



Comments of the

Canadian Airports Council

To the

Standing Committee on Transport

Presented by

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Introduction

The Canadian Airports Council (CAC) is one of the Canada's newest industry associations. The CAC is the voice of Canada's airport industry, representing the interests of 43 members, operating more than 130 airports, in matters of air policy, legislation, and regulations. One hundred percent of international air travellers and air cargo pass through CAC member airports as well as more than 95% of all domestic passengers

Although Canada's network of airports has served Canadians for decades, privatised, local control of airports has only existed since 1992 when the first federal airports were transferred to local airport authorities. Even though the first airports were transferred Airports in 1992, it is interesting to note that, on average, airports have only been operated by local airport authorities for 7 years.

Airports are a major force in the Canadian economy with an economic impact well beyond the airport fence. Canada-wide, airports generate \$34 billion in economic activity and are responsible for 300,000 Canadians earning their livings directly or indirectly from airport activities.

More remarkable CAC member airports have invested almost \$9 billion dollars to upgrade and improve an aging infrastructure inherited from Transport Canada. In the few short years since transfer, the investment by airports have transformed tired and worn out terminals into buildings communities are proud to call theirs. These new terminals are modern, efficient, and a great deal more than just warehouses to hold passengers until the airplane is ready to board.

Airlines benefit when airports are able to generate additional revenues from other sources like retail and parking. As these revenues grow, airports are in better to position to keep aeronautical fees competitive. With planning and a good consumer research, retail stores, services and food outlets offer the kinds of goods and services travellers want. They also provide passengers with a diversion as they spend time prior to boarding. With airlines suggesting that domestic travellers need to check in at least an hour before departure and international travellers two hours, there need to be facilities, like retail stores and food services, to help passengers pass the time.

David Pang, CEO of Hong Kong's wonderful new international airport says that airports are in the experience business. He's right! Modern airports have become an essential part of the travel experience made up of elements like retail, services, food, lounges, waiting areas and a strong overall design theme. At a recent public consultation meeting at Vancouver International Airport, noted social justice advocate, Severn Cullis-Suzuki related how proud she was to return home through Vancouver airport as it represented BC so well.

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By any measure the transfer of the national airports systems (NAS) airports has been a success: a success for communities, air travellers, airlines and even government. In the last year that Transport Canada operated airports, taxpayer subsidies to airports totalled more than \$125 million. Twelve years later, the federal treasury annually receives some \$280 million in rent.

Liberalization of Air Transport Policy: Introduction

The Minister of Transport, the Honourable Jean-C. Lapierre, indicated to the Standing Committee on Transport (SCOT) that it was time to consider further liberalization of Canada's air policy. He asked SCOT for its assistance and suggested SCOT may wish to consult stakeholders on the opportunities and challenges. The Minister provided a "guidance document" prepared by Transport Canada that offered a series of questions on three policy fronts: domestic, transborder and international air services.

SCOT is looking for stakeholders for input. The following represents CAC's positions on air policy and, in particular, the questions asked of SCOT.

CAC Position on Air Policy

The CAC position on air policy matters is driven by one overall policy objective: to promote the broad economic and social interests of Canadians by eliminating policy-based intervention, thereby facilitating and promoting the operation of market forces to provide Canadian communities with a world-class air transportation system that offers the broadest possible range of competitive passenger and cargo services.

CAC has adopted the following as policy principles:

- The purpose of international air transportation is to serve the needs of passengers and shippers. Policies designed to promote carrier financial interests at the expense of user interests are inherently self-defeating.
- In a competitive environment, carriers are able to, and motivated to, respond to the services passengers, shippers, tourism and trade interests, communities and airports are telling carriers they need. Economic regulation is not required, and government oversight of international air transport should be limited to facilitating the development of services and ensuring that services are provided in a safe and secure manner.
- Government policy should not favour one carrier over another and instead should let market forces prevail. In exceptional circumstances, when market forces clearly fail, government intervention would be warranted to assist, or discipline, a particular carrier in order to preserve a competitive market.

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- All-cargo airline services (as opposed to joint production (i.e., cargo and passenger airline services)) are distinct products serving multiple markets in unique ways and should be dealt with as separate issues in negotiations or as separate negotiations.
- Adequate data must be made publicly available to industry stakeholders in a timely fashion.

Within the policy objective and policy principles of CAC, we offer the following guidance to TIAC in the development of its position on the questions asked of it by SCOT.

Domestic Air Services

Question: Should Canada increase the limit on foreign ownership of voting shares in Canadian air carriers from the current 25 percent to 49 percent?

Answer: Yes.

The airline industry is a capital-intensive global industry. Restricting ownership in Canadian air carriers to 25%:

- limits their access to capital, holding back expansion opportunities;
- raises the cost of capital, decreasing the viability of Canadian carriers;
- forces Canadian carriers into convoluted means of accessing capital without violating regulatory restrictions; and
- is increasingly out of step with developments elsewhere in the world.

Increased foreign ownership of Canadian carriers is not a threat to the future of Canadian carriers, airports, or users of the service, nor are foreign ownership restrictions necessary to ensure that the safety and security concerns of government are addressed. Raising the limit on foreign ownership will help ensure a more vibrant, more viable Canadian airline industry to the benefit of travellers, shippers, communities, and the economy.

The International Civil Aviation Organization (ICAO) has recommended that wording in air service agreements should change from ownership and effective control to "principal place of business" and "effective regulatory control" and the International Air Transport Association is itself seeking removal of the restrictive foreign ownership limitations.

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Question: Should Canada go further and remove constraints on who controls Canadian air carriers, such that foreign interests could establish, or acquire control of, air carriers in Canada, for the purposes of offering domestic services only (right of establishment)?

Answer: Yes.

CAC believes that the granting of **right of establishment** is a means of ensuring the most competitive environment for Canadian travellers and shippers. Aside from the obvious competitive aspect for domestic services, **right of establishment** also has significant implications for international air access. Foreign carriers and carrier alliances that do not have a Canadian partner currently may not have affordable on-line access to traffic behind/beyond Canadian gateways thereby inhibiting access to competitive air services to many Canadian transportation consumers. In the absence of carriers in Canada with the capacity to provide 'beyond the gateway' seats to international carriers, the Canadian carriers have the opportunity to stifle competition. For instance, if a carrier from Germany wanted to develop a scheduled service between a new point in Germany (e.g., Dusseldorf) and points in Canada, that carrier would certainly require support from German tour operators to fill aircraft. Those tour operators would likely have a requirement to be able to carry their passengers to multiple points in Canada via connecting services. Over and above not providing the connection capacity that is requested, the Canadian carrier could ensure that those tour operators do not get the seats they require on their own (Canadian carrier) flights if they were to support the 'new' service. Carriers set up under the **right of establishment** policy would enhance competition on international as well as domestic markets by providing alternative choices to Canadian and foreign consumers of air transportation.

It should be noted that under this approach, foreign owned carriers established in Canada should be required to employ Canadians to operate the airline, and would be required to register their aircraft in Canada and adhere to all domestic Canadian safety, security and language regulations. It is recognised that measures might also have to be taken to avoid concentration of such services on high-density corridors and provide competition in the areas where it is most needed. Consultation on appropriate measures should be undertaken with airports and other affected stakeholders, as well as airlines, if this is deemed to be an issue.

Question: Should Canada permit foreign air carriers, as a matter of principle or on a case-by-case negotiated basis, to provide air services between points in Canada? If so, under what conditions?

Answer: The Canadian Airports Council has not reached a consensus on the issue of cabotage.

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The Canadian air transportation system serves a critical role for passengers, shippers, and the economy in all parts of the country. The granting of cabotage rights does offer the benefit of potential additional competition; however, this would have to be weighed against the possibility of significant disruption to the Canadian air system. CAC will evaluate this issue as we move forward.

Transborder air services

Question: Should Canada seek negotiations with the United States in an effort to further liberalize the current air agreement between the two countries?

Answer: this is the minimum Canada should do.

Canada needs a more open air services agreement with its most important trading partner. The last round of liberalization between Canada and the U.S. resulted in significant growth in transborder services. Canada's tourism industry benefited, trade was facilitated, and shippers and travellers had greater choice and lower cost. Canadian air carriers benefited as well, with Air Canada becoming the dominant Canada-US carrier and with WestJet, Canjet, and Jetsgo recently breaking into the large U.S. market.

Removing current restrictions on cargo co-terminalization, through flight numbering for sixth freedom passenger services, and price leadership on fifth and sixth freedom operations is the minimum that should be done to further stimulate activity and provide user benefits.

Question: Should Canada seek negotiations with the United States in an effort to achieve a U.S.-style open skies agreement?

Answer: Yes.

Removing existing restrictions, and providing for open fifth freedom rights and open cargo seventh freedom rights would provide for enhanced tourism opportunities and export opportunities for Canadian shippers. It would also provide opportunity for Canadian carriers to piggy-back upon the U.S. market in providing international air services.

It should be noted that the so-called "modified sixth freedom" for passenger operations proposed by Air Canada are not typically part of U.S. open skies agreements, primarily because such operations only make sense in regard to Canada and to a lesser degree Mexico. Thus in negotiating a U.S. style open skies agreement, this element of liberalization should not be forgotten.

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Question: Should Canada seek negotiations with the United States to address issues that go beyond open skies? If so, what issues specifically?

Answer: As noted previously, an exchange of modified sixth freedom rights (passenger) as well as right of establishment should be sought with the U.S.

International air services

Question: How should the Canadian government balance the often conflicting interests of Canadian airports and local governments on the one hand, and air carriers on the other hand, during bilateral air negotiations?

Answer: The proper focus of the Government of Canada should be on creating an environment that benefits the Canadian community at large. It should not be attempting to subjugate the interests of Canadians to the interests of privately held airline companies. CAC notes that in the open environment advocated by CAC, the issue of balancing conflicting interests does not arise. In an open environment, air carriers operate in a manner that best meets the needs of users of air services, and hence the manner that best meets their own needs and the needs of Canada at large.

The objective of Canada's policy should be to promote the broad economic and social interests of Canadians by eliminating policy-based intervention, thereby facilitating and promoting the operation of market forces to provide Canadian communities with a world-class air transportation system that offers the broadest possible range of competitive passenger and cargo services. There is no longer a policy imperative to protect Canadian airlines from competition (to any greater extent than the Government of Canada protects any other Canadian corporation). Airlines are privately owned, for-profit corporations, with a Canadian and international shareholder base, operating in a mature industry with sophisticated management and information systems. There is simply no longer any need to restrict competition to protect individual carriers to preserve shareholder return.

This objective meets the essential needs of all stakeholders. Passengers and shippers, tourism and trade, and communities and airports will all benefit from a competitive air transportation system. Canadian carriers as well will benefit for a number of reasons. First, a user-oriented policy will allow user demand to flourish, which will facilitate the growth of the entire market and provide opportunity for individual carriers to grow and flourish. Second, a removal of restrictions that fetter aggressive, proactive carriers will enable them to take advantage of global opportunities. CAC notes that Canadian carriers need not fear this – indeed they should welcome this. Canadian carriers have shown their innovation, capabilities

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and ability to compete domestically, in transborder service and in international service.

CAC considers stakeholder “interests” as met if government establishes and maintains a competitive environment that allows carriers to compete and succeed based on superior performance. In other words, interests are based on opportunity to succeed – or fail. Under the policy framework defined above, there would be no need for government to be involved in any “trade-offs.” Conflicting interests and trade-offs only enter the equation if narrow definitions are used. For example, if “interests” are defined to include the right of a specific carrier to a guaranteed level of profit or degree of success – then trade-offs become necessary. Meeting this narrow interest will require the imposition of restrictions on other carriers that in turn come at the expense of users. CAC maintains, however, that such narrowly defined interests are not legitimate in a mature, privately held, competitive industry.

Question: Should Canada further liberalize its charter policies to lessen or remove remaining restrictions on granting authority for charter flights between Canada and third countries?

Answer: Yes.

In a mature competitive industry with a global focus, economic restrictions to limit access no longer play a useful role. Moreover, over time, as the distinctions between scheduled and charter services have lessened, maintaining restrictions on charter operators serve little purpose in a steadily liberalizing scheduled services environment.

Question: Should different approaches be taken to the two questions above for passenger and all-cargo services?

Answer: Creating an open environment for both scheduled and charter services is the desired outcome in both the passenger and all-cargo services sectors.

CAC has been long concerned about the need to address cargo issues in light of the growing importance of air cargo in global supply chain management and the impediments often created by passenger service considerations. Thus, to the extent passenger service issues impede all-cargo liberalization, the two should be de-linked so that all-cargo liberalization can be expedited. The ultimate goal for both, however, remains an open operating environment.

Question: Should Canada consider introducing domestic service, ownership and control, and market integration issues into its international negotiations, and if so, under what conditions or with which bilateral partners?

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Answer: Canada should seek right of establishment and “place of business” criteria in lieu of “substantially owned and control” clauses in agreements with all parties. Market integration issues should be a priority for Canada with the U.S and with Mexico.

Right of establishment should be sought with all interested partners. Replacement of foreign ownership and control provisions in air services agreements by place of business criteria or such other clauses recommended by ICAO, should also be a priority in all international agreements.

With respect to market integration, it is ironic that despite Canada, the U.S., and Mexico having negotiated the North American Free Trade Agreement, aviation, one of the most global of industries, lingers in a restrictive operating environment between these nations. Efforts to develop a single aviation market within North America to match the NAFTA environment should be evaluated.

Question: Would Canada be better served by adopting a multilateral (many countries) or plurilateral (smaller group of like-minded countries) approach for further air liberalization? Would this be practical?

Answer: Negotiations among like-minded nations for open skies is preferred to a continuation of the bilateral approach which has led to a complicated, inconsistent operating environment. A multilateral approach would offer the greatest benefit, but is less likely to occur in the short to medium term. Thus a plurilateral approach would be most practical.

The Trans Atlantic Common Aviation Area is an initiative that could achieve success on this front in the relatively short term. As this initiative gathers momentum, Canada must not be left out of the picture.

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OTHER AREAS OF COMMITTEE INTEREST

The CAC will address the other four areas of interest that the Committee has chosen to study. The paper will:

- clearly show how the transfer to local authorities has made airports more responsive and more accountable to their communities, without the need for overarching federal legislation;
- make a strong case for the elimination of federal rent, which is clearly not rent but a tax;
- describe the work that airports do to keep the airport secure and why CATSA's funding must be sufficient to cover all the mandates they have without transferring some of the costs to airports; and
- talk about local and regional airports and their important role in the economic lives of the communities they serve.

Governance

The corporate behaviour of NAS airports is currently governed by the lease between Her Majesty and the local airport authority, especially **Article 9 – Corporate Matters** and the **Public Accountability Principles for Canadian Airport Authorities**. These two documents lay out specific requirements for good governance including qualifications of board members, good fiscal management, transparency and active consultations with the community.

All of these components of good governance flow from the leadership of the airport authority board of directors. It is a point of pride for CAC member airports that their boards reflect their community. Each local Board takes on the flavour of the community it serves. The appointment process seeks to identify the most qualified people to serve on airport boards. Some have a significant number of appointees from the business communities, others have appointees from several local municipalities, and others have a mix. The imposition of a national standardised structure just doesn't work here.

The annual reports of NAS airports provide a wealth of information. They are readily available on the internet. The annual report lists the members of the board and their backgrounds. The members of a NAS airport authority board would be welcome at just about any corporate board in Canada. They come from banking, unions, law firms, engineering, retail, business, tourism, accounting, municipal government and more. Notwithstanding who appoints them, airport boards take their responsibilities seriously and are dedicated to making certain their airport serves their community.

The nature of corporate governance is to be changing. Airport authorities, like all other corporations need the flexibility to adjust their committees and practices to

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ensure that they are responsive to these changes. The lease and public accountability principles provide a solid base for corporate governance. As they are not wrapped in legislation, airports will have the flexibility to meet changing governance requirements as they evolve.

Governance of airports is not just a matter for Transport Canada. The Minister of Industry has introduced Bill C-21, an Act respecting not-for-profit corporations and other corporations without share capital. This bill will replace Part II of the Canada Corporations Act and will cover all federally incorporated not-for-profit-sharing corporations. In fact, Minister Emerson's press release, when C-21 was introduced, specifically noted that C-21 would apply to airports. Its provisions, in combination with the current governance requirements of the lease and public accountability principles establish strong and effective rules for airport boards.

Although NAS airports are not-for-profit organizations, they must operate like a business with a keen eye toward the bottom line. It is essential that they have excess of revenues over expenditures if they are to have the funds necessary to maintain and continuously improve the buildings and important infrastructure. Unlike their American competitors, who have access to grants to fund their capital requirements as grants from the US federal government through the Airport and Airways Trust Fund, all NAS airports must fund all of their own needs from their own resources.

Every NAS airport's annual report provides detailed financial information. It not only complies with the lease and public accountability requirements but also with the growing requirements of the accounting profession in the "post Enron" world. Audited financial statements contain all the standard operations and balance sheet information. In addition the extensive notes to a NAS airport's financial statements include details with respect to a number of the airports activities including the Airport Improvement Fee (AIF), Board and senior management compensation, information on significant single source contracts and more.

An airport does not exist in a vacuum. All NAS airports are heavily involved in their communities and therefore must be transparent in all their relationships with the community they serve. Airports will be involved in most, if not all, of the following;

- Annual General Meetings, inclusive of audited financial statements by public accounting firms*
- Community Consultative Committees *
- Noise Committees
- Access Committees
- Annual Lease Audits*
- Environmental Audits by Environment Canada
- Presentations to Municipal Councils

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- Presentations to various community groups (Rotary, Chambers of Commerce, Kiwanis Clubs, local business clubs/groups etc.)
- Presentations to local MP's, MLA's
- Increased public awareness of airport issues through stronger marketing focus of individual airports
- 60 day notifications in local media of increased rates and fees*
- 5-Year Reviews*

*Ground Lease Requirement

In addition, airports use the internet and other communications devices to ensure they reflect community needs. For example, every major airport has community advisory committees and likely an accessible transportation advisory committee. Depending on the communities' interests, other structures are established to reflect community concerns. Vancouver International Airport's broad based Environmental Advisory Committee is just one example.

Rent

The rent that airports pay to the Federal government has been a matter of discussion for some time. To understand where airports are today, one must consider the time before the first airports were transferred to local authorities. One of first principles was that Transport Canada be "no worse off" after airports were transferred. At the time of transfer Transport Canada was providing subsidies to airports of about \$125 million annually. Fast forward 12 years and "no worse off" would have equated to an accumulated subsidy of \$1.5 billion. Instead, the government has received rent revenues of \$2 billion to date and is projected to receive another \$2.3 billion over the next 5 years. That's \$5.8 billion better than "no worse off".

At the time of transfer, the net book value of Canada's 9 largest airports was \$1.16 billion. This low value reflected the fact that Transport Canada's annual capital investment in airports had been reduced to a mere \$50 million dollars in 1993. As a result, Canada's airports, by and large, were old, inefficient and not nearly able to handle the growing demand for air travel that exploded in the 1990's. Once transferred, local airport authorities faced the daunting task of operating the airport they acquired and upgrading their facilities to meet the demands of both passengers and airlines. To date airports have invested some \$8.9 billion in capital improvements to terminal buildings, runway and taxiways, and such mundane things as services building and garages. All are necessary for airport operations.

The world of commercial air transport has changed significantly since the original leases were negotiated and rents established for local airport authorities. The national airports policy was developed at a time when air service in Canada was

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effectively a duopoly. Air Canada and Canadian Airlines International dominated the market. Their costs were high and their fares reflected those high costs. There were no low cost options except certain charter carriers who offered seasonal services to very few Canadian markets. In fact, Air Canada and Canadian dominated the market with well over 90% of the passenger traffic.

Westjet was formed in 1996 as the first truly low cost carrier. Since then every new airline in Canada has taken up the low cost model. Including Westjet, five new jet airlines have been established in Canada all offering low cost travel. Canjet, Jetsgo, Zoom, Harmony and a number of smaller regional carriers now provide Canadian's with real choice in travel. With Air Canada's emergence from CCAA protection all airlines offer very low cost travel within Canada. A quick survey of fares taken on January 31st 2005 revealed that one could purchase air travel between Toronto and Vancouver for as little as \$139 on Harmony and \$150 on Westjet and \$150 on Air Canada.

Although not all the numbers are in yet, many airports are reporting record passenger numbers in 2004. With fares so low, air travel has become accessible to more and more Canadians. It's clear that Canadian's like the low fare model. Yet, airfares could be lower if rent were removed from the airlines costs.

There is only one source of revenues for all segments of the air transportation business, including the federal government, and that is the passenger. The passenger pays for the airfare, car parking, their meals, a magazine, scarf or watch and pays the government GST, HST, Air Traveler Security Charge. In the new low fare environment government imposed taxes and fees can add significantly to air travel costs. At least at the airport, the passenger gets value for their purchases and the revenue obtained through retail sales helps the airport to mitigate the costs of landing fees and terminal fees paid by airlines. GST, HST, ATSC and rent, all end up in the government's coffers.

Canadian airports, especially the nine airports that currently pay federal rent, compete in a North American market. Halifax, Montreal, Ottawa, Toronto, Winnipeg, Calgary, Edmonton, Vancouver and Victoria work hard to provide good local services but they all know that growth will be found in attracting international traffic. But their major competitors, US airports, do not pay rent. In addition, the US government provides access to federal grants for US airport capital requirements through the Airport and Airways Trust Fund. One expert has estimated that these grants equate to about 30% of US airport landing fees. The CAC is not asking the federal government to provide access to grants for capital projects of Canadian airports. It is important however, when comparing Canadian airports to other airports around the world, to recognise that federal rent, and its impact on aeronautical fees, is a major impediment to the growth and success of Canadian airlines and airports.

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The argument has been made that the federal government, since it leased these airports, is entitled to a return. That's fair. How much return is reasonable? In 12 years the government has been paid double the initial net book value of the airports. Not only that, airports have made such significant improvements that the net book value has more than doubled. Certainly there has been a fair return. The only public policy reason for continuing to collect rent would appear to be "we need the money"

The issue of rent raises even greater concerns when it is applied to small airports, those with less than 2 million passengers annually. Victoria Airport is the only small airport currently paying rent. In 2003 Victoria paid \$1.09 million in rent. Other small airports will begin paying rent over the next few years. Quebec City starts this year. Regina, Saskatoon and St. John's are scheduled to pay rent in 2006. Although these airports have been financially self sufficient to this point, the rent projected for 2006 will cripple their ability to remain viable. Although revenues may increase somewhat over 2003, the last full year financial reports I have access to, it is clear that revenues will not increase enough to meet the rent required. 2006 rent represents 302% of St. John's Airport's 2003 net revenues, 385% of Regina's 2003 net revenues, 251% of Quebec City's net 2003 revenues and 70% of Saskatoon's net revenues. These figures do not take airport improvement fee revenues into account as that revenue is specifically dedicated to capital improvements. These smaller airports will find it impossible to increase their fees to meet these increased costs. The CAC feels strongly that no small airport should be paying rent.

Many small NAS airports, those with less than 2 million passengers annually, are facing additional costs which need to be addressed. Beginning in 2006, these small NAS airports will be required to pay for chattel acquired at the time of transfer. Airports had no choice but to accept this equipment and consumables at net book value. Given Transport Canada's reduced capital expenditure program in the years prior to transfer, much of the equipment was not new and has subsequently been replaced. Twelve smaller NAS airports face payments totalling \$20.4 million through 2014. These airports had no choice but accept the imposition of this cost at the time of transfer. The CAC continues to urge the Minister to forgive the requirement to pay for equipment that has become outdated and consumables long ago consumed.

The CAC strongly believes that there is no public policy reason for Canada's airports to continue to pay federal rent. The collection of rent was not the primary reason for the transfer of airports. The government's eight core policy objectives, as noted at the time were to:

- Permit each respective airport to serve local interests better;
- Enhance regional economic development;
- Allow the airport system to operate more efficiently and commercially;

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- Bring capital expansion more quickly than under federal government stewardship;
- Leave the government no worse off financially;
- Reduce the effect of airport operating and capital expansion on the federal deficit, and over time diminish federal funding;
- Provide equitable benefits packages for employees; and
- Not diminish safety and security standards.

Local airport authorities have a remarkable record of success in achieving these core policy objectives in record time. The continued collection of federal rent, especially as the quantum grows, makes it more difficult to maintain the successes achieved by airports.

Federal rent demands will grow to more than \$500 million annually over the next 10 years if the situation remains unchanged. Canada's airports have paid their fare share and made significant investments in infrastructure. Rent makes Canada's airports uncompetitive, hinders growth, and could force many smaller NAS airports to return the airport to the Minister.

Notwithstanding the CAC's strong view that federal rent should be eliminated, last May, the CAC proposed a rent scheme that our members felt was reasonable. The current rent regime imposes rent levels that make no sense. Ottawa International Airport, for example, currently pays more than \$11 million in annual rent. That's more than Montreal, Edmonton and Halifax airports combined. The CAC updated its proposal, in January of 2005 providing details on how the proposed \$150 million in total annual rent (50% of the current rent level) would be allocated among CAC airports based on enplaned and deplaned passengers. The chart outlines the recommendation.

Rent per Passenger Schedule

Tier	Rate per Passenger
0-2 million pax	\$0.00/pax
2-5 million pax	\$x/pax*
5-10 million pax	\$3.50/pax
10-15 million pax	\$4.00/pax
15-20 million pax	\$4.50/pax
20+ million pax	\$4.70/pax

* "x" is the amount needed to reach the total aggregate rent after applying the other rent calculations

An airport with 8 million passengers annually would pay \$0 per passenger for the first 2 million passengers, \$x per passenger for the next 3 million passengers and \$3.50 per passenger for the final three million passengers. To date we have received no response from government.

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Security

Canada's airports take their security obligations very seriously. As the operators of large and complex facilities, airports have developed robust security programs. These programs ensure that employees on the airports have the proper identification and that the airports control access to the restricted areas of the airport making use of both high tech and trained staff. Since September 11th, airports have added significantly to their security infrastructure, investing millions of dollars, to ensure that the airport remains a safe and secure place for travellers and those employed at the airport.

Passenger security screening, as mandated by Transport Canada, is not part of the airport's direct responsibility. It is the responsibility of the airlines and CATSA. However, we recognise there are some clear links between the work of the airport and that of CATSA. Airport management and CATSA need to work closely and cooperatively and new airport interior designs need to ensure that CATSA can perform its functions.

Airports should not be responsible for any portion of CATSA's mandate. CATSA's mandates are:

- Pre Board Screening
- Screening Checked Baggage
- Non-Passenger Screening
- The Restricted Area Identity Card (RAIC)
- Air carrier Protective Program
- Airport Policing Contribution

In general, CATSA does a good job of providing pre-board screening services at Canada's airports. It is their most public activity and, as a result, subject to much scrutiny. Studies have shown that on average the lines move reasonably well. Of course at certain times of the day and in certain seasons these screening lines can be longer than people would like.

Airports have long sought the opportunity of contracting with CATSA for the provision of passenger screening services. Currently, airports are specifically prohibited from submitting bids for screening services at their airports. We believe that an airport operator is as able as any other third party to provide these services and the airport brings an added customer service focus to the task. Although the CATSA Board of Directors indicated more than a year ago that CASTA should consider a pilot program for an airport operated passenger screening program, none has yet been discussed.

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Many of CATSA's other mandates have significant cost implications for airports. Funding police services is one that affects a number of airports. The requirement for a police presence flows from regulations that require an armed response to the screening point within three minutes. This cannot be managed without police officers being on site. Although CATSA provides funding for some of the police presence, many large airports either carry the additional cost burden themselves or bill the airlines, on a per passenger basis, to recover the additional costs. For example, CATSA provides less than half the over \$2 million dollars cost of policing at Ottawa International Airport. Here again, costs are being added to the airline which will ultimately recover its costs through higher air fares. CAC members are frequently caught between a regulatory requirement to ensure the service is available and CATSA's limited ability to finance the project's associated costs.

Screening checked baggage will pose serious problems for airports. Undertaking such activity involves much more than just some additional pieces of equipment. Airports will need to find sufficient and appropriate space, make significant modifications to that space and to the system of belts and rollers that move baggage once it is checked. CAC member airports have advised us that the provision of electricity to support baggage screening will run into millions of dollars. Airports have no comfort that CATSA, given its current funding, will have the ability, let alone the desire, to pay for these costs.

In the 2003/2004 fiscal year, the government collected \$414 million in Air Traveler Security Charges (ATSC). In this same year, government provided from the consolidated revenue fund, according to CATSA's last audited statements, just under \$245 million to CATSA. Where is the other \$169 million being spent? CATSA has already advised the CAC that they will have a budget shortfall of approximately \$21 million. This relates only to their current projects. The addition of baggage screening and other expensive activities will necessitate additional funding. There needs to be a full accounting to clearly show how \$414 million has been spent.

The CAC supports increased funding for CATSA so that it can carry out its mandates. That said, the CAC's position is that it is government's responsibility to secure Canadians against terror attacks. Airlines and airports were not and are not the targets of terrorists; it is our governments and institutions. As was clear in the tragic events of September 11th, airlines were just the means. Isn't collective security one of government's primary obligations? Yet, when it comes to protecting air transportation, government downloads those costs to air travellers alone.

Our Council is a member of a broad coalition of organizations representing all facets of the tourism industry concerned with rising government imposed charges and fees. The group includes the Air Transport Association of Canada, Tourism Industry Association of Canada, The Canadian Chamber of Commerce and the Hotel Association of Canada and the Association of Canadian Travel Agencies. With one voice, these organizations are calling for the removal of the ATSC. It not only

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unfairly burdens air travellers with the cost of security, the additional cost to passengers has a significant negative impact on air travel itself. The ATSC is among the highest security charges in the world. It may be the highest for international travellers and certainly the domestic charge is well in excess of that charged by the US. Given the current low fare environment the ATSC alone can easily reach 5% of the total cost of travel.

CAC member airports accept the obligation to ensure the security of the airport. However, CATSA must meet its mandated requirements without the need for additional financial contributions from airports. Currently that should require additional allocations from the ATSC. However, in the long run, the ATSC must be eliminated from air travel costs.

Viability of Small Airports

The viability of small airports, those airports with less than 2 million passengers annually, is a subject that has been studied at length over the past few years, yet agreement on key issues, let alone their resolution, remains elusive and the federal government is in the process of reconsidering its roles and responsibilities.

The National Airports Policy made it clear that the federal government wanted to get out of the business of operating airports. Unlike the airports within the National Airports System, the regional and local airports were sold to their respective owner/operators. At least 180 communities are served by local and regional airports that receive scheduled air service. These airports are an important link to the wider world. Additionally, these airports provide services for medevac, forest fire fighting and local services like flying schools and air taxi operations. Small airports are important drivers for social and economic development.

The objective of the NAP was to maintain a "viable" airport system. Divested airports were expected to be safe and secure, more responsive to local needs and able to function in a more commercial manner. Moreover, small airports were expected to be financially viable in order to ensure a "healthy feeder airport system in Canada." In recognition of this latter role, the government offered financial assistance for safety-related, airside capital projects since the national system ultimately benefits from passengers and cargo fed from the small airports.

But these small airports were plagued by years of neglect and faced degradation of essential infrastructure. Since divestiture, they have faced declines in service and revenues due to restructuring of the airline industry which favours the more lucrative routes between major centres. Nevertheless, most small airport operators have met the objectives of divestiture by reducing costs and increasing revenues and an effort to remain viable. Transport Canada's own internal review concluded that small airports have done all they can to cut costs and attract new revenues. In short, they have done the best they could under trying circumstances.

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The report that was commissioned by the provincial governments identified three classes of small airport: those that are able to manage their operational costs and make a contribution to capital expenditures, those that are able to pay for operational costs but cannot fund capital expenses and those that have insufficient cash flows to meet even their operational costs. It is important to note that there is no distinction made here between small airports within the NAS system and those outside. Rather, it is a question of total traffic and the ability to raise revenues and reduce costs that distinguishes small airports - not an arbitrary designation. The reality is that some small airports are quite capable of managing without any outside financial support but others, in order to continue to serve their communities and contribute to the national system, will require some form of government assistance.

A recent Transport Canada internal review concluded that there are very few programs that exist to provide support to airports on their safety-related capital expenditures. ACAP is the only mechanism through which the department provides capital funding. Other federal infrastructure funding programs, such as those offered through the Canada economic Development Agency in Quebec, the Western Economic Diversification Agency and the Atlantic Canada Opportunities Agency, exclude airports that are eligible for ACAP. Provincial programs for airports exist in Manitoba, Alberta and British Columbia but they either exclude ACAP eligible airports or give them low priority for funding. It is much more difficult for a small airport to raise capital through financial institutions. Without ACAP funding, many small airports would not be able to ensure the continued safety of their facilities.

Since its inception, ACAP has provided \$227 million to small airports, an average of only \$22 million per year. Of the four priority categories, only priority one and two projects have received funding. Transport Canada has estimated the demand on ACAP to be \$237 million over the five year period to 2010 but has only funded \$175 million leaving more than 25% of safety-related projects unfunded. Yet, over the period 1995-96 to 2002-03 the department saved over half a billion dollars; more than enough to satisfy what has already been expended plus the forecast requirement for the next five years. At the same time, the government has collected approximately \$2 billion in rent revenue.

In its own internal studies, Transport Canada has concluded that the transfer of NAS airports to local control has been a success. These airports have proven their ability to operate safe, efficient and fiscally responsible businesses that are responsive to both users and their communities. Since small NAS airports have proven their ability to function without government support, they would like the option to negotiate the transfer of land title to the existing operator. Coming out of the NAS system and owning the land the airport sits on provides these smaller airports with a number of benefits. These include:

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- debt financing and additional avenues for capital
- the ability to assign leases
- opportunities to develop new business partnerships
- greater flexibility to meet user needs.

The government has already established the precedent of transferring airport land to regional and local airports and could use the same terms and conditions for small NAS airports. We do not know how many smaller NAS airports might want to take advantage of this option, but it should be available.

The other role of the federal government is to use its regulatory and legislative authority judiciously. Since the transfer of airports, Transport Canada, unencumbered by the fact that they were also the airport operators, has been free to exercise its regulatory imagination. Currently, there are 15 separate regulations affecting airports that are awaiting final justice review. The CAC has petitioned the department to conduct proper risk assessment and benefit/cost analysis as part of the early development of regulations. Under the current process, the regulatory impact analysis statement (RIAS) does not appear until the proposed regulation is published in the Canada Gazette Part I. It is essential that regulators first substantiate the need for a regulation and then justify the associated cost on the basis of a clearly defined safety benefit. Airports, and other stakeholders, must have an opportunity to review the assumptions and be able to question the results well before the regulation is cast in stone.

The one size fits all approach adopted by regulators often imposes financial and administrative burdens on smaller airports. More than 3300 people work directly for CAC member airports. But only 18 % of this total serve smaller NAS and local and regional airports. Airport regulations often involve costly facilities and equipment and complex reporting requirements that are far beyond what smaller airports can afford. These costs must ultimately be passed on to the airport users, whether passengers or carriers. The impact has not escaped the department's internal auditors. A recent study of the airport divestiture program concluded that, "Transport Canada should be increasingly conscious of the cost impact of proposed new or amended regulations on airports since Transport Canada's corporate knowledge about the cost structure of running an airport will continue to decrease as a result of its divestiture program." Regulators must take care to ensure that regulations or legislation are the last best choice to address their concerns.

Small airports have also had to bear the brunt of cost recovery policies imposed by the Canadian Border Services Agency. As a result of the strict implementation of the Treasury Board *Cost Recovery and Charging Policy* of 1997 which was subsequently replaced by the *External Charging Policy* in August, 2003 border services were "grandfathered" at existing levels. Any subsequent requests are treated on a direct cost recovery basis or not provided at all. This was further

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exacerbated by requirements following 9/11 which put an additional financial strain on the CBSA budget and reduced some existing services.

The larger airports already have extensive service coverage, based on historical demand. It is the small airports that are being unfairly penalized by this policy since service levels are not adjusted to reflect current demand. Where airports are obliged to contract with CBSA for additional scheduled service, they either lose a large portion of the benefit from the new transborder and international traffic, or must increase aeronautical fees to cover the cost. Carriers and passengers both suffer from this inequitable treatment as the costs are passed on to users and the ability to attract new service for the community suffers.

The economic benefits resulting from increased transborder and international air traffic can far outweigh the cost of providing Customs services. Direct tax benefits to the federal government alone should justify the additional cost. Where it can be demonstrated, through pre-determined criteria, that the benefits of this service extend beyond a single user or supplier, the system should adjust to accommodate the need without additional cost to the airport operator. Existing services should be reviewed and more appropriately allocated to meet demand.

In terms of small airports, we propose four actions. The federal government should help ensure that small airports are able to operate safely, by providing an adequate, secure and stable level of funding for the ACAP program, resolve the current inequities in the provision of border services, provide an option for small NAS airports to become masters of their own destiny by opting out of the NAS, and be more cognisant of the impact that regulations will have on airports, especially small airports, and be creative in finding alternative ways to achieve what they seek.

Conclusion

The CAC supports the Standing Committee's decision to look into significant airport issues. The CAC is confident that at the end of the Committee's work it will determine that:

- Canada's locally operated airports have been an unequivocal success.
- Airports are accountable and responsible to their communities and they operate in a manner far more transparent than most other organizations. Additional legislation will not change this.
- Airports have paid their fair share for the use of the NAS airports. Its time that federal rent and the requirement to pay for outdated chattels be eliminated for all NAS airports.

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- CATSA's mandated services must be fully funded. Downloading of CATSA costs to airports just creates a hidden tax as these costs will ultimately translate in higher air fares.
- The federal government's role in local and regional airport viability is addressed through an adequate and predictable funding of the Airport Capital Assistance Program and a regulatory regime that is based on sound risk assessment and an understanding that smaller airports are less able to meet the financial demands that regulations often impose.

The Standing Committee is beginning a fascinating journey. Over the coming weeks members will hear from a number of CAC members as well as others who represent diverse points of view. The CAC welcomes the dialogue and stands ready to assist the Committee in its work as it see fit.