Source

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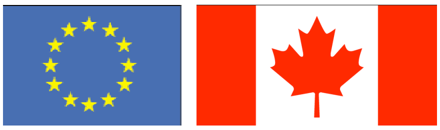
An EU - Canada Open Aviation Area on the Horizon

As a next step towards achieving targeted aviation agreements with selected third countries, the European Union is now turning its attention to Canada. The stated aims include 'creating new economic opportunities by opening up markets and promoting investment opportunities', ensuring 'fair competition' as well as reaching 'high standards of safety, security and environmental protection by promoting regulatory co-operation and convergence.' In turn the Canadian government has vowed to further liberalise its air transport market. Talks started in late 2007 and both parties are optimistic that an agreement will be reached in the near future.



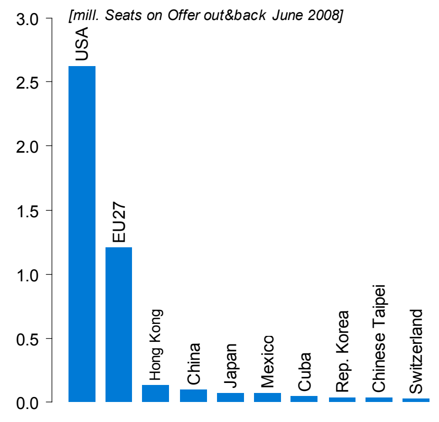
Air Transport Market Characteristics

Canada has 42 airports with an air traffic control tower and a further 53 without. The Canadian government has a determined policy to overcome the potential isolation of its regions resulting from the geography of the land, marked by straits, mountains and forests. Air transport is one arm of that policy, together with rail and waterways. Not surprisingly domestic air transport accounts for 46% of the 68.2 million passengers which travelled to, from & within Canada in 2006 according to Transport Canada's latest data. A further 30% travelled on services between Canada and the USA, known as 'trans-border' services. The remaining 24% are international passengers with destinations beyond the North American continent.

By far the largest airport in Canada is Toronto Pearson International Airport, with 31.5 million passengers and 424,699 movements in 2007. It is the largest airport in all categories: domestic (13.8 million passengers or 44%), trans-border and international (8.8 mill. or 28% each). With 17.5 million passengers Vancouver International is the second largest airport, with domestic operations accounting for 51% of the total, USA 25% and other international destinations 24%. There are only two other airports in the list which

Fig. 1:

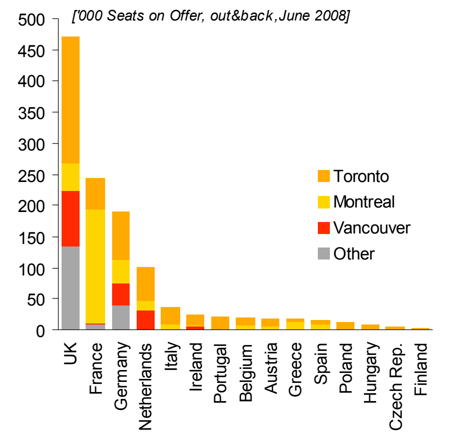
Top 10 Intern'l Destinations to/from Canada



Source: OAG

Fig. 2:

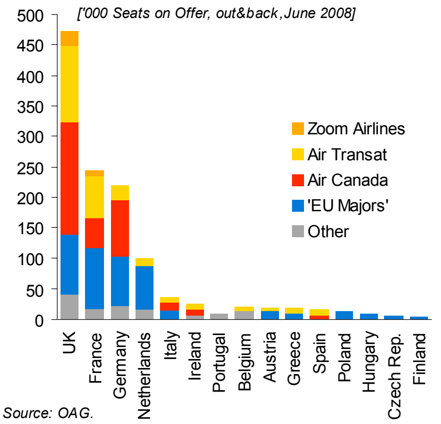
EU-Canada Capacity by Destination Airport



Source: OAG

Fig. 3:

EU-Canada Carrier Participation by Country



Source: OAG.
'EU Majors' are British Airways, Air France, Lufthansa, KLM, Alitalia, Austrian, Olympic Airways, LOT, Malev, Czech Airlines and Finnair.

handle in excess of 10 million passengers annually: Montreal's Pierre Elliott Trudeau International and Calgary International with 12.4 and 12.2 million passengers respectively. In terms of international passengers other than USA, three airports account for the bulk of the traffic: Toronto (8.8 mill. passengers), Montreal (4.2 mill.) and Vancouver (4.1 mill.).

