



**AN INDUSTRY IN CRISIS: SAFEGUARDING THE
VIABILITY OF THE CANADIAN AIRLINE
INDUSTRY**

Report of the Standing Committee on Transport

**Joe Comuzzi, M.P.
Chair**

April 2003

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THE STANDING COMMITTEE ON TRANSPORT

has the honour to present its

SECOND REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied the viability of the Airline Industry in Canada and has agreed to report the following:

AN INDUSTRY IN CRISIS: SAFEGUARDING THE VIABILITY OF THE CANADIAN AIRLINE INDUSTRY

INTRODUCTION

On 1 April 2003, Air Canada filed for bankruptcy protection under the *Companies' Creditors Arrangement Act* (CCAA), and obtained an order from the Supreme Court of Ontario providing creditor protection. It also petitioned under the U.S. *Bankruptcy Code*. In filing for protection, which was undertaken to facilitate corporate restructuring, Air Canada indicated the fundamental need to restructure labour costs through changes to collective agreements, work rules and wages in order to become a leaner, more efficient, lower cost airline through savings mainly from aircraft lessors, lenders, bondholders and labour unions. More generally, it indicated a need to restructure its balance sheet and its operational costs to bring them in line with what it termed "the new environment," and to change its business model to better meet the needs of customers and the company to develop profitable, stand-alone businesses.

At the time, Air Canada also announced that it had secured US\$700 million (or an equivalent amount in Canadian currency not to exceed \$1.05 billion) in liquidity through Debtor-in-Possession (DIP) secured financing from General Electric Capital Canada Inc., available in two stages: a term loan of US\$400 million for up to 18 months, and US\$300 million as revolving term credit. With unrestricted cash on hand of approximately \$375 million, this financing is expected to provide sufficient liquidity for Air Canada to continue normal operations throughout the CCAA process.

Consequently, the House of Commons Standing Committee on Transport held hearings on the viability of the airline industry in Canada. During the course of its examination, the Committee heard from a wide range of stakeholders, including the Minister of Transport, Air Canada, representatives of unions that negotiate on behalf of Air Canada's unionized employees, the Superintendent of Financial Institutions, WestJet, Air Transat,

Air North, and spokespersons appearing on behalf of air carriers, travel agencies and the tourism industry. This report summarizes the testimony presented by witnesses, reiterates some of the conclusions reached and recommendations made by the Committee in its December 1999 report on airline restructuring in Canada and its December 2001 report on building a transportation security culture, and makes proposals for change.

THE COMMITTEE'S DECEMBER 1999 REPORT

In October through December 1999, the House of Commons Standing Committee on Transport examined the policy framework for a restructured airline industry in Canada as a consequence of the position taken by Canadian Airlines International Limited that it was in critical financial shape and would not have the necessary fiscal resources to “go it alone” for much longer. The Committee held hearings that resulted in its report *Restructuring Canada's Airline Industry: Fostering Competition and Protecting the Public Interest*.

In the report, the Committee made 42 recommendations designed to achieve the twin goals of fostering competition within the airline industry and protecting the public interest, which included consideration of the impact of airline industry restructuring on consumers, airline employees, and residents of small and remote communities. Some of the Committee's recommendations found legislative expression in Bill C-26, *An Act to amend the Canada Transportation Act, the Competition Act, the Competition Tribunal Act and the Air Canada Public Participation Act and to amend another act in consequence*.

The Committee's hearings and report, and the federal government's subsequent legislation, reflected the situation that existed in the airline industry at that time. Such circumstances as the terrorist attacks of September 2001, the economic slowdown in North America, rising fuel costs and the war in Iraq could not have been predicted. Nevertheless, these – and other – situations have had a significant, and negative, impact on the airline industry around the world.

THE COMMITTEE'S DECEMBER 2001 REPORT

In October and November 2001, following the 11 September 2001 terrorist attacks in the United States, the House of Commons Standing Committee on Transport and Government Operations held hearings designed to provide guidance on the measures needed to enhance aviation security. Among the 15 recommendations in the report *Building a Transportation Security Culture: Aviation as the Starting Point*, the Committee argued for the creation of a Transportation Security Authority within the portfolio of Transport Canada, with responsibility for the Authority given to a Secretary of State for Transportation Security. In the Committee's view, the mandate was to include responsibility for all modes of federally regulated transportation.

THE CURRENT ENVIRONMENT IN THE AIRLINE INDUSTRY

Over the last several years, air carriers around the world have faced a number of challenges: the decline in the high technology sector which had a significant effect on air transportation, an economic slowdown, the September 2001 terrorist attacks, the emergence and growth of new and existing competitors, rising fuel costs, the war in Iraq and the outbreak of severe acute respiratory syndrome (SARS). Consequently, air carriers worldwide have experienced financial difficulties, including US Airways, United Airlines, American Airlines and Air Canada in North America, and Sabena, Swissair, KLM, Finnair and British Airways in Europe.

In announcing its filing for bankruptcy protection, Air Canada cited data from the International Air Transport Association suggesting airline industry losses in the past two and one-half years totalling US\$31 billion and an additional US\$10 billion in losses forecast because of the war in Iraq. Moreover, it noted a Global Equity Research report which provided loss estimates in the North American airline industry, for 2003, of US\$6.5 billion.

PROPOSALS FOR CHANGE

As its financial position deteriorated, Air Canada stressed the need to reduce labour costs by \$650 million annually. Unions representing Air Canada employees responded in various ways to the company's request for labour cost reductions. Air Canada has also noted funding issues related to the twelve pension plans for its more than 51,000 unionized employees, retirees and survivors.

With a deterioration in the value of the pension plans in 2001 and 2002 as a result of declining interest rates and stock values, and the company's financial position, the Office of the Superintendent of Financial Institutions requested that Air Canada suspend its contribution holiday, conduct an early pension valuation and fund any liability as soon as possible. It also requested that Air Canada provide adequate disclosure to plan members about the situation. The company indicated that, depending on the outcome of the corporate restructuring, it was considering such alternatives as reducing accrued benefits, freezing benefit accrual for a period of time, or moving to a defined contribution pension arrangement. It should be noted that any restructuring of the plans would require approval by the Office of the Superintendent of Financial Institutions, having regard for the fairness of the proposal, the proposal's viability and the fairness of the process used to determine the restructuring proposal.

The Committee makes no comment or recommendations on collective bargaining or pension issues, believing that decisions in these areas are best left to the parties themselves, as well as to the Canada Industrial Relations Board and the Office of the Superintendent of Financial Institutions. We do, however, note recommendations made by witnesses regarding the creation of a government guarantee fund for all federally regulated pension plans, special one-time contributions to the pension plans of Air Canada employees, retirees and survivors, and regulatory relief related to solvency funding.

A number of the Committee's witnesses suggested that the periodic crises in the Canadian airline industry are the result of a number of factors, including deregulation and failure by the federal government to create a policy framework that assures the industry's viability and the success of a national air carrier. They also mentioned that the neglect of the industry by the government in some areas has occurred at the same time that other government actions have had a negative effective on the industry.

Witnesses proposed a range of possible solutions for assisting the Canadian airline industry in this time of crisis. While the crisis may be particularly acute for Air Canada, it is important to note that other Canadian air carriers are suffering reduced prosperity. In particular, mention was made of:

- a government subsidy to assist the airline industry, and particularly Air Canada;
- fee moratoria, reductions or elimination in a number of areas, including NavCanada fees and the Air Travellers Security Charge, and the payment of certain fees, such as for airport security, out of general tax revenues;
- a rent moratorium, reduction or elimination for Canada's airports;
- a moratorium, reduction or elimination on the payment of the federal aviation fuel excise tax;
- changes proposed in Bill C-26, *An Act to amend the Canada Transportation Act and the Railway Safety Act, to enact the VIA Rail Canada Act and to make consequential amendments to other Acts*;
- federal government guarantees regarding the normal pension benefits of Air Canada employees, retirees and survivors;
- federal government funding of early retirement incentives and other voluntary severance packages to assist in the downsizing of Air Canada;
- re-nationalization of Air Canada;
- changes to the *Competition Act*;
- foreign ownership limits;
- reciprocal cabotage;

- discrepancies between Canadian purchasers and foreign purchasers regarding aircraft financing related to Export Development Canada rules for aircraft purchase;
- a government subsidy to fund a program similar to the Essential Air Service Program in the United States;
- a national fund for regional carriers;
- bilingualism grants related to the *Official Languages Act*;
- “proper” regulation of, and policies for, the airline industry;
- a “trust accounting system” or legislation to implement a passenger protection plan; and
- a changed business model within the airline industry.

In the Committee’s view, a government subsidy for Air Canada (which would not be carrier neutral) or for the airline industry more generally is not appropriate, and nor are funds for pension guarantees, early retirement incentives or other voluntary severance packages for airline employees. We continue to believe that the implementation of certain recommendations contained in our December 1999 report will lead to a vibrant airline industry, notwithstanding such unforeseen events as wars, terrorist attacks and economic slowdowns. We do, however, feel that the federal government should take action in a number of areas.

The Committee is aware that Bill C-28, *An Act to implement certain provisions of the budget tabled in Parliament on February 18, 2003 (Budget Implementation Act, 2003)*, would amend the *Air Travellers Security Charge Act* to reduce the Air Travellers Security Charge for domestic air travel from \$12 to \$7 for one-way travel, and from \$24 to \$14 for round-trip travel, applicable to purchases made on or after 1 March 2003. Nevertheless, we believe that the reduction proposed is insufficient for domestic travel, and that – at a minimum – a reduction should also be introduced for international travel. Moreover, we support the recommendation made by the House of Commons Standing Committee on Finance in 2002 regarding the development of a mechanism for ongoing

review of the manner of calculation and amount of the charge in order to ensure that revenues collected are just sufficient to cover the reasonable costs of air security.

That being said, the Committee's clear preference remains the recommendation made in our December 2001 report *Building a Transportation Security Culture: Aviation as the Starting Point*. As noted earlier, in that report we argued for the creation of a Transportation Security Authority, to be led by a Secretary of State for Transportation Security. We continue to believe that attention must be paid to the safety and security of all modes of transportation, and we feel that safety and security are public goods. From that perspective, we feel that the costs associated with ensuring the safety and security of transportation in Canada should be funded out of the Consolidated Revenue Fund, rather than by users through such mechanisms as the Air Travellers Security Charge. For this reason, the Committee draws upon the recommendations contained in the December 2001 report and recommends that:

RECOMMENDATION 1:

The federal government wind-up the Canadian Air Transport Security Authority and establish a multi-modal Transportation Security Authority. The operating costs of this Authority, as well as expenses associated with providing safety and security, should be funded out of the Consolidated Revenue Fund. This Authority should report annually to Parliament on the state of transportation security within Canada.

RECOMMENDATION 2:

The federal government eliminate the Air Travellers Security Charge.

In the Committee's view, transportation security is a vital national issue that should receive federal funding. We believe that financing transportation security in this way,

rather than through user charges, would result in more airline passengers, thereby enhancing the revenue prospects for Canadian air carriers.

Moreover, the Committee believes that there is an urgent need to review the full range of fees – including not only the Air Travellers Security Charge but also Airport Improvement Fees, NavCanada charges, landing fees, etc. – applied to air carriers and airline passengers, and to eliminate them or implement a moratorium on their payment wherever feasible. Elimination of unnecessary fees paid by passengers could result in increased air travel by them – and increased revenues for air carriers – and the eradication of unnecessary fees paid by air carriers would also enhance their viability.

The Committee feels that airports must play a role in safeguarding the viability of Canada's airline industry. At present, air carriers are required to pay landing fees to airports. In turn, airports must pay rent to the federal government, which also should play a role in resolving the current crisis in the airline industry. To that end, we believe it is appropriate that airports reduce the fees charged to air carriers, in return for a reduction in the rent paid by them. Consequently, the Committee recommends that:

RECOMMENDATION 3:

The federal government suspend rental payments by airports for a two-year period and the airports shall pass the rental savings to air carriers.

Beyond this measure, the Committee urges those airports that currently charge an Airport Improvement Fee to freeze the fee for a two-year period. Moreover, we encourage those airports that currently do not charge such a fee to refrain from so doing for the same period of time.

Moreover, the Committee believes that additional federal assistance to the airline industry should occur through a reduction in the rate at which the federal aviation fuel excise tax is paid. It is for this reason that the Committee recommends that:

RECOMMENDATION 4:

The federal government, for a two-year period, reduce by 50% the federal aviation fuel excise tax rate.

The Committee suggests that the provincial governments also play a role in helping the airline industry through the current crisis through similarly reducing the rate at the provincial level.

Finally, the Committee believes that, while two of the recommendations made by us include a two-year timeframe, the concessions given may be required for a longer period of time or may require adjustment. For this reason, we intend to undertake a review of these recommendations in 18 months to determine whether extension or adjustments should be recommended, with a report to Parliament on our conclusions.

CONCLUSION

The Committee believes that a range of actions should be taken – by a range of stakeholders – to assist in the revitalization of Canada’s airline industry. We are concerned about the long-term health of the industry, and continue to believe that changes must occur in the airline industry to assure its ability to maximize its viability, and some of these changes will require federal action. Clearly, the industry is in crisis, and all stakeholders have a role to play in ensuring its recovery. The Committee intends to continue the examination of the viability of the airline industry, with additional information about programs offered through Human Resources Development Canada and about NavCanada charges in a further report to Parliament.

LIST OF WITNESSES APPENDIX A

Associations and Individuals	Date	Meeting
Air Canada Fred Gaspar Manager	03/04/2003	17
Stephen P. Markey Vice-President		
Air Canada Pilots Association Jean-Marc Bélanger Special Advisor		
Donald K. Johnson President		
Paul Middleton Director		
Bob Parnell Chair		
CAW - Canada (International Automobile, Aerospace, Transportation and General Workers Union of Canada)		
Anne Davidson President		
Gary Fane Director of Transportation		
Basil "Buzz" Hargrove National President		
Department of Transport Kristine Burr Assistant Deputy Minister		
Jacques Pigeon Senior General Counsel		

Department of Transport
Louis Ranger
Deputy Minister of Transport

David Collenette
Minister of Transport

Superintendent Financial Institutions
Nick Le Pan
Superintendant

West Jet
Clive Beddoe
President and Chief Executive Officer

Air Line Pilots Association, International
Kent Hardisty
President

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Art LaFlamme
Senior Representative, Canada

Steven Linthwaite
Representative

Air Transat
Bernard Buissières
Vice President

George Petsikas
Director

Philippe Sureau
Executive Vice President

Air Transport Association of Canada
Warren Everson
Vice-President

Cliff MacKay
President and CEO

Association of Canadian Travel Agencies
Marc-André Charlebois
President

Canadian Union of Public Employees

Richard Balnis
Director of Research

Pamela Sachs
President

Teamsters Canada

Phil Benson
Lobbyist

Robert Bouvier
President

Michael Crawford
Coordinator

François Laporte
Director of Government Affairs

Air North

Murray Leitch
Vice President Legal and Director

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Canadian Tourism Commission

Thomas Penney
Vice-President

Department of Human Resources Development

Catherine Cody
Associate Director General

Gordon McFee
Acting Director General

**International Association of Machinists
and Aerospace Workers in
Canada**

Louis Erlichman
Canadian Research Director

**International Association of Machinists
and Aerospace Workers in
Canada**

Dave Ritchie

Canadian Vice-President

Tourism Industry Association of Canada

Randy Williams

President and CEO

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to the report within one hundred and fifty (150) days.

A copy of the relevant Minutes of Proceedings ([Meetings Nos 17, 18, 19 and 21 which includes this Report](#)) are tabled.

Respectfully submitted,

Joe Comuzzi, M.P.
Chair

MINUTES OF PROCEEDINGS

Meeting No. 21

Thursday, April 10, 2003

The Standing Committee on Transport met *in camera* at 5:06 p.m. this day, in Room 253-D, Centre Block, the Chair, Joe Comuzzi, presiding.

Members of the Committee present: Larry Bagnell, Rex Barnes, Joe Comuzzi, Liza Frulla, Roger Gallaway, Jim Gouk, Stan Keyes, Mario Laframboise, James Moore, Marcel Proulx and Lynne Yelich.

In attendance: From the *Research Branch of the Library of Parliament:* John Christopher and June Dewetering, Principal Analysts

Pursuant to Standing Order 108(2), Examination of the viability of the Airline Industry in Canada.

The Committee met to consider a draft report.

It was agreed,-- That the draft report as amended and as adopted by the Committee be translated today and, that the Chair be authorized to table it in the House tomorrow, Friday, April 11, 2003, as the Second Report of the Committee.

At 5:56 p.m., the Committee adjourned to the call of the Chair.

Georges Etoke

Clerk of the Committee