



**Brief submitted by Transat A.T. Inc. to Transport Canada  
regarding the Consultation on a New International Air Policy**

Montreal, November 8, 2006

The present is the formal submission and response of Transat A.T. Inc. (hereinafter "Transat") to Transport Canada's invitation to stakeholders of October 25, 2006 to provide comments on a proposed new international air policy that would outline the approach to be implemented with respect to bilateral air transport negotiations, air cargo transshipment and foreign air carrier access (hereinafter the "Consultation Document"). Furthermore, Transat herein provides its views and recommendations regarding the issues raised in the Consultation Document under the heading *Looking Ahead: Beyond the Policy* namely, a comprehensive Canada-European Union air transport agreement, ownership and control regimes of foreign air carriers, a North American open aviation market and multilateral liberalization initiatives.

Transat is Canada's largest travel company after ACE Aviation Holdings, and one of the world's leading integrated holiday-travel and tourism services providers. With annual revenues in excess of \$2.5 billion CDN, Transat employs over 6000 people in all major regions of Canada, as well as in several other countries including France, the United Kingdom, the Netherlands, Greece, Mexico, Cuba and the Dominican Republic. Transat owns several major travel wholesalers and retail distribution interests including Transat Holidays, Nolitours and the Marlin Travel/TravelPlus/Club Voyages travel agency networks. In addition, and especially relevant in the context of the present consultation, Transat owns Air Transat which, from nine gateways including its bases in Toronto, Montreal and Vancouver, operates the second largest network in Canada of international passenger air services with scheduled and chartered flights to 92 destinations in 31 countries worldwide. As a critical component of Transat's vertical integration strategy, Air Transat's ability to develop services and to viably compete in the international air transport marketplace is a key factor in the future success of our multinational organization, and thus makes Transat a primary stakeholder in the present consultation exercise.

As one of Canada's most successful and enduring travel companies over the last two decades, Transat has developed and thrived in the context of progressive air transport liberalization. As evidenced by our leading market share in the holiday/leisure travel sector in Canada and our investments abroad, we are no strangers to vigorous domestic and international competition. Having established our pre-eminence nationally, we are now focused on growing our business into a major global presence and leading worldwide industry player. Consequently, Transat welcomes the government's efforts to further liberalize Canada's international air policies and to secure new market development and traffic growth opportunities for industry, as well as provide new services and enhanced competition to Canadian consumers. However, while we support the current initiative, it is imperative that certain fundamental principles, in addition to those outlined in the Consultation Document, be recognized and firmly integrated into the government's overall policy-making approach. They are the following:

***1. A financially viable, globally competitive Canadian air transport industry is vital for Canada's sustained economic and social health, as well as for the support of critical infrastructure and the maintenance of a sound air transportation network***

There has been considerable criticism over the years of the regulation of international air services through the bilateral agreement system, as per article 6 of the *Convention on International Civil Aviation*. Many have viewed this as an outdated, mercantilist and highly protectionist approach to the regulation of a global industry which should normally be subject to the established multilateral frameworks e.g. WTO, GATS, etc., that govern the trade of goods and services worldwide. In addition, Canada's own policies in the bilateral context have been attacked as too protective of Canadian airline interests and not responsive enough to consumer and regional development requirements.

While there is no doubt that the bilateral system has been used by certain countries to stifle competition and to protect bloated and uncompetitive monolithic airlines, Transat nevertheless believes that it has generally worked well as far as Canada's interests and special circumstances are concerned. Indeed, it can never be forgotten that Canada is a relatively small market appended to the world's largest economy. Moreover, in air transport routing terms, it is located between this superpower and the giant European and Asian economic blocks. In a fully globalized, open skies environment, it would have been far too easy for Canada to have become an afterthought as far as direct international air services are concerned and to have been consigned to the role of spoke in an international network of hubs located in Paris, Chicago, Singapore, Dubai, etc.

Instead, the current system has allowed Canadian carriers to aggressively develop new international markets and direct air services, which have clearly benefited Canada, its consumers and its economy. For example, Air Canada offers more direct point-to-point transborder air services than any other North American airline and is an anchor member of the Star Alliance. For its part, Air Transat offers direct own-aircraft air services on over 57 transatlantic city-pair routes, more than any other airline in the world. This is not a coincidence. Canadians traveling from point A in Canada to point B in the world are not necessarily condemned to spend hours transferring at congested point C, as is the plight of travelers from countries with weak, ineffectual or non-existent airlines. It is submitted that the new policy should seek to maintain and foster this favourable, consumer-friendly reality, and not consign Canadians to transfer lounge purgatory for the sake of liberalization or open skies.

Moreover, Canada's airlines directly employ over 60 000 people across the country and are key drivers and facilitators of the overall economy and tourism sector, the latter of which directly and indirectly produces over \$62 billion annually in economic output. Canadian air carriers and their customers are also, by far, the biggest financial supporters of this country's aviation infrastructure i.e. airports and air traffic control services. Indeed, although we understand and respect the desire of airports to have their interests recognized in the new policy, we would remind the government that as not-for-profit entities which in many cases use residual accounting e.g. Toronto, these stakeholders have no commercial or financial risk *per se*. Rather, this is assumed by the debt-holders who in turn are dependant primarily on airside revenues to guarantee their investments and recover their returns in this regard. The vast majority of airside revenues at all of Canada's airports are generated by Canadian air carriers. Therefore, it is clear that what is good for Canada's airlines is also good for these important crown assets.

***2. Any substantial liberalization of international air policy must be undertaken in the context of a sound economic and tax policy framework if the Canadian air transport industry is to thrive and be globally competitive***

One of the fundamental tenants of success in competing in the often cutthroat global marketplace is the unrelenting necessity of ensuring the lowest and most competitive cost base for one's operations. Canada's airlines are world leaders in maintaining some of the industry's lowest and most competitive controllable seat-mile costs through, among other things, painful but highly-effective corporate restructurings and innovative and assiduous cost control management. Unfortunately, uncontrollable third-party imposed costs which, in some cases, have increased astronomically over the last decade, are the single greatest threat to the viability, competitiveness and ultimate success of Canada's air carriers in an open skies environment.

Whereas many countries, including major industrialized nations such as the United States and several European Union states, financially support their air transport industries through either direct or indirect subsidy, Canada has consistently done the opposite. Starting in the early 1990s and motivated simply by federal deficit reduction objectives, the government began moving critical aviation infrastructure assets off its balance sheet and set them up as stand alone semi-commercial businesses. The result has been a cost disaster for Canada's airlines. Whereas air traffic control services were previously funded through a federal air transport tax, over a two year period starting in 1996 the industry was forced to absorb several hundreds of millions of dollars in new and direct ATC charges. Air traffic control services in the U.S. and most of the European Union remain publicly funded.

The impact of enormous airport fcc increases across the country over the last decade, and the aggravating role played in this respect by the federal government's annual \$300 million take (almost \$2 billion to date since airport devolution) in crown rents for fully paid infrastructure, is of course well documented. The real world result: it costs a major European competitor such as Air France approximately \$3500 CDN to land an A330-200 at its Paris-Charles de Gaulle hub and use the terminal facilities, while Air Transat must pay almost \$11 000 CDN to do the same thing with its own A330 at its main Toronto-Pearson base. These two airports represent the vast majority of the network airport system costs incurred by these respective air carriers. It therefore becomes evident that Air France enjoys a substantial proportional airport cost advantage in relation to Air Transat and can use this to cross-subsidize its operations on Canada-France services. While the government proposes more open and free air transport markets, its airport rent policies are actively working to *distort competition to the detriment of Canadian air carriers*. France is only one of numerous examples where this imbalance and uneven playing field exists. Now more than ever, this must end.

The arguments against fuel excise taxes (taxing economic inputs instead of outputs) and the regressive effects on demand of the world's highest aviation security charges (which far exceed the financial requirements of the system), as well as their distorting effects on competition, are also well known. For example, one can only imagine the laughably low and subsidized amounts an air carrier such as Emirates is paying for fuel at its Dubai hub (the airline is owned by the family which controls the emirate and its oil income, and which also owns the airport and runs the civil aviation oversight authority). The United Arab Emirates is one of the countries anxious to conclude an open skies agreement with Canada. Could this possibly be fair and undistorted competition under any conceivable scenario? The answer is certainly not if the Canadian taxpayer continues to net over \$500 million CDN annually in taxes, fees and charges from our industry. We have never asked for subsidies. We simply want government to stop treating our business as a reliable cash cow.

Another example of regressive and short-sighted tax policy applied to Canada's travel and tourism sector is the recent announcement by the Department of Finance to eliminate the GST/HST Visitors' Rebate Program. This program, introduced in the early 1990s by the Mulroney government, rightly recognized the role of Canada's tourism services and products as an export industry generating revenue from foreign tourist spending and on which, consequently, consumption taxes should not apply. This approach was consistent with the policies of most OECD countries including Mexico, Australia and the European Union, all of with whom Canada competes vigorously for foreign visitor tourism revenue. The measure announced by the government will effectively apply a new 6% tax to this sector thus rendering it even less globally competitive, particularly in the context of the rising Canadian dollar. This will clearly have another negative impact, not only on companies such as Transat both with respect to our incoming tour operations and air transport services, but on the overall Canadian economy as well,

as it is a direct threat to our share of the international tourism market, which represents a key export industry. In 2004, Canada was displaced from the list of the ten leading tourist destinations worldwide. Our market share of international tourism, once at 3.5%, is now estimated at approximately 2.9% and is expected to eventually fall to 2.5% according to the *World Travel and Tourism Council*. For its part, the UN's *World Tourism Organization* very recently announced that while the number of tourists traveling worldwide was up 4.5%, Canada saw a 4.1% decline in its own foreign inbound tourist traffic. This is disastrous news and reflects an ominous trend with respect to the negative growth in this important source of export income for our country and its economy. This is therefore certainly not the appropriate time for government mandated tax disincentives for our vulnerable industry.

All of the above demonstrates the glaring failure on the part of governments, both past and present, to apply an integrated and harmonized approach to sound economic and tax policy-making with regard to Canada's critical air travel and tourism sectors in order to truly establish a framework which can allow us to viably compete on a global scale. It is Transat's understanding that detailed economic studies currently being prepared by two independent and respected Canadian think tanks and due to be released shortly will confirm the burden on industry that this disjointed approach over the years has created and the ongoing negative impact it has on competitiveness and demand. Transat therefore believes it is completely disingenuous on the part of the current administration to ignore this reality and to proceed with an open skies agenda in some sort of divine isolation without addressing this damaging fiscal framework with which our industry is forced to live.

In a speech to the *Canadian Institute of Chartered Accountants*, the Minister of Finance was cited in the October 17, 2006 edition of the *National Post* as having stated the following:

*"I don't think I need to convince anyone in this room that taxes in this country are still much too high. We've made progress in this area but more needs to be done if we are to strengthen our economy and remain at the forefront of this highly competitive global economy... Canada must continue to improve our tax competitiveness even further."*

Transat wholeheartedly agrees. There are few sectors in Canada as exposed to global competition as air travel and tourism. On the eve of the government's initiative to open skies even further, Transat hereby states unequivocally that more than ever our industry needs to be an integral part of Minister Flaherty's clear vision and competitiveness agenda.

Notwithstanding, Transat does not expect the government to delay its new air policy announcement until a much needed review, harmonization and overhaul of Canada's economic and tax policies as they apply to the air travel and tourism sectors is undertaken consistent with the finance minister's stated objectives. Nevertheless, we call upon the government, concurrently in announcing its new air policy, to publicly commit to a formal and coordinated multi-departmental review in this regard (possibly in the form of a joint government/industry task force) with clear terms of reference, objectives and timelines. We consider this to be a minimal and reasonable short-term commitment and a sign that the government is prepared to treat our industry and its tens of thousands of workers and stakeholders fairly and equitably.

3. *The focus of liberalization efforts and initiatives under the new policy must be on priorities and objectives identified by Canada's airlines that are of real value to industry, the economy and Canadian consumers*

Canada has to date concluded two "Open Skies"-type agreements, as described in the Consultation Document, with our largest markets for international air travel i.e. the United States and the United Kingdom. These were appropriate starting points as they constituted fully mature and developed origin/destination traffic markets. This logic should continue to apply going forward under the new policy. Transport Canada has classified potential North American and Transatlantic open skies regimes as being longer-term issues. In fact, they are urgent priorities.

• **North American Open Skies**

Canada's third-largest international air transport market is Mexico. Mexico is a contracting party to the *North American Free Trade Agreement*. The bilateral arrangement which governs air services between Canada and Mexico is a relic of 1960s style protectionism. It is currently obstructing efforts on the part of Canada's air carriers to develop more services for the benefit of travelers, shippers, airports and communities in both countries. Transat has major operations and interests in Mexico which we are anxious to develop in the context of Canada-US open skies. A modern, fully liberalized air services agreement with Mexico, as a first and critical step in achieving a true North American open skies area, is not a luxury or long-term issue...it is a current necessity.

Transat is fully mindful of the reluctance demonstrated thus far by Mexican authorities to engage in bilateral consultations to achieve the above objective. Since efforts in this regard at the official administrative level have proved fruitless to date, it is now time for Canada to use all the high-level political and diplomatic means at its disposal to entice Mexico to the bargaining table and to seek the conclusion of an air transport regulatory regime which would be consistent with the free market principles that apply to our bilateral trade in all other goods and services. To this end, Transat is prepared to support the conclusion of a comprehensive arrangement that would include open 3<sup>rd</sup>/4<sup>th</sup>/5<sup>th</sup>/6<sup>th</sup>/7<sup>th</sup> freedom rights and possibly the exclusive and fully reciprocal exchange of rights of establishment.

• **Transatlantic Open Skies**

Canada currently has relatively liberal 3<sup>rd</sup>/4<sup>th</sup> freedom regimes with the majority of our western European partners. The glaring exception remains France, which has stubbornly refused to agree to a balanced liberalized arrangement despite several negotiating attempts in this regard over the last decade. Furthermore, we have fairly restrictive and, in some cases, non-existent air transport agreements with most of the eastern European countries which joined the European Union a few years ago.

It is Transat's considered view that despite being Canada's fourth largest international market, France will never agree on a bilateral basis to a truly open, balanced and reciprocal open skies regime. This is not encouraging since our organization owns two major tour operators in France, which together serve a wide array of international destinations worldwide, and operates, through Air Transat, scheduled/charter air services between several Canadian gateways and seven points in France. The current restrictive agreement acts as a blatant obstacle to our attempts to enhance our already substantial air service between the two countries and to maximize the synergies and cooperation between our Canadian and French subsidiaries. The only hope in breaking this impasse lies in a plurilateral approach through the EU Commission.

The US and the EU have been attempting to negotiate a comprehensive or so-called “vertical” open skies arrangement for several years. Efforts in this regard are currently stalled as a result of political issues surrounding U.S. ownership and control rules. In contrast, the EU has approached Canada with a much less ambitious proposal for a “horizontal” agreement that would essentially have Canada agreeing to incorporate a “Community” designation clause in our existing bilateral agreements with EU states in return for reciprocal open 3<sup>rd</sup>/4<sup>th</sup> freedom entitlements. While this would improve access to eastern Europe, it would do nothing to resolve our issues with France and would in fact amount to an unreciprocated grant of 7<sup>th</sup> freedom rights for EU carriers operating from any point within the EU to Canada. As far as Transat is concerned, this discussion would be a waste of time.

Instead, we firmly believe that Canada should immediately initiate consultations with the EU Commission with a view to negotiating a comprehensive “vertical” transatlantic open skies arrangement along the lines of EU-US, but which would in fact go further since we would recommend the exchange of full 3<sup>rd</sup>/4<sup>th</sup>/5<sup>th</sup>/6<sup>th</sup> and 7<sup>th</sup> freedom rights with the EU along with reciprocal rights of establishment, similar to the model we proposed for Mexico. Such an arrangement would obviously settle in one action the access issues with France and eastern Europe, provide consumers with extraordinary new service options and would enable Transat to fully maximize its growth strategy in Europe as a whole, as well as to export and implement its successful vertical integration model to key markets such as France, the United Kingdom and Spain.

- **Canada-Caribbean Open Skies**

The Caribbean has been a favourite destination for generations of Canadians for obvious reasons. Canadian industry has responded by offering substantial year-round air and package tour services to almost all major Caribbean countries. Even countries ravaged by civil strife such as Haiti benefit from regular Canadian air service. In short, it is a region where Canadian companies have done well, and can do even better with the right free trade framework in air services.

Consequently, Transat recommends that Canada take the lead in organizing like-minded Caribbean partners and setting up concurrent bilateral or even multilateral open skies negotiations in order to achieve a true Canada-Caribbean open aviation area. The potential candidates we would see participating in this process would be the Bahamas, Barbados, Antigua, St-Lucia, Trinidad & Tobago, Anguilla, Aruba, Jamaica, Cayman Islands and the Dominican Republic. Protectorates of European states such as St-Marten/Curaçao and the French Antilles would be covered under the Canada-EU arrangement. Furthermore, depending on the outcome of leadership succession issues, Cuba may be prepared to also eventually embrace more free market principles in its air transport relationships with Canada and its Caribbean neighbours.

- **Bilateral air service markets with a minimum of 300 000 one-way origin/destination passenger trips**

Once the three priorities and corresponding objectives listed above have been achieved, Transat believes that the government should thereafter proceed to progressively negotiate open U.S.-style regimes i.e. 3<sup>rd</sup>/4<sup>th</sup>/5<sup>th</sup>/6<sup>th</sup> freedom rights in bilateral markets where a minimum 300 000 one-way passenger trips threshold has been reached. This would therefore include such countries as Japan, Hong Kong SAR, China, Brazil, etc.

As far as countries that do not meet the above threshold are concerned, liberalization initiatives should be undertaken on a lowest priority, case-by-case basis. Moreover, the potential impact on the integrity of Canadian 3<sup>rd</sup>/4<sup>th</sup> freedom services within the region in question as a result of foreign carriers being overly reliant on 6<sup>th</sup> freedom traffic given the dearth of 3<sup>rd</sup>/4<sup>th</sup> freedom passengers in the bilateral market must be properly evaluated and given serious consideration. Again, as discussed earlier in this brief, it is a question of vision and whether the government is prepared to sacrifice Canadian direct air services in exchange for a myriad of connecting flights for the sake of concluding open skies arrangements in marginal o/d markets such as Iceland, the UAE, Singapore, etc.

### ***Other Issues***

- **Market access obstacles created by facilitation / security / airport access considerations**

Our airline unit, Air Transat, has consistently argued in the past that rights acquired under newly liberalized air services regimes must be of practical and commercial value to Canada's air carriers. A traffic right is not worth the paper it is written on if security/facilitation requirements, or airport congestion/slot unavailability issues make the landing of an aircraft impossible at a specific airport or the maintenance of a particular service commercially or financially unfeasible. There are many classic examples: despite an open skies agreement with the UK, new Canadian regularly scheduled air services at London-Heathrow will be limited at best as a result of major slot constraints; there is a minimum 10-year wait for landing slots at Tokyo-Narita; the operation of inbound fifth freedom services into the US is commercially unattractive as a result of the significantly increased costs from the double-handling of passengers and baggage (including those in-transit for Canada) and extra ground time for the aircraft, all as a result of US security/facilitation rules. Canada must ensure that such issues, as identified by industry, are adequately addressed with a negotiating partner *before* concluding a liberalized or comprehensive open skies arrangement.

- **Ownership and control regimes of foreign air carriers**

Although all of Canada's current bilateral agreements stipulate that ownership and control of a foreign airline must reside in the nationals of the foreign contracting country in question, there are major unilateral exceptions to this rule currently being made by Canadian authorities on a *de facto* basis without formal consultation of stakeholders and certainly without compensating benefits for Canadian air carriers. Two major examples of this phenomenon are KLM Royal Dutch Airlines, which clearly no longer qualifies as a carrier majority-owned by Dutch interests, and Corsair, a carrier designated by, and operating to Canada from France while being wholly-owned by German conglomerate TUI. Of course, since these are both European airlines, the issue would be resolved through the Canada-EU open skies regime recommended above.

However, in the event that such an agreement is not concluded or a foreign carrier is operating to/from Canada in a manner inconsistent with the ownership and control provisions of the relevant bilateral agreement, there must be a transparent and consultative process in place that addresses this problem and seeks a resolution that is satisfactory to *all* Canadian stakeholders, including airlines. Indeed, despite the fact that Canada essentially provides a free pass to a major French operation, France's aeronautical authorities were quick to pounce on Transat several years ago further to an investment we had made through our local tour operator subsidiary in a French airline that was deemed to be inconsistent with their ownership and control laws. Unlike Canada, not all countries believe in unilateralism on this issue and will defend their interests fervently.



Canada should do the same by, at a minimum, seeking consultations with the country in question and negotiating a satisfactory, mutually beneficial resolution based on Canadian stakeholder interests and requirements, failing which the unilateral exemption in question should be withdrawn.

Finally, although the Consultation Document has limited the question of ownership and control to considerations applied by Canada in this regard to foreign air carriers, it is nevertheless essential in the context of an open skies policy discussion to reflect on the current state of our national legislation on this point. Indeed, Canada has held firm to date on the 25% foreign ownership threshold of Canadian air carriers despite liberalization initiatives to this end by major jurisdictions such as the EU, which has moved to a 49% limit. Transat would support a similar legislative amendment by Canada because we see it as an integral part of our efforts to expand internationally through joint ventures and cross-equity strategic alliances. However, such a loosening of domestic foreign ownership and control rules must be undertaken in a harmonized manner with the United States (which also remains at 25% and unfortunately shows no sign of movement in this respect) and must ensure fully reciprocal opportunities abroad for Canadian interests.

- **Multilateral negotiations**

We touched on this subject briefly in our earlier comments regarding the potential Canada-EU and Canada-Caribbean open skies areas. Apart from these particular regions, which in fact would be more plurilateral rather than classic multilateral agreements, Transat does not see much in the way of short-term opportunities for such multi-party liberalization or open skies discussions. While we are familiar with the mini open skies blocs that have been established among the Andean countries of South America, as well as a small group of southeast Asian countries including Singapore, Brunei and Indonesia, we do not see value for Canada in becoming a party to these arrangements based on the considerations outlined above including insignificant 3<sup>rd</sup>/4<sup>th</sup> freedom traffic levels and the potential for overt 6<sup>th</sup> freedom traffic diversion.

- **Foreign Carrier Access (FCA)**

While Transat had no problem with the objectives of the FCA provisions of the 1994 international air policy statement, which were essentially designed to promote air service by foreign airlines to communities where Canadian carriers were not interested in serving the bilateral market in question, we have never fully understood why such services could simply not be introduced and operated pursuant to a properly negotiated and executed air services agreement between Canada and the relevant country in question. Thus, in the event a foreign airline was interested in serving Canada where an air transport agreement did not exist, it would be incumbent on the foreign government in question to request formal consultations with a view to concluding such an accord.

Of course, such negotiations should only be undertaken consistent with the priorities outlined earlier in this brief. Furthermore, the eventual agreement would need to reflect the specific characteristics of the market in question, most notably 3<sup>rd</sup>/4<sup>th</sup> freedom traffic patterns and the risk of undue 6<sup>th</sup> freedom traffic diversion by the foreign carrier, in which case we would expect capacity/frequency limitations to be included. In short, lack of Canadian carrier interest should not preclude the negotiation of such agreements and, as such, the FCA should be scrapped.

- **Air Cargo Transshipment**

Transat has no problem with the recommendations outlined in the Consultation Document on this subject.

In conclusion, Transat is prepared to support and work for substantial air transport liberalization and, indeed, go further than Canadian policy has ever gone before in this regard. However, it is clear that a new international air policy must not be adopted in a vacuum or with tunnel vision. It must recognize the particularities and special challenges facing Canada and its air carrier industry in the global air transport marketplace. It must address and implement real priorities and objectives of concrete benefit to Canadian industry, the economy and consumers and not seek to avoid them because they are not "quick fixes". Finally, any liberalization initiative must be undertaken in tandem with a meaningful review and overhaul of the economic and tax policy framework and infrastructure cost burden with which Canada's air travel and tourism industries must deal, and which, if done right, may enhance and promote the competitiveness of said industries and their development into world class players or, alternatively, cripple them in a hyper-competitive, globalized marketplace and essentially put an end to great Canadian success stories.