Measured in seats offered in the upcoming schedule for June 2008, 57% of international capacity is reserved for trans-border operations to the US. Beyond trans-border traffic, EU27 is the largest single destination for Canada, accounting for 26% of planned seat capacity. The remaining, much smaller ,shares are for services to/from Asia (9%), Mid & South Atlantic (5%) and to North Africa, Middle East and non-EU countries in Continental Europe (Russian Federation, Switzerland, Ukraine and Iceland), each representing just 1% of capacity. (Fig. 1)

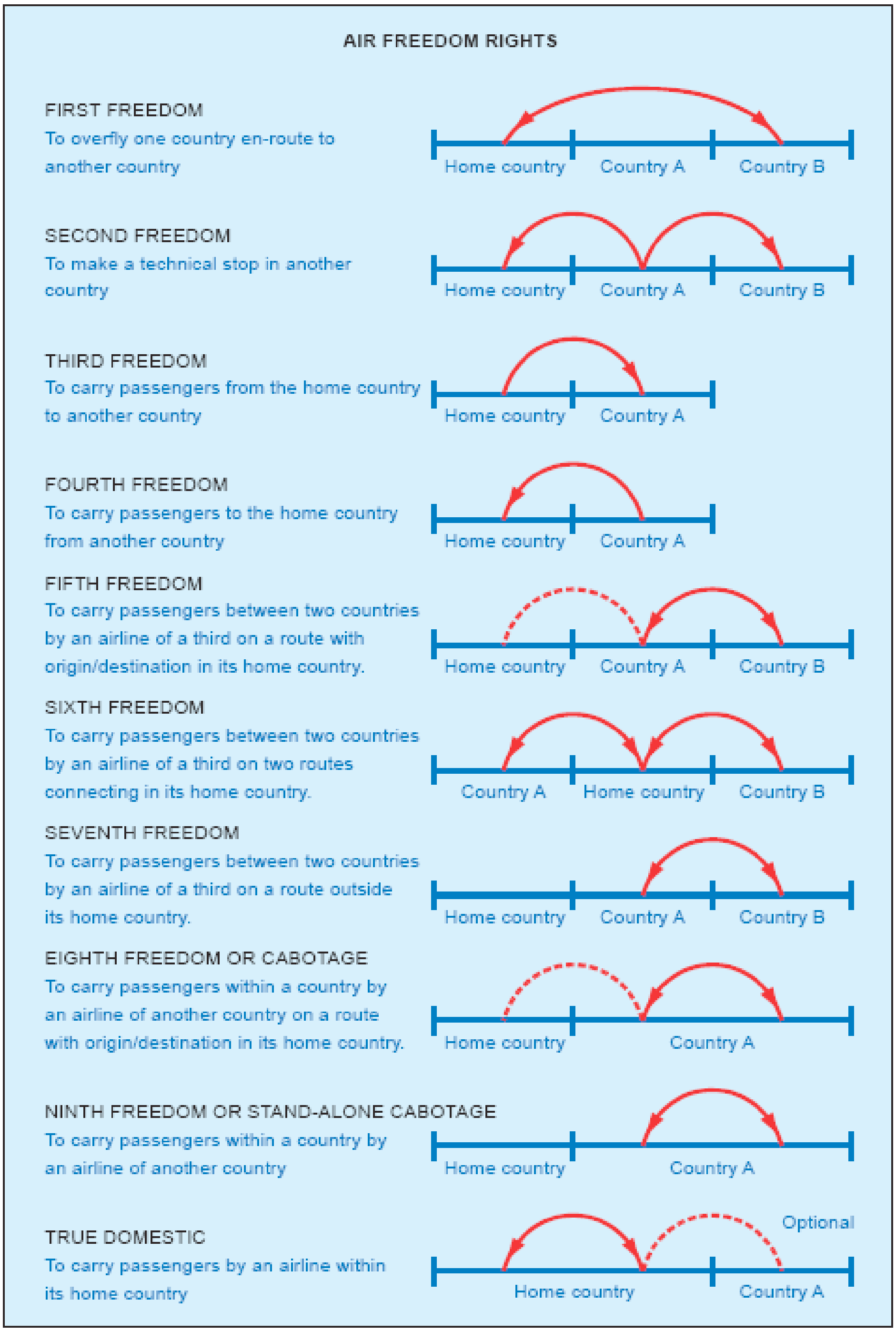
Within EU27 the United Kingdom is the most important market, accounting for 44% of traffic between the two regions and on its own 6.5 times larger than the third most important international destination: Hong Kong. France, closely followed by Germany, are respectively the second and third largest markets in the EU, each approximately half the size of the UK. The three countries together account for 78% of EU-Canada seat capacity (Fig. 2). Eurostat reports that EU-Canada accounted for 8.65 million passengers in 2006.

There are currently three Canadian carriers operating to EU27. The largest is the 'flag carrier' Air Canada, which operates an extensive network and was a founding member of the STAR alliance. The company was privatised in 1988, one year after the deregulation of the Canadian air transport market with the National Transportation Act of 1987. In 1999 Air Canada absorbed Canadian Airlines and took over Canadian Regional Airlines in 2000. In April 2003 the company filed for bankruptcy protection, from which it emerged successfully in September 2004. The Air Canada holding company is also the owner of Air Canada Jazz, a regional subsidiary operating North American services.

The two other Canadian carriers with operations to Europe are Air Transat, a wholly owned subsidiary of a leading tour operator, and low-cost carrier Zoom Airlines which started operations in 2002 and has a UK subsidiary based at London's Gatwick Airport.

Worth mentioning but otherwise not featured in our international view of the market is WestJet. The company was founded in 1996 and has grown to become a highly successful low cost airline. With hubs at Calgary and Toronto it operates services within Canada and to the USA and is currently the second largest carrier in Canada after Air Canada.

On the EU-Canada market Air Canada has the highest amount of capacity planned for June 2008, accounting for 30% of the market overall, with fast expanding Air Transat taking 22.8% and young Zoom Airlines a 2.9% share, including its UK affiliate. Together the Canadian carriers have the lion's share of the EU-Canada market with 55.7%. They



have seen steady growth since 2004 when their share was 4.5 %-pts lower. EU carriers account for most of the remaining market. Air France is marginally the largest contender, with 8.3% of total capacity on offer, followed by British Airways at 8.2%. Lufthansa's share of 6.7% and KLM with 5.9% means that the four largest EU carriers collectively represent 69% of all capacity put into the market by EU airlines. Figure 3 shows the relative weight of the carriers operating, whilst figure 2 shows the Canadian airports served from each EU country.

EU members of Star Alliance -Austrian, bmi, Lufthansa, LOT, SWISS and SAS - also market a wide range of services within Canada through code-shares on flights operated by local partner Air Canada.

Regulatory framework of agreement

In October 2007 the Ministers of Transport of the 27 EU Member States gave the European Commission a mandate to launch negotiations with Canada on a comprehensive Open Aviation Area, or the creation of an 'airspace without borders' between the Union and Canada. The Canadian government has also signalled its desire to discuss liberalising the air transport market between the two blocks, in the framework of a general shift towards a more open aviation policy aimed at enabling increased travel, tourism and trade.

Currently air transport between EU and Canada is governed by bilateral air service agreements (ASA). Traditional ASAs include a nationality clause which limits the rights awarded by the agreement to airlines substantially owned and effectively controlled by nationals of the signatory states. As this clause contravenes the provisions of the EU's constitutional foundation, as confirmed by the 2002 ruling by the European Court of Justice, it must be removed from all ASAs. The EU would seek a priori to correct this to ensure 'legal certainty' for services between EU and Canada.

A next step consists of achieving a high level of regulatory co-operation and convergence in areas such as aviation safety, security, environment and passenger rights. This has been the focus of discussions in the first two rounds of talks, which took place in November 2007 and February 2008.

Yet to be addressed are issues of traffic rights and ownership and control, which have been the sticking points in the on-going negotiations with the US. In particular the Canadian delegation is seeking 'beyond 5th freedom' rights, i.e. the right to carry passengers on a flight originating in Canada with additional boarding in the EU for onward travel to a point beyond the EU, such as Montreal-Paris-Singapore. It has also indