenges of airline restructuring in Canada.

There is a great deal at stake, as the impact of air service is felt in the heart of every community. Stakeholders generally have little direct say in the operations of the airlines, and many, rightly or wrongly, believe they have little influence over government policy as well. Nonetheless, these groups feel the impacts of airline business decisions and government policies most acutely.

Urban, rural and remote communities

The "winning conditions" that most carriers look for when they serve a community are:

- Its economic diversity
- The relative wealth of residents
- The quality of its airport infrastructure, and proximity to other airports
- The quality and relative cost of other transportation options available
- The size of its tourism industry
- Number of post-secondary schools, hospitals, etc.
- The diversity of its population (which could drive demand for "VFR" traffic)

The core issue, put simply, is that many communities are caught in a classic "catch 22". Airlines fly where there is consumer demand and a diverse economy, but communities feel that they can neither build demand nor diversify their economies without first having good access.

Remote and Rural Communities

More than anywhere else in Canada, it is true when people say, "it's different here". Dealing with monopoly service is nothing new – it's been the norm for many of these communities, given their relatively small populations. Likewise, air travel has traditionally been seen as more expensive than in other parts of Canada. Some people are convinced that this means that the carriers are "cross-subsidizing" more competitive routes at their expense.

Airlines claim that higher prices are a result of less demand in less populated area. The limited data, which is available to support or reject this assertion, is ambiguous. The U.S. Secretary of Transportation released a study of rural airfares in April 1998, which found *"The available data suggest that travellers to and from small communities, as a group, pay higher fares than travellers between large hubs do[9]".*

As well, rural communities in the United States pay more than their non-rural but small community counterparts *"the data show that the average yields for city-pair markets involving rural small communities are higher in every mileage category than those for city-pair markets involving non-rural small communities.*" However, the same study found "*when fares in city pair markets involving small communities are compared to fares in large hub markets without low fare service, they are comparable*". The study also stated "*a notable feature of the available fare data is the wide variance in average fares and yields between communities as well as between city-pair markets at the same community"*

While we cannot say with certainty that Canadian communities are facing the same issues, we can say that pricing for remote, rural and small communities is a complex and unresolved issue.

For the most part, the problems and issues are the same as they were when Air Canada and Canadian Airlines first merged, and include the following concerns:

- Reductions in capacity, which has led to
    - Fewer "seat sale" tickets available for purchase
    - Smaller aircraft, which are uncomfortable for some
    - No business class seating
    - Less "belly cargo" space, which affects
        - The shipment of high-end products (e.g. live animals [for sale as pets], fresh flowers, sea food, specialty produce)
        - Specialized gear brought in by eco-tourists, fishers, hunters
    - Increased use of corporate jets in some communities, which further degrades commercial demand

[9] Rural Air Fare Study, Report of the Secretary of Transportation, April 1998

- While WestJet is a welcome player in every community it serves, some see Air Canada or an Air Canada designated carrier as essential for certain kinds of travel:
  - Networked international inbound travel for tourism and international business trade, especially from key markets such as the United States
  - Seamless, well priced long haul and international travel (through Star Alliance)
  - Accumulation and travel on frequent flyer points
  - Business travel based on high frequencies, availability of lounges and other business-focussed services

A new twist for some communities is Air Canada Regional's elimination of jet service. This could further reduce capacity and services on some routes, exacerbating some of the existing problems.

Remote issues

Some issues faced by truly remote and northern areas are clearer and simpler than those faced by their rural counterparts. The question of air service vs. air infrastructure tends to disappear when the reality is that air is the only way to access some of these communities: in certain cases, the roads (or marine ferry routes) are not passable for parts of the year, in other instances, there are no roads or other forms of access, period.

A few, like les Iles de la Madeleine, could be facing a crisis. Currently at one flight a week, Air Canada Regional announced that it would be eliminating service entirely in January.

Rural issues

Rural communities face a number of unique challenges. They have year round access through at least one other mode to the rest of Canada. Some are quite close (but not always conveniently so) to sizable regional or major airports. Many do not have very diverse economies, and rely on one or two main industries. Some lack the expertise or resources to build an air access strategy to attract new services.

The full impact of airline restructuring is yet to be felt in some of these areas. Once Air Canada has the right to exit certain routes as of January 2003, some communities may have to look elsewhere for airline service, although it is impossible to say which communities, would be affected. It is important to note that a loss of AC/ACR may not mean that communities are doomed to no service. There are regional carriers that could be interested in serving these routes, especially if they do not have to compete directly with Air Canada. However, some challenges as described in the section on independent regional carriers, may have to be addressed first.

As a buffer to the potential loss of service, a number of individuals have put forward the idea of creating an "Essential Services" program, modeled on the one in the United States. In the States, the Department of Transportation subsidizes one connection to a hub for communities that are more than 70 miles away from an airport and have lost all of their scheduled service. The program budget is $50 million a year. If you use the "1 to 10" ratio to compare Canada to the United States, that program might cost about $8 million in Canada annually.

Despite the traditional view of airports as non-competitive "natural monopolies", communities are in fact, competing for air services, as they attempt to use their airports and air service to attract new residents, new businesses and more tourism traffic.

Decisions to relocate a family, start a business, or travel to a tourism destination are highly influenced by the quality and price of transportation access, including air, offered by a community. The communities with good air service and good airport facilities seem to have a decided advantage over those that do not

The concern most often expressed by rural communities seems to be centred on the longer-term viability of airports. In the last two years, airlines have merged, gone bankrupt, reduced capacity. Consumers are travelling less now than they did a year ago. Some people are getting in their cars to travel to an airport served by WestJet, saving money, but possibly reducing demand at their own local airport. Others are just getting in their cars. The impact of these issues are reviewed in the sections under the heading "Airports"

Urban Communities

Unless the community happens to be Montréal, Toronto or Vancouver, even major urban centres are experiencing challenges similar to those felt by their rural and smaller counterparts. Some, such as Saskatoon, have standing and active committees that interact with the airlines on a continuous basis. Relationships have developed over time, and these communities have a cadre of expertise to draw on and a conduit to the carriers. This has been a positive outcome, even though few communities achieve all their air access goals.

Some mid-sized cities, which are close to major hubs, have their own challenges. Québec City is one such example, where its outbound demand is less than its potential inbound traffic driven by tourism, as many residents drive to Montréal and fly directly out of that major hub.

The availability of direct air access to other cities is a factor in attracting conventions, trade shows and business or association meetings. Those communities with direct and seamless access have a clear advantage in attracting inbound traffic than those that don't, as organizers may be reluctant to consider a city that has no non-stop connections with at least some large hubs. This has been identified in communities across Canada as a significant issue that represents millions of dollars in lost opportunities every year.

Some of these centres were significantly affected by the demise of Canada 3000, as it served large and mid-sized cities. Others are still trying to keep up with the rapid changes in the airline industry since September 11th. Routes, connectivity, equipment are all being "fine-tuned" from the carriers' perspective. From the communities' point of view, trying to understand what is happening and to plan accordingly is more like hitting a "a moving target"; to borrow one person's phrase, and trying to stay on top of the changes and deal with the airlines is a huge task.

For the international gateway hubs, the main challenge still seems to be moving people beyond the gates where the largest cuts in capacity and service are. Generally, there is still a great deal of competition, with a number of carriers serving these points, and of course, competition from other modes as well.

Provinces and territories

Although not formally considered "stakeholders", provinces and territories have felt the impacts of airline changes in their communities and on their residents. The issues for communities often end up squarely in the laps of these governments, as municipalities are provincial constructs. Provincial and territorial governments are being asked, with greater frequency, to act as interlocutors for their communities. As well, the level of air service they receive, and the federal policy, which frames it, affects their own infrastructure and regional development programs significantly.

Some provinces provide support to regional carriers or airports through programs or subsidies. All of the provincial governments have banded together to examine the issues of regional airports in a joint study, currently underway.

There is a great deal of information and knowledge at the provincial/territorial level about community needs, infrastructure, development opportunities and so forth, that can add to and expand the discussion and eventual resolution of issues around air service in Canada.

**A NEW APPROACH TO REGIONAL AIR SERVICE:
CHARLO, NEW BRUNSWICK**

Charlo had been served for many years by various regional carriers, however, with the failure of Inter-Canadien, successful scheduled air service was lost. Since that time, the Charlo Airport Commission had searched for replacement service. From discussions with a number of candidate carriers it became evident that, in the new air transportation environment created since the takeover of Canadian Airlines by Air Canada, airlines were reluctant to initiate service to small markets and take risk The Charlo Airport Commission then decided to take an unprecedented step by taking charge of its future air transportation needs, and is creating Bay Chaleur Air to begin service between Charlo and central Canada in the near future. Bay Chaleur Air is different from traditional approaches to pursuing air service in that the Airport Commission has taken the leadership role in operating this air service as a new business located in its region. It will be marketed extensively to the travel trade, in central Canada and throughout its catchment area of more than 100 thousand people, currently served only by Air Canada Regional through another airport in the region.

Bay Chaleur Air will provide both passenger and overnight all-cargo services between north eastern New Brunswick and central Canada using contracted aircraft services of sizes suited to support its market size and desired flight frequency. This 'community owned' approach will also provide the impetus for future business development initiatives for both Charlo Airport and northeastern New Brunswick. Bay Chaleur Air has received significant support from the many communities in its catchment area.

Airports

Airports of all sizes are challenged by declines in traffics, increases in costs, and the extensive expansion programs launched prior to the economic downturn, although most have the capacity to delay or scale back these projects. Some smaller airports may end up fighting for their very survival, and not all might make it.

The government will introduce a *"Canada Airports Act"* which is intended to spell out more clearly the roles and responsibilities of airport authorities and the federal government. The *Canada Airports Act* will apply primarily to the National Airport System (NAS) airports, and will also address certain concerns at non-NAS airports. It will focus on issues related to accountability to the public and users, improved governance, principles for setting fees, oversight of subsidiaries and the requirement to respect Canada's international obligations as they affect airports. The draft bill, originally scheduled for release this fall, has been postponed because of the events of September 11th, and is expected to be ready for consultation this spring. The federal government is also currently conducting a review of its rent policy for the National Airport System airports.

However, concerns have already been expressed by many members of the airport community relating to the need for:

- Rent programs that encourage re-investment into the airport network, not penalize growth (as some have claimed)
- A separate federal strategy and appropriate funding formula for small airports, which take into account their unique needs and vital role to communities
- A fairer apportioning of security costs between airport users and residents of Canada, who also fall under this umbrella of protection from acts of terrorism
- Clearer and more rationally applied safety regulations, based on a cost/benefit analysis
- The provision of commonly available aviation data.

Consumers

No one has been as buffeted by changes in the airline industry, particularly after September 11th, as travellers. Already put upon, passengers had to suffer through extended waits at airports and long lines at security. Some were stranded by the sudden demise of Canada 3000, and many were left with fewer travel options.

A fundamental problem is that the major power of the consumer to discipline a business by using another's service is difficult if not impossible, given Air Canada's dominance. Often, there is no choice.

All of this has exacerbated a common view that travellers are ill served by the current environment. For example, Air Canada frequent flyers have complained about delays in accessing Aeroplan flight benefits and that there are more restrictions on using the benefits. Air Canada has modified its plans somewhat in response, but not before angering a sizable number of frequent flyers.

At the same time, services such as hot meals have vanished from some shorter-haul flights. People in the Yukon have noticed the changes most acutely, as their AC flights between Whitehorse and Vancouver are now considered "long haul" if they're using points. As a result, what used to "cost" 15,000 Aeroplan points now costs 25,000. On the other hand, the flight is considered a short-haul when it comes to food service, and no hot meals are served.

Bruce Hood, the Air Travel Complaints Commissioner, has proven to be a valuable asset to Canadians, mediating and helping redress issues. Since July 5, 2000, the Commissioner acted upon 2,603 complaints, or 89 per cent of the total number received. Overall, 43 per cent of complaints under the Commissioner's jurisdiction were resolved at the close of the second reporting period, June 30, 2001.

It's impossible to say how many complaints don't make it to Mr. Hood's desk. He estimates he receives only two percent of total complaints. That's staggeringly small, and we can only assume and hope that the carriers are successfully responding to clients' concerns on their own. Air Canada's Customer Protection Plan has met with some success, and many people have told me that wait times on the phone have been reduced a great deal and that service has generally improved.

Neither the conditions of contract (tariffs) nor the pricing policies (yield management) are well known or understood. In other words, consumers don't know what they're paying for and why they're paying it. Is it any wonder that people are distrustful?

For consumers, choice is power. Without it, any thing else can only do a partial job of ensuring that customers are well served.

Business

Virtually all businesses are affected, to some degree, by the quantity and quality of air service, and how it can be used as a tool to attain business objectives. The two business sectors that seem most affected are travel agencies and tourism. The impact on tourism, which is a key contributor to many local economies, also has significant economic impacts on many other businesses in the communities as well.

Since September 11th, the Canadian business community has been leading efforts to ensure safe and trade-efficient borders. While much of the discussion has centred around moving goods by land or waterway, the implications of a corridor that is safe yet also facilitates trade has implications for the air system as well.

Our business climate (and therefore, business travel) is dependent on the growth and health of our trade relationship with the United States, which represents about 87% of Canada's international trade.

A business-led Coalition for Secure and Trade Efficient Borders has prescribed a number of recommendations and solutions needed to foster a strong border. Among these are:

- That the necessary resources – funding, people, training, technology and infrastructure, must be allocated by government
- Transportation issues affecting all modes must be addressed

The Coalition also prescribed actions for international travellers entering Canada through airports, and identified the importance of expediting the entrance and movement of low-risk goods that have entered our country.

Travel Agents

Virtually no travel agency in Canada has been unscathed by the events of 2001. Sales are down – both business and leisure. At the same time, agents must stay on top of a swirling and troubled airline industry that is fraught with scheduling changes, capacity reductions, bankruptcies and more.

Issues for travel agents and travel agencies have been reported in previous reports of the Observer. While the issues today are similar, most have been exacerbated by the events of 2001. More than ever, travel agents are the "intermediary" between airlines and passengers, having the responsibility to explain the hows and whys of the fares and fees, the changes to schedules, to services and so forth. Agents are traditionally the "agents" of the travel providers, but they must also serve their customers. Agents must deal with Air Canada's dominance, and the pressure to sell Air Canada internationally, in order to get their "override" bonuses on domestic ticket sale. At the same time, they want to provide their customers with options and choice. As a result and understandably, agents can find themselves in the middle of an uncomfortable situation.

Because of the decline in traditional revenue, many agents are charging service fees to customers. While this is understandable, the agency's fee is one more "user fee" piled onto the customer. There is also the impact of Internet ticket sales that must be considered. Many airlines, including Air Canada and WestJet are offering special "web" fares. Not only is this an issue for some consumers, who might not have access to the Internet, it could undercut the prices that travel agents are directed to charge by the carriers.

Despite these challenges, travel agents remain an integral part of the airline's distribution service, as well as an important resource for consumers. Given all the changes and challenges in their sector, it might be an appropriate time to re-examine all of their working relationships and define a new and innovative role.

For example, agencies are the repository for a great deal of information on passengers and on ticket sales. Can we find appropriate ways to use this information to assess passenger risk or to source some of the data that many are seeking? As well as data, agents have a great deal of knowledge and expertise in airline matters. Should we look for a way to use this invaluable resource to better inform travellers?

While the challenges for agencies are very great, the opportunities may be even greater.

Tourism

Tourism is affected in two ways by the airline industry. The first way affects those Canadians who wish to travel. Their concerns are covered for the most part under the section "consumers". The second impact that the airline industry has on tourism is inbound travel: the tourism that brings visitors to our communities, supports our attractions, hotels, restaurants, provides employment and creates wealth across Canada.

Tourism is a highly competitive business, and there are many similar tourism products to be had. You can ski in Banff or Whistler, but you can also ski in Vail or G'staad. Price/value and ease of access are important determinants as to where people travel.

September 11th has been seen by some as an opportunity for Canadian tourism. A number of studies have supported the notion that vacationers, particularly Americans, want to travel to some place that isn't too far from home and that has a safe reputation. Canada certainly fits that description. In recent months, the Canadian Tourism Commission, in cooperation with Industry Canada launched a new marketing program both in Canada and the United States to encourage people to travel in and to this country.

However, international and American tourists have to get here first. If they want to get to Canada in the most seamless way, it helps if they live in one of the 800 communities served by Star Alliance. If they are using a charter, their tour operator may have to find a replacement for Canada 3000.

Some communities have reported that while the level of air service they receive is adequate for outbound demand, it does not provide enough capacity or opportunity for inbound travel for conventions and other types of large-group travel. In many cases, travellers have to be accommodated over several flights – which could take days. Convention planners and attendees tend to favour locations that they can get in and out of quickly and easily.

Traditional airlines seem to have mixed feelings about leisure travellers. Vacationers are not like the much sought after (but vanishing) high-yield business flyer, who provides steady and lucrative demand over a year. Vacation travellers create high demand for short periods of time – its difficult for carriers to match equipment with the blips. Also, vacationers represent a lower yield – they don't pay as much. Until the downturn, full service carriers saw low-fare travellers as a secondary customer base. Today, however, that might change, as they try to capture that market share as well.

Tourism operators have continued to report issues both with Air Canada and with WestJet, but for different reasons. Getting people beyond the gateways continues to be the critical challenge. Moreover, according to some inbound operators, Star Alliance does not have the strength in the Asian market that Oneworld had. Canadian destinations are losing out as a result. WestJet doesn't interline, so vacationers have to buy two tickets, get off their international flight, get their bags, and check in again at a WestJet counter.

The benefits of a strong tourism industry are felt locally, and many smaller communities have noted the loss of tourism opportunities caused by the airline situation. Some the most attractive destinations from a tourism point of view are some of the most expensive and difficult to get to, as they are the most remote. Ironically, often these areas can benefit the most from tourism to diversify their economies and develop new employment and business opportunities.

Airline Employees

The second report of the Observer attempted to sketch out the some of the difficulties faced by Air Canada employees. The subsequent months have taken even a larger toll. Air Canada is still in the process of merging seniority lists. It's a complicated and delicate process that requires willingness to compromise and work together. This is made even more difficult by the clash of airline cultures that, according to some employees, is still very much a part of their day-to-day world. Shrinking capacity and reducing costs not only affects those who are, or will be, let go. It also means that moving up the seniority lists will take longer, too, and some employees may never reach their career goals. As most pensions are based on "the best six years", the effects could last well into retirement for some.

Another human cost for Air Canada employees is the toll of working for a company which is arguably up for "The most reviled company in Canada" award. Front line staff at check-in counters and flight attendants endure the most of the public's anger. Those who have dedicated decades of performance and loyalty are faced daily with media's reports of how bad their company is. All of this is being played out against the hard fact that Air Canada is losing a great deal of money, and the future can seem as uncertain as the past. On the other hand, union agreements are sometimes pointed to as one of the barriers to airlines' ability to compete and to maximize profits.

The answer here is far from simple or clear. Air Canada is still struggling to merge the two airline labour groups – and while they have covered a great deal of ground, the process is not over. Government's role seems limited to the functions of the Canadian Industrial Relations Board and Employment Insurance funds and programming that is available through the Department of Human Resource Development. Airline employees have not been singled out for any special consideration, compared with employees facing similar challenges in other sectors.

Data: The Importance of Knowing

"…the need for airline financial and traffic services did not end with deregulation. The responsibility for air service improvements has now shifted to the communities and carriers. Their effort to identify service needs and attract carrier service has produced a broader demand for the statistics. Airlines, too, have shown an increased use of the traffic and financial information as they monitor and adjust their competitive position and look for new route opportunities"[10]

INFORMATION SEEKERS' TOP FIVE[11]

The most frequently demanded types of information are:

1. Detailed and timely information for all areas
2. Average fares by market or market segment
3. Number of passengers by market or market segment
4. On time, delayed and cancelled departures
5. Lost baggage and consumer complaints

One of the barriers to solving our aviation issues is simple: we don't really know what we're talking about. To put it another way, many stakeholders lack the data – the basic information – to analyze the current state of air service and build economic or marketing strategies based on current, detailed numbers.

Little timely and detailed data has been collected since deregulation on passenger air service and virtually none at all on air cargo. Even more problematic, the limited data that has been collected (two year old market-level passenger origin-destination data for domestic Canadian air journeys) has been suspended effective the first quarter of the reference year 2000.

Under the Statistics Act, the department cannot release corporate data that would reveal specifics about any single company. Given Air Canada's dominance, a general release of aviation data would mean that Air Canada's proprietary information would be exposed. Beyond that, a number of other carriers are the only ones serving some destinations. Their specifics would also be public knowledge, potentially making them prey to other carriers' competitive actions.

This is not to say that no data are available at all. There are common tools, such as the Official Airline Guide and Bank Settlement Plan (BSP) that are available and used by both airlines and some stakeholders. However, these tend to be somewhat limited, expensive to purchase, and require a high level of expertise to run and analyze. While some Canadian airports and communities are using these options, many others lack the resources.

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[10] U.S. Department of Transportation, Bureau of Transportation Statistics, "Collection and Distribution of Airline Statistical Information at the United States"

[11] The term and use of a "Top Five" list should not be considered priorized or all encompassing. It is intended simply to impart information in a reader-friendly way.

The Minister of Transport recognized the issue as serious, and called a one-day Forum on Aviation Data in June 2001. This forum was the first opportunity for stakeholders and airlines to publicly state and debate their points of view, and is a valuable benchmark. However, the events of September 11th and the subsequent decline in domestic competition have given the issue a new urgency and have reinvigorated the call for action.

> *"A few carriers, initially reluctant to collect and report the required statistics, later recognized the benefits of the structure and content of the information"* U.S. Department of Transportation

There is a need to weigh the "greater good" of disseminating information that may be in the public interest with the need to protect commercial confidentiality. There is little doubt that airlines would use this information to compete even more vigorously, and it's no surprise that the airlines are very reluctant to "open their kimonos" as one airline representative famously described it.

However, many industry watchers believe that clear and forceful anti-predation laws would mitigate the impact, and some think that these data would help the competitive environment, as carriers would be able to assess new market opportunities. This view is supported by the U.S. Department of Transportation, which noted that because of its own collection and dissemination of detailed aviation statistics that "*A few carriers, initially reluctant to collect and report the required statistics, later recognized the benefits of the structure and content of the information".*

Despite the Statistics Act, and the competitive impact on the release of this information, the call for improved data is vocal and wide spread. The Canada Transportation Act Review panel supported the view that more information is required, noting: "*The Panel was struck by the inadequacy of data on the airline industry. Better data would facilitate more in-depth research, would give observers a better basis for assessing the performance of Canadian carriers and would help participants and potential entrants identify new opportunities"*[12], and recommended "*that* ***the government and transportation industries expand the collection of transportation data*** *and develop new procedures to reflect changes occurring in the domestic and global economies*"[13] This view was confirmed in Transport Canada's 2000 Annual report, which stated: "***Data availability has always been a key limiting factor*** *with this annual report. Ideally, it should cover the year 2000 throughout, but this* ***up-to-date reporting occurs only where the necessary data were available****. (emphasis mine)"*

On the consumer side, Bruce Hood, the Air Travel Complaints Commissioner, noted in a recent report, "Full disclosure of performance records would allow the public to evaluate a carrier's quality of service on an informed and reasonable basis. It also would help interested parties to better understand the challenges that face the air

[12] "Vision and Balance", final report of the Canada Transportation Act Review Panel, June 28, 2001

[13] Ibid, Recommendation 18.2

travel industry, from a carrier's perspective. Voluntary disclosure of vital service statistics would reflect the Canadian air travel industry's collective and individual commitment to providing the highest level of service for its customers"[14]. The report then went on to recommend the voluntary or legislated collection of these data.

The Tourism Industry Association of Canada, representing tourism operations across the country, recommended increased and improved data collection and dissemination, stating *"TIAC observed that **improved data requirements will make for better policy formation, will act to keep air carriers competitive and will ensure that consumers are better informed**"*[15]. Airport Authorities, communities and consumer groups have supported these views.

In contrast to Canada, the U.S., as noted, does collect and disseminate detailed data. This difference may give American communities a significant advantage over their Canadian counterparts in some areas, such as tourism marketing, where pricing can be finely tuned to marketplace realities, while Canadians must rely on relatively expensive tools that can only approximate the same information.

[14] Air Travel Complaints Commissioner's Report, July 2000 to July 2001

[15] "Flying Forward: Options for Air Policy and the Tourism Industry in Canada, October 2001

THE ADVANTAGES OF DETAILED DATA

- Government departments and agencies would be able to monitor the airline industry with a great deal more rigor, and develop policies, programs and strategies based on fact-based and standardized data
- Canadian tourism, businesses, consumers, airports and communities would have equivalent tools to their United States counterparts and be able to compete on a more equal basis
- Cargo strategies could be developed in a more formalized way, and could lead to new revenue options for Canadian airports
- Communities and businesses could develop strategies to attract new services, review pricing policies and rigorously analyze the impacts of the service they are receiving
- Carriers would have better tools to identify new market opportunities, potentially increasing competition
- The information gap has created an understanding vacuum. Better and well-communicated information would lead to a better understanding of the realities of the airline industry, empower stakeholder groups, and engender a greater sense of trust between stakeholders and airlines
- The information would be available to all, ensuring a better level of equality of opportunity for regions
- Consumers could track improvements (or reductions) in quality of service over time and make appropriate and informed decisions
- Issues around proprietary information release may be eased by an examination of the American system, where statistics on major carriers are made public, despite high level of hub dominance by single carriers.

THE DISADVANTAGES OF DETAILED DATA

- More detailed data isn't a panacea. It will not, in and of itself, ensure any improvements in service or competition, while it might make the business of running a scheduled airline more complex. Taken to an extreme, a requirement for high levels of data may dissuade new entrants from coming into the marketplace, as their early strategies would be revealed to the competition
- Some data might be open to misinterpretation. How does one assess flight delays in inclement weather? Most passengers would accept delays happily for security and safety reasons. (e.g. de-icing, baggage checked without the owner boarding the flight, etc)
- Statistics Canada would not be able to release this information under its present statutory obligations. The law would either have to be changed or another institution would be called on to collect and disseminate the data
- Airlines would become obvious and easy prey for each other, increasing the possibility of increased bare-knuckled competitive practices; some airlines could be seriously harmed
- Airlines would face an increase in their paper burden; compliance or accuracy in reporting may be poor, making the data virtually unusable or misleading, an issue that has been of concern to officials in the United States in their own data collection.

HOW THE AMERICANS DO IT

Federal law requires the Department of Transportation to collect statistical and financial data on the following:

- **On-Flight Traffic Statistics:** (aircraft of 60+ seats)– monthly, quarterly reports contain segment, market traffic and capacity by airport pair, aircraft operating statistics by aircraft type and enplanements by airport. International segments information is withheld for a period of time
- **Financial Statistics:** (aircraft of 60+ seats)– filed quarterly or semi-annually, financial reports that include: balance sheet; statement of changes in financial position; P&L; aircraft operating expenses by aircraft type; operating expenses by objective and functional groupings and changes in aircraft fleet inventory as well as fuel usage and cost
- **Origin and Destination Survey of Scheduled Passengers:** (aircraft of 60+ seats) 10% survey of all tickets used in scheduled service, including a full ticket itinerary, operating and advertised carrier, fare basis codes and total ticket value
- **Domestic On-Time Flight Statistics:** (12 of the largest carriers) – on-time and cancellations, by flight number, by day of months; mandatory filing in markets of largest 31 airports; voluntary for other domestic markets
- **Non US Carriers:** similar to "On-Flight Traffic Statistics" above (for all carriers landing at a U.S. point and "Origin and Destination Survey of Schedule Passengers" as above for foreign carriers granted anti-trust immunity, limited to tickets with a U.S. point (this data is only available for government use
- **In addition the DOT also collects:** consumer-related data such as denied boarding reports, consumer complaints and carrier notifications to terminate service at small and remote communities.

Data collection, editing and processing:

- Requires a staff of 25 and budget of $(US) 4 million.
- Two-thirds of U.S. carrier data submitted electronically
- Data entry and validation software has been distributed to regional carrier industry
- All reports submitted to DOT are accompanied by a certification of accuracy signed by an officer of the airline

Data cycles:

- **Monthly traffic statistics**: due within 30 days after the month, processed in 30 days by DOT; net, 60 days old
- **Monthly on-time statistics**: due within 15 days after the month, processed in 20 days by DOT; net, 35 days old
- **Quarterly financial statistics**: due within 45 days after the end of quarter (90 for 4th quarter) processed in 75 days by DOT; net, 115 days old
- **Quarterly regional carrier traffic statistics**: due with 40 days of the end of the quarter and processed within 75 days; net, 115 days old
- **Origin and destination survey**: due within 45 days of the end of the quarter and processed within 75 days; net 120 days old. Foreign carrier information is restricted from public disclosure

HOW THE AMERICANS DO IT (continued)

Distribution of Airline Statistics

- **Direct Data Bank and File Access**: Accessible within DOT and subsets made available to other federal departments
- **Electronic File Subscription**: Commonly used data subsets are created for subscription sales of e-files, available for purchase by the public
- **Recurrent publications**: Edited data run through programs that generate several monthly and quarterly statistical publications, available for public purchase
- **Public Reference Room**: hard copies available to the public
- **Web Sites** – the DOT Bureau of Transportation Statistics; Office of the Secretary and the Office of the Assistant Secretary for Aviation and International Affairs all have a number of aviation statistics and statistical reports available on their web sites
- **Resellers**: several companies purchase the data and in turn produce proprietary data products and extractions which are sold

Uses and users

- **Federal government – DOT/FAA**: transportation decision and policy-making; negotiation of international agreements, monitoring competitive behaviour; antitrust and merger analysis; airport and airways planning, distribution of airport improvement funds (and other uses)
- **General public**: interested in consumer-related information, including complaint history, quarterly fare reports, and on-time/flight cancellation data
- **Airlines**: marketing and price planning, efficiency comparisons, identifying new market opportunities, flight and crew scheduling and competitive evaluations. The DOT notes “New carriers, initially reluctant to collect and report the required statistics, later recognize the benefits of the structure and content of the information”
- **Local and regional governments and airport operators**: Communities are aggressively using the available statistics to identify needs and potential solutions and market them to potential carriers. This is seen as critical to DOT as under deregulation, the communities are responsible for assuring existing and improved air service
- **Other organizations** using the data include tourism and travel related enterprises (vehicle rental companies, tour organizers and complementary and competing transportation modes)

Issues and Options for the Future

Where do we go from here? Few people are happy with where we are, but it seems that even fewer agree on what the solutions might be. There are also different types of questions. Some are large and complex: should we re-regulate the entire airline industry? What happens if Air Canada needs a cash infusion to survive? Some are smaller, but no less complex: should we subsidize certain routes to assist economic development?

There are a number of options. We can support Air Canada to ensure that we have a Canadian carrier that serves our needs. That support can range from tweaking the regulatory environment to returning Air Canada to a crown corporation, owned by taxpayers. We can continue with our current course of action, which is to develop Canadian competition in a relatively unrestricted environment. We can push for new carriers to come into Canada, reciprocally, which would take longer, but open new markets to Canadian carriers, or unilaterally, which might give some communities "instant" new choices, but could also weaken our own carriers – including Air Canada and WestJet.

On a slightly different tack, we can decide to assist the airline industry – subsidize marginal routes, provide loan guarantees to carriers, encourage investment in airlines. We could lower the input costs – taxes, fees and so forth.

Clearly, we could do many things. It's far more difficult to determine what we **should** do to get the outcomes we need. This section reviews some of the options that have been raised most frequently. More details on the "pros and cons" of these recommendations are found in Appendix I "Weighing the Options".

Should we protect our airlines?

Canada has already lost carriers. Since the merger of Air Canada and Canadian Airlines, Canada 3000, Royal Aviation, CanJet and Roots Air have disappeared. Air Canada is facing serious problems, as is Air Transat. Because of the importance of air transportation to Canada, the carriers' problems become our problems as well.

There are two very different views about protecting "Canadian" carriers. One view is that having a "made in Canada" airline industry is essential, as Canada, with its relatively small population and large land mass cannot rely simply on foreign carriers to serve us adequately. The second view has much more faith in the marketplace, and believes that market-driven solutions offer the best option for Canadians.

The government has been trying to encourage the development of "made in Canada" competition. However, the current crisis in the airline industry has made this a more difficult goal than anyone could foresee.

What seems to be clear, now, is that the airline industry's instability is its norm. This is not the first economic crisis to bring carriers to their knees, nor unfortunately, is it likely to be the last. There are a number of options that the government can take, in the short and long term, which recognize and compensate for the airline industry's instability.

Increasing Competition

Air Canada dominates. Its extensive network offers more destinations (both domestic and international), more perks and more flights per day than any other carrier flying in Canada. On the other hand, there is competition at the gateway hubs, which are served by other international carriers. WestJet is competing successfully on many routes to the point that in some markets it has more than 50% of passengers and is continuing its expansion program. Independent regional carriers also provide competition in certain markets. Some new charter services have been launched, and are beginning to fill part of the void left by the demise of Canada 3000. However, there are many smaller destinations in Canada that have always been served by only one carrier, and that hasn't changed at all.

Since the merger, Air Canada stands alone in providing full-service, networked carriage for domestic passengers. With reductions in high-yield demand, it is now beginning to compete for the low-fare segment of the market, which is WestJet territory, while keeping its network intact.

The first option we have is to increase competition. Theoretically, increased competition should provide a number of benefits: better service, more choice and lower prices. However, it should be noted that when some people talk about the importance of "competition" they really are referring to "low-fare tickets", and don't care how many airlines serve their community. That might be a bit shortsighted, as true competition can deliver benefits that go beyond mere price. For this reason, competition is the most desirable outcome.

Increase Opportunities for Canadian Carriers

Many people thing that this is the ideal "made in Canada" solution: a competitive airline industry that is "for Canadians, by Canadians". The question is how to best achieve this goal, given Air Canada's current dominance.

Increasing carriers' opportunities by decreasing Air Canada's capacity

One suggestion has been to limit Air Canada's capacity. If Air Canada is forced to reduce its market share, other Canadian carriers might fill the gap. Few people with whom I spoke seem comfortable with the idea. Some people believe that they could be worse off, with AC capacity cut, but no new service arising to replace it, or that the new service would offer less capability than Air Canada might have. There are also some unanswered questions: what would be cut, where, and who would decide? Would the new carrier be able to offer the same joint fares as Air Canada would? Would the government offer incentives to ensure a certain level of service, and if so, how would that be determined? These issues must be addressed before this concept can be further reviewed.

A variation of the above proposal is to have Air Canada divest Air Canada Regional, providing another "network" in Canada. The advantage of this idea would be that this new regional airline could not only serve secondary and tertiary markets, but also could grow, and eventually attract a second global alliance into Canada. This idea has a number of supporters. However, in order to ensure that the "new" independent regional carrier could be viable, a number of issues would have to be resolved. The new carrier would probably require the elimination of current "scope" clauses. It might want to code share with more than one carrier. There is no certainty that a buyer would be found. Even if all of this was in place, there is nothing in the law currently to prevent Air Canada from starting another regional service. The idea of divestiture of ACR has potential, but must be thought through thoroughly to ensure that if this action were taken, it would lead to a viable and sustainable carrier.

Removing barriers

While artificially restricting Air Canada's market reach and/or size is an option, an alternative or parallel solution could be created, which would increase competitive opportunities for other carriers. Two that have been proposed are to enhance financing opportunities, such as a loan-guarantee program and to re-examine the provisions of C-26 to ensure that other carriers are operating on a "level playing field". Both of these are quite complex, and require careful examination before the appropriate actions could be taken.

Another financial barrier to Canadian airline development that has been identified is the limit to foreign ownership. An increase to 49% could stimulate investment, many feel, and provide new sources of capital, and may allow foreign carriers to have a greater stake in the Canadian airline system. Critics have said that without reciprocal ownership provisions, this is merely a back door into the Canadian market. However, despite the concern, many people have pointed to this limit as something that can be resolved quickly, and give all Canadian carriers access to foreign capital.

Increase Foreign Access to the Canadian market

Globally, there seems to be a general (although incremental) push toward increased liberalization. The European Union now has a Common Aviation Area – any European carrier can fly between any European points. This common aviation area has replaced the traditional bilateral, country-to-country agreements between member states. As well, given the recent ruling by the Advocate General of the European Union, the EU may soon be allowed to pursue a multi-lateral approach to open skies agreements with non-member states as well. The United States seems to be headed towards more Open Skies agreements. (However, in practice, the US model appears more restrictive than first supposed). The Canada Transportation Act Review Panel recommended that Canada, the United States and Mexico enter into negotiations to achieve a North American Common Aviation Area.

A hallmark of most agreements, whether bi-lateral or multi-lateral is their symmetry – they are reciprocal, offering the same opportunities for signatories in one another's markets. There is vigorous debate on the merits of keeping a "reciprocal" policy vs. moving to a "unilateral" liberalization program.

The advantages of reciprocal agreements are that Canadian carriers can compete fairly in both markets. The disadvantage is that reciprocal agreements are slow – even if you can reach agreement, the process may take years. Unilateral agreements simply open our doors to other carriers – a boon for those seeking options that are more competitive – but don't open foreign markets to Canadian carriers. Some have suggested that a unilateral agreement would be the end for Canadian-owned airlines.

There are a number of ways that Canada can liberalize its domestic market. Some of the most-often discussed options are:

Right of Establishment. This would permit a 100% foreign owned domestic carrier to operate in Canada. The advantage would be the potential development of a new national network, which might offer international destinations through a non-Air Canada alliance, such as Oneworld.

Modified "6th freedom". This would allow U.S. carriers to fly passengers between Canadian points, but through an American hub, for example Toronto to Vancouver via Chicago. This measure has been touted as a good first step to further liberalization, and would increase choice for travellers. However, given the heightened security at U.S and Canadian airports, and more importantly, the requirement to clear both Canadian and U.S. customs just to travel between Canadian cities, this option may not be practical at least in the short term.

Full cabotage. This would allow a foreign carrier to serve two or more Canadian points before returning home – for example, Seattle – Vancouver – Calgary – Seattle. This could attract new foreign carriers into the Canadian market as they could fill seats at two locations rather than just one, providing more options for travellers. However, critics believe that this would lead to "cherry picking" the most lucrative routes, weakening domestic carriers and potentially harming the longer term sustainability of the Canadian air transportation network.

Liberalized bilateral agreements. Although these agreements apply to international routes, many people have noted that at least to some degree, the domestic and international airline routes are closely related, and the liberalization of international agreements could help strengthen the entire network, including domestic routes. Liberalized bilateral agreements would affect the current rules of negotiating air service with foreign governments, without changing the game itself. Proponents, such as the airports, have asked to be part of the Canadian negotiating team to ensure that stakeholders as well as airlines are heard. Another suggestion would change the terms of the agreement, and allow an interested foreign carrier to fly into this country, even if there is no Canadian carrier that wishes to reciprocate at that time.

Increasing Demand

Nothing assures service more than demand. However, given the economic downturn, and lingering effects of September 11th, fewer people are flying and those who are want to pay less and be subject to fewer restrictions.

Since demand is a reflection of the health of the economy (the stronger the economy, the more people want to fly for business and pleasure), the best cure is a rapid return to economic health. However, there are actions that have been suggested for the short term that could mitigate the impact of the slowdown on airlines.

Reducing the cost of flying

Much has been said recently about the "hidden" costs of flying --- user fees that are piled on passengers. The most recent, the security fee, is being seen by some as the last straw – and could negatively affect people's decisions to fly. To stimulate travel, government could consider reducing or eliminating some of the fees and taxes it is currently imposing on the airline sector. A few that have been noted are: aviation fuel taxes, the new security fee and airport rents. However, if these are removed or reduced, some of the burden could be shifted to taxpayers – and there are arguments both for and against this shift. Moreover, we would have to be certain that any cost-reductions would be passed along to consumers.

Tax Incentives

Another idea that has been proposed is that government stimulate travel directly by creating tax incentives for travel, or indirectly, by introducing a general economic stimulus package. However, in practice, these type of government interventions tend to be costly to taxpayers, vulnerable to abuse, of limited value, and their effectiveness very difficult to measure. Congress has stalled the frequently touted economic stimulus package in the United States, yet the economy seems to be recovering on its own both there and in Canada.

Facilitating trade

Perhaps one of the most practical and useful suggestions to stimulate demand is to continue to work on liberalized cross border movements, given the importance of trade with the United States to Canada's economic health. Canada is already engaged in discussions with the U.S. in this regard, and what will benefit Canada as a whole will almost certainly benefit the airline sector as well.

Re-regulating the airline sector

The idea of imposing new and extensive economic re-regulation on some or all of the airline industry is a hotly debated topic, and has become more so over the last few months.

Essentially, the "pro" side argues that deregulation hasn't fulfilled its promise, which was to increase choices and lower prices for consumers. To those who favour re-regulation, there is little in the way of consumer choice, we have lost our ability to use air service as an extension of national economic or social policy, and have no control over the dominant carrier whose main objective is to return to profitability, not serve Canadians. For those who view air service as a public utility, nothing short of heavy government intervention will do the job.

However, it should be noted that the "good old days" of regulation were perhaps not so good in reality. "Ottawa" decided which carriers would fly which routes and at what price. Communities had to take what they got, for the most part, with limited intervention. Consumers complained about the quality of service. Government was accused of lagging behind the marketplace, and was not able to demonstrate either agility or innovation.

If air service is too vital to be left in the hands of airlines and consumers, a new approach by government would be necessary. It is difficult to conceive of what that might be, but it is unlikely that one can simply turn back the clock to 1970 and expect positive results. As one person said, "I might be in favour of re-regulation if I could believe that we wouldn't be worse off than we are now."

Other government measures

Some stakeholders have recognized that the traditional tools that government has used in the past may not be enough to solve today's issues, and have suggested a broader nexus for discussion than only air transportation policy.

Integrated transportation policy

The first suggestion is to create a new integrated national transportation policy. Transportation modes differ in terms of funding mechanisms and jurisdictional oversight. Yet, it must be assumed that each mode serves a similar end for Canadians – encouraging trade, linking communities and so forth. The Transportation Blueprint initiative could serve as a launch pad for a new and integrated transportation policy; one that brings together different modes in a cohesive way, and recognizes and incorporates the needs and abilities of different jurisdictions. For example, better integration of rail/road/air may help resolve some regional access issues. This would be a significant undertaking that could provide long term and forward thinking solutions to transportation challenges generally, and air issues specifically.

Essential Services Program

Although the development of integrated transportation policy could hold great promise for the future, short-term solutions are also required. One idea that has been espoused is the creation of an "Essential Services" program, similar to that in the United States. Some people have raised a concern that carriers could leave routes that are being paid for by travellers and return when the route was being supported by taxpayers - subsidized, but limited service, could be a barrier to the creation of locally-based and innovative access strategies that promote long term growth.

However, properly focussed and with clearly defined rules, an Essential Services program might help communities bridge short term challenges, such as when Air Canada can vacate routes as of January 2003.

Regional Development Programs

For some communities, good air access is an essential part of their strategies to increase their economic diversity. Seen in this light, air access seems more of an issue of regional development, which focuses on growth opportunities for Canadians rather than one of transportation policy, which is concerned with the health and performance of the national transportation system. If one considers air access as part of regional development, it may be possible to access the existing programs and funding mechanisms such as the Atlantic Canada Opportunities Agency (ACOA) or Western Economic Diversification Canada (WD) to support air access goals. On the face of it, this approach seems to meet the challenges as expressed by many rural and small communities: that air access is one of the elements they need to be competitive and to diversify. As well, some communities may have already approached these organizations. However, it might prove more effective to create a new program element for air access rather than deal with it on an ad-hoc basis.

Critics dislike the regional development programs generally, and do not think air issues would be well served by inclusion in these initiatives. As well, others have raised a concern that the demand for program funding would be overwhelming, and could not be met under current funding formulae.

Increasing information to stakeholders

Few people were prepared two years ago to deal with the challenges they now face. Prior to the merger of AC and CAI, many communities had excess capacity. Now they have to make a business case to carriers, sometimes successfully, sometimes not. The over-capacity meant that few regional carriers moved into either Canadian Airlines or Air Canada territory. Today, capacity cuts and changes in routes (with more to come) have opened opportunities for many small carriers. But they must "home-grow" the expertise. Customers cannot rely on competition in the marketplace to discipline airlines and ensure service. They must be more demanding. But to do that, they have to know what their rights are.

This suggests that there is a significant knowledge gap in Canada. People must be able to convert numbers into information if they are to make informed decisions and create new opportunities for air service.

As a result, new information sources or products may be needed. For example, non-scheduled airlines may want to explore the possibility of expanding to scheduled service, but need to assess the market and the cost/opportunities. Communities may need help in developing access strategies that airlines would respond to. Passengers might need information on their rights. While it is not necessarily government's role to provide this information, it might be useful for government to work with stakeholders to identify these needs and develop cooperative programs to fulfill them.

Conclusion: Can the Airline Industry Be Fixed?

The combined events of the economic downturn and September 11th exposed weaknesses in the airline industry, and gaps in government policies. These may have self-corrected if the world unfolded as we expected on September 10th. Unfortunately, that was not to be.

The events of the latter part of 2001 have acted like a case of the flu on civil aviation: a temporary and correctable illness in the healthy; a devastating and potentially fatal blow in the ailing. An American regional carrier, Midway, closed operations on September 12th. In subsequent weeks, it was followed by Swissair, Sabena (Belgium), Ansett (Australia), and of most concern for Canadians, Canada 3000. Air Canada is still on its feet, but deeply wounded. The airline industry's troubles are not over. For government, new circumstances forced a re-evaluation of the adequacy of its policies, laws and regulations.

The harsh realities

I am convinced that we will not only solve, but also best, any challenges we face. However, we have to face some harsh realities. We have to deal with the fact that every solution seems to breed a new set of problems. Economic re-regulation can mean stability and assurance of a basic level of service, but it can also stifle innovation and breed inefficient, mediocre and bureaucratic airlines, paid for by every taxpayer in the country. Fully opening our routes to foreign carriers may mean robust competition on some routes, but may also lead to our skies becoming little more than "branch offices" of big foreign carriers, with little accountability to Canadians or our government. Some think that allowing foreign carriers into this country unilaterally could spell the end of "made in Canada" airlines.

Airlines exist in a state of uncertainty – profits turn to red ink, airlines struggle, and some even fail. It seems to be the natural order of the industry, but it makes it very uncomfortable for consumers and communities, for whom reliability and stability are important. Governments can step in and create a form of stability (some would argue that what governments create is not so much a stable as a static environment), but at best, their efforts are "band aids" and do not deal with the underlying dynamics of airlines.

Another reality to face is that we're demanding a great deal, and may not be able to get everything we want. We want safe, reliable, reasonably priced, quality, competitive service no matter where we live or what local demand is like. We want an airline industry that supports regional development goals and enhances our communities' growth and well-being. At the same time, the airlines need to make money, and investors want to see their share values increase. We may not be able to achieve all of it, given the vast size of our country and the relatively few people who populate it.

Air service is expensive, and becoming more so, yet more user-fees are piled on to passengers. Taxes, navigation fees, airport improvement fees and now security charges are all the customers' responsibility. Until now, it didn't matter quite so much – people were flying in ever increasing numbers and the imposition of these charges didn't appear to slow them down. However, that was in the heady days of the 1990s. The most recently announced user fee, the Air Travellers Security Charge is to be implemented during an economic downturn. For the first time, user-pay policies may lead to a decline in traffic, and a further reduction of capacity serving Canadians.

Airlines need to plan, but we don't even know what the airline sector will look like in the future. Full service carriers have lost their traditional client base. This is a serious problem for airlines that have spent the last ten years courting big spenders with points, frequencies and upscale services. All of this costs the carriers a great deal, and currently, very few customers seem willing or able to pay. Are we seeing the end of high-cost airlines that cater to high-end business travellers? If the examples of WestJet and the other low-fare carriers are any indication, we might be. Today's airline passengers seem to have borrowed a phrase from the 1992 U.S. election, "It's about price, stupid!" and virtually the only airlines making money and attracting passengers and investors around the world are those that follow the same model as WestJet.

As appealing as the low-cost, low-fare model is, the rush to compete in that market may be difficult. Traditional carriers, including Air Canada, will have a difficult time shifting down; not because they don't "get it", but because their entire business model has been following a very different, and perhaps entrenched, approach for years. To add to the confusion, the potential market for low-fare service is still unknown. We are at the bottom of the economic well – and no one is taking bets on what our recovery will look like, or even when it will happen. It may be economy prices that matter for now, but what about in six months or in a year? The only certainty is that the economy will eventually pick up. If history is a guide, in fairly short order a new breed of business "sky warriors" should emerge, willing to spend large coin to receive whatever value they think worth the price. Full service carriers should be ready to anticipate and meet these new customer demands.

Government's harsh reality is that right now, it can't do very much. The concept that drove current policy was to allow deregulation to set the market pace, and then insert small "fixes" to retain some kind of fairness or equilibrium. This was clearly seen in the form of Bill C-26, which re-imposed some restrictions on Air Canada following the merger with Canadian, in an attempt to protect Canadians from monopoly prices and route abandonment, as well as protect other carriers from predatory practices. Although explored more carefully in the section "The Government Framework" in this report, a cursory assessment of Bill C-26 is that in its present form, it is inadequate, in many people's view, to deal with post-September

11th issues. It was designed to be a tool to meet a different set of challenges, and cannot do the unexpected job it has been called on to perform today. Moreover, devolution and deregulation mean less government power. The power (and costs) of much of the airline industry, for better or worse, has shifted over more than a decade to users and to private sector operators. Not only does the government have fewer tools, but it has fewer teeth as well.

Government has been forced to start at the beginning (again) and work through all the tools it thinks it will need. It is a painstaking and therefore long process, and it is difficult to wait for the system to come up with something while the country is in such a state of uncertainty. However, this might be just the opportunity that the government needs to develop an innovative framework, to meet these new challenges head on.

The last reality to face is Air Canada itself. It casts a huge shadow, both because of its current dominance, but also because it isn't just any airline: it's Air Canada, and it once belonged to all of us. It doesn't any longer of course, but some Canadians think it still does, and others think it should again. The reality is that it is a business, like any other, not a tool of social or economic policy.

Where do we go from here?

Today's environment reflects a new reality. Industry and government driven changes, privatization of airports, recent global events and the true financial state of most air carriers have created a significant challenge for everyone involved in the future of transportation, both for passenger and air cargo services. This is particularly true for Canada's smaller markets that often do not enjoy a critical mass of airline and onsite activity, industry knowledge or efficient access to gateway markets.

Given these seemingly unsolvable issues, what can we do next? Much of the debate centres on some key questions. For example:

- Should government protect consumers and communities by re-regulating the airline industry?
- Should we allow foreign carriers to sell in our market and not care if Canadian carriers do not have the same ability to sell in foreign markets?
- Should government subsidize routes or carriers?
- Are we protecting Canadians by protecting our Canadian-owned airline industry?
- Is "nation building" something that we need the airline industry to do?

There are no simple answers, but part of the real problem is the questions themselves: they do not go far enough. They are reactive, and lack vision. We may need to devise a fresh approach – one that looks forward, not back; one that creates something new, and innovative.

This report has examined a number of options – both the tried and true and the innovative and risky. It uses input from across Canada, from leading aviation experts to those whose expertise begins and ends with getting on an airplane. It includes ideas and comments from pilots and baggage handlers, provincial governments, and community leaders. It looks at what some other countries have done, and what seems to be working, and what is less successful. It examines some of the innovations that are happening in this country at this moment, and where we are stagnating. It also reviews the gaps in our policies, knowledge and abilities that are stopping us from achieving a more resilient and reliable airline sector. The report attempts to provoke discussion, encourage debate and eventually, help us achieve resolution.

It is my hope, and expectation, that we will resolve our air service issues. We can do it, because we must, and because there is a tremendous amount of good will, expertise and desire to get this job done.

Appendix I Weighing the Options

Government could increase opportunities for Canadian carriers

Restrict Air Canada's capacity, system wide

PROS

- Demand for other carriers could be assured
- Easier for other carriers to take existing demand rather than create it or compete for it
- Can provide "instant" competition on certain routes

CONS

- Difficult (if not impossible) for government to know how much capacity to limit, where
- Reduces Air Canada's ability to generate revenue, can put carrier at high risk
- Other carriers may not offer same services as AC (e.g. international connectivity), leading to increase in carriers, but reduction in choice
- Air Canada is already reducing capacity, with mixed results for other carriers replacing it. Unlikely that a forced reduction would have more positive results.

Divest Air Canada Regional

PROS

- ACR could focus on its own route development, rather than as a feed network for Air Canada mainline.
- Could interline with a different global alliance, providing international as well as domestic competition and offer multiple code sharing agreements and maximize choice
- May lead to better service to medium and small communities
- Could develop into credible competition for full service carriage

CONS

- Current scope clause might have to be eliminated in order to allow new alliance and code share agreements
- Many regional routes thin, little could change on these
- Buyer may not be found, as in the case of Canadian Regional Airlines
- Air Canada could set up a new regional service competing with its former regional network

Encourage financing of carriers

PROS

- Could encourage investment in carriers by demonstrating government confidence in Canadian carriers (e.g. guarantees or other programs)
- Could help financing of new equipment
- Could be fined tuned to assist start ups or expansions, if so desired

	- Could shelter carriers from current harsh environment **CONS** - Taxpayers could be stuck with costs, if carriers fail to repay loans - Carrier could still fail - No framework in place, program would be ad hoc, and difficult to access success - Could be unfair if only certain carriers are eligible, could be costly if all carriers are eligible
Review provisions of C-26	**PROS** - Would allow for reevaluation in post September 11th environment **CONS** - Could be slow and complex process - Not likely to answer all marketplace questions

Government could increase foreign competition in the Canadian market

Allow Right of Establishment (foreign- owned domestic) Carriers	**PROS** - If the foreign-owned domestic carrier interlines with its international counterpart, it could provide new network alternative to Air Canada and Star Alliance, an important addition to the competitive environment - It would be headquartered in Canada, with the benefits of jobs, infrastructure, etc. - It could open competitive options on tertiary routes, as independent regional carriers would have option of allying with either Air Canada or other carrier to connect with international or transborder routes - Precedent in Australia **CONS** - If Canadian carriers can't reciprocate by establishing Canadian-owned carriers in foreign markets, could be an unfair advantage for foreign carriers - Growth of the new carrier would be slow, and determined by the marketplace. No instant answers - Would compete for limited demand, and could weaken Canadian carriers without adding a great deal to the mix - If it does not interline, would compete primarily with WestJet and Air Canada's domestic routes with no new potential international

network benefits, but could weaken our existing domestic carriers

- Interest by carriers to develop this product could be low, at least in the short term, given the current economy and their own priorities at home
- Would impact on growth of emerging carriers in Canada, which could develop similar options without foreign ownership

Government Could Review Merits of Unilateral vs. Reciprocal Agreements

Reciprocal

PROS

- Canadian carriers would have same opportunities to sell to foreign travellers as foreign carriers would have to sell to Canadians, open new markets for Canadian airlines
- Liberalization can be done in incremental stages, beginning with "modified 6th freedoms" allowing Canadian flights to "hub" through American airports and their counterparts to do the same. (In practical terms, this would, at least initially, apply only to Air Canada, as it is the only Canadian-owned international scheduled carrier.)
    - Could provide more choice for Canadian travellers
- Further liberalization, which would allow foreign carriers to serve point to point domestic markets, could proceed based on the outcomes of the initial stages
- Liberalization could be expanded to include new arrangements such as multi-lateral agreements or the formation of a North American Common Aviation Area
    - Would bring aviation in line with other trade sectors
    - Could give Canada more clout dealing with EU Common Aviation Area

CONS

- Foreign carriers may not be interested in serving Canadian destinations, or may be prevented by union scope clauses
- Travellers may not want the hassle of travelling through an American hub, (clear immigration, customs, waits, etc.) simply to save money using a "modified 6th freedom"
- Negotiations could be slow and protracted – no immediate solutions or relief for travellers, and no guaranteed outcomes

<table>
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<td>Unilateral</td>
<td>
PROS

Foreign carriers likely to be open to idea, as there would be no Canadian airlines competing reciprocally in their domestic market, a clear advantage for the non-Canadian carriers
Could increase competition on major routes
Would provide travellers with more choice, potentially, as foreign airlines begin flying Canadian routes
Could assist airports and communities attract new carriers
Could be seen as putting “good” for communities and Canadians above the “good” of protecting Canadian carriers

CONS

Canadian demand limited – may not be enough business to interest foreign carriers in any meaningful way
Carriers could exit routes as easily as they enter them, increasing instability and uncertainty in marketplace
Open potential market of 30 million to foreigners without receiving reciprocal market opportunity for our airlines is contrary to trade policy which should work to strengthen Canadian opportunities internationally
Foreign carriers likely to fly on most lucrative Canadian routes rather than invest in market development – they could “skim the cream”, and weaken (or destroy) Canadian airlines, including Air Canada and WestJet

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<td>Liberalize current bilateral agreements</td>
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PROS

Bilateral system already in place, international air policy currently under review and could be liberalized fairly easily
Would allow Canadian carriers same or similar opportunities as foreign carriers in Canada, protecting our national carriers

CONS

Present system is straight quid-pro-quo, and agreements are generally made considering interests of Canadian carriers rather than stakeholders
System doesn’t change “status quo” – the environment would be very similar to what it is now

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Government could increase demand by reducing costs to passengers, airports and airlines

Reduce user fees paid by passengers

PROS
- Eliminate “sticker shock” to consumers, who will have clearer idea of what they would be paying up front
- Lower the price (and encourage greater amounts) of airline travel
- Some fees (such as security) would be more fairly shared between passengers and Canadians, all of whom benefit by the enhanced security measures

CONS
- Loss of revenue to government (and taxpayers) at time of fiscal restraint
- Moves away from current policy of user-pay

Reduce aviation fuel taxes on carriers

PROS
- Reduces airline expenses
- Excise tax system punitive

CONS
- Loss of revenue to government
- May be out of step with tax policies for excise tax on other fuels (e.g. automobile gas taxes)
- No guarantee that airlines would pass savings along to consumers

Reduce rents to NAS airports

PROS
- More capital could be available for certain airports
- Overall cost of system would be reduced

CONS
- Most NAS Airports still owned by the federal government, and some believe any profits should be returned to Canadians
- No guarantee that reduction would be passed on to airlines or passengers

Government could increase demand by stimulating travel

Introduce tax credits for travel in Canada	**PROS** • Could encourage new demand **CONS** • Could be very costly to taxpayers, who would see no immediate benefit • Very difficult to monitor, and assure that abuses would be kept at a minimum • Might have to include other travel providers (e.g. hotels, etc.), which could be unfair to other economic sectors • Difficult to encourage travel even with tax credits if rest of economy is weak
Create economic stimulation package	**PROS** • Could jump start entire economy, with benefits accruing to many sectors, including air • Can be used to heighten opportunities in disadvantaged regions of Canada **CONS** • Limited impact, as Canadian economy cannot be "fixed" in vacuum – ignores great reliance on international trade for national economic growth and health • Can divert funds from other priorities, such as health care or other forms of infrastructure (e.g. roads)
Facilitate cross-border movements	**PROS** • All sectors and regions would benefit, not only air service • Trade and economy recovery could rebound more quickly **CONS** • May force Canadian systems to match American systems • Focus might be on land border and goods, rather than passenger air

Government could support air access needs by

Building an integrated transportation policy

PROS

- Initiative already in place through the "Transportation Blueprint" consultation
- Could define integrated roles for different types of transportation within a multi-modal context
- Could define new and innovative roles in cooperation with all levels of government
- Could review transportation policy to enhance international trade opportunities, and other "21st century" opportunities not even considered a few years ago.

CONS

- Process likely to be complex and slow, would not deal with immediate challenges

Designing an Essential Services Program

A government subsidy which funds basic air service from a community to a hub if no scheduled service is available and community meets criteria.

PROS

- Provides support to communities which have lost service
- Could assist communities dealing with short-term access issues
- Could be a bridge when Air Canada has the right to exit routes
- Cost to taxpayers could be relatively small

CONS

- Service is minimal; might reduce the incentive to create market-based, better solutions and self-sufficiency
- Not all communities which have lost service would necessarily be eligible and wouldn't totally level playing field
- Wouldn't solve underlying air service issues, just provide temporary buttress
- Decisions could be, or could be perceived to be, politically influenced

Using existing regional development programs	Existing government programs (e.g. ACOA, WD, etc.) could be re-defined to include air access support as part of overall development package
	
	PROS
	• Recognizes air access as more than something needed to fulfill current demand, but also needed to create new wealth, job opportunities for communities
	• Programs already exist, criteria could be expanded to include air access
	• Programs are based on regional criteria, so air access could become a strategic part of overall development strategies
	• Could encourage a greater role for municipal and provincial governments, who have no jurisdiction over air transportation, but must deal with its economic and social implications
	• Would allow air access to be reviewed within a larger context of development needs, and could lead to
	    o Locally-based solutions created jointly by all levels of government,
	    o Multi-modal or intermodal solutions
	
	CONS
	• Effectiveness of regional development programs is topic of much debate
	• Program criteria vary between regions, may lead to air service support being different across the country
	• Cost to taxpayers

Government could create information tools for (examples)

- **Tertiary airlines wanting to expand scheduled service**
  - Securing investments
  - Government regulations and requirements
  - Interline or code-share agreements with other carriers
  - Etc
- **Communities wanting to increase air service**
  - Data products
  - How to talk to an airline
  - How to incorporate other modes
  - Tools available for airports
  - Etc
- **Consumers**
  - Information on airline performance
  - Recourses under the law
  - Rights under "Official Languages Act", Canadian Transportation Agency, Human Rights Commission, etc.
  - Etc.
- **Airports**
  - Tools to maximize revenues
  - Clearly described "rules of the game"
  - Etc.

Information tools (continued)

PROS

- Could deal with some of the problems arising from lack of information and expertise, and assist in locally-developed solutions
- Stakeholders with limited funds could still access information
- Could be easily communicated through Internet web sites
- Meetings with stakeholder groups would serve added purpose of bringing groups together to find joint solutions

CONS

- Process likely to be complex and slow, would not deal with immediate challenges
- Government not traditionally in the "information business" for this type of need
- Information may be discovered by stakeholders without need for government intervention or cost to taxpayers

Re-regulation

PROS

- Supports the assertion that passenger air service is essential, serving social and economic needs and therefore legitimately open to government control.
- Might offer protection from repercussions of the instability of the airline industry
- Re-regulation supports contention that Canada, given its unique challenges of population "thinness" and geographic vastness can never rely solely on competition and "discipline of the marketplace" to ensure quality of service or fair pricing practices
- Government regulation might allow a better integration of "multi-modal" policies, allowing for alternate services to air, such as rail or road, since air access in a policy framework is only one type of access that can be regulated
- Regulation could imply the control over a key Canadian industry by Canadians for Canadians
- Re-regulation could allow the government to protect the interests of Canadians (and limit the excesses and weaknesses of the carriers) in a direct and definitive way
- Would counter the opinion that, left to its own devices, the airline industry tends to consolidate to protect its own interests, leading to systems that are oligarchic and non-competitive actions, even in a field of multiple carriers
- Could represent a shifting away from the last two decades of deregulation of essential services and commodity providers.

CONS

- Canada moved away from a regulated airline industry because many believed it didn't work for Canadians. A prevailing view was that air service prior to 1988 was inefficient, vulnerable to claims of political influence, highly bureaucratic, costly and mediocre. Some say that Air Canada is still trying to get out from under its bureaucratic legacy, and has made the carrier slower to respond to the challenges of today
- Regulation does not mean success – a regulated airline could still fail, leading to ever increasing taxpayer bailouts, and a lessening of market discipline
- Under a regulated regime, there is a danger that airlines will have to spend time and resources dealing with Ottawa regulators that could better be used to serve customers directly
- Local control of local destiny is very difficult to achieve

- Decisions made in Ottawa tend to be unbusinesslike: slow, reactive, risk-adverse, leading to an even further reduction in quality of service and innovation
- Entrepreneurs would not enter a highly restrictive and regulated environment, making positive gains such as the start up and growth of WestJet almost unthinkable under re-regulation
- A regulated domestic industry would interface awkwardly with a relatively free and open international market, reducing competition to and from the Canadian market
- It is possible that the travelling public would be vulnerable to changes in government policy without direct recourse to influence the marketplace at first hand: local decisions would be left in the hands of regulators, not users
- In a regulated environment, stagnation could be mistaken for stability, to the detriment of the future health and growth of an economy
- The domestic airline industry is only one piece of a complex and international sector; in effect, the tip of the iceberg. An attempt by government to “manage” or regulate this one element may not be possible, as seen by the lack of success in other countries, irrespective of how severe or liberal the regime is.

Appendix II Meetings Held/Input Received

August 2001 to January 2002

Abbotsford Airport Authority
Air Canada
Air Canada Regional
Air Labrador
Air Line Pilots Association
Air Transportation Association of Canada
Airport Council International
American West airlines
Association of Canada Travel Agents
Atlantic Airports Council
Avia Marketing Consultants
Canada 3000
Canadian Airports Council
Canadian Chamber of Commerce
Canadian Tourism Commission
Canadian Transportation Agency
Capital Canada Ltd.
China Airlines
City of Gander, Nfld. & Lab.
City of Prince Rupert, B.C.
City of Terrace, B.C.
Competition Bureau
Council of Tourism Association of British Columbia
El Al Airlines
Federation of Canadian Municipalities
First Air
Government of B.C.
Government of Alberta
Government of Saskatchewan
Halifax Chamber of Commerce
Hawkair
HeliJet International
Hospitality Newfoundland and Labrador
Hotel Association of Canada
InterGlobe Technologies
Japan Tourism Bureau
Newfoundland/Labrador Department of Transportation
Office of Official Languages
Pacific Coastal Airlines
Policy Shop
Premier of Yukon
Prince George Airport Authority
Provincial Airways
Regina Airport Authority
Rick Erickson
Rural Secretariat
SABRE Reservations System
Saskatoon Airport Authority
SkyComm Air Management Ltd.
Tourism British Columbia
Tourism Industry Association of Canada
Tourism Saskatchewan
Tourisme Montréal
Tourism Toronto
Transport 2000
Transportation Partners
West Coast Air
WestJet
Yukon Dept of Tourism

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Appendix IV Mandate of the Independent Observer

From August 2000, and continuing for a period of 24 months, the Independent Transition Observer will review the impacts of airline restructuring on stakeholders and will assess whether the airline industry is healthy and competitive and meets the needs of Canadians.

In particular, the Observer will:

- Consider the views of consumers, urban, rural and remote communities, travel agents, airports, airlines and airline employees;
- Assess whether Transport Canada, the Canadian Transportation Agency and the Competition Bureau responsibilities relating to airline restructuring are clear and being carried out appropriately;
- Consider whether the government's monitoring measures are adequate;
- Assess industry support to the measures introduced in Bill C-26, including the commitments and undertakings of Air Canada to the Federal government;
- Assess Air Canada's linguistic obligations; and
- Assess the need for a Travellers' Bill of Rights.

Interim reports will be produced every six months with one final comprehensive report to the Minister. Two interim reports have been issued and are available on the Transport Canada web site, www.tc.gc.ca, follow the links on "airline restructuring". The final report will include recommendations on monitoring and related airline restructuring matters. The interim and final reports will be made public.

Debra Ward, the Independent Transition Observer was appointed by David Collenette, the federal Minister of Transport on August 1, 2000. She is an Ottawa consultant specializing in communications and policy strategies relating to tourism and travel issues. She has served on a number of national and international boards and committees and federal government advisory committees for the Auditor General, the Minister of National Revenue, the Minister of International Trade and the Canadian Labour Force Development Board.

Formerly President of the Tourism Industry Association of Canada, Debra has done extensive work on policy issues relating to the impact of the Canadian transportation system on communities, small and medium-sized businesses and the economic and social well being of Canada and Canadians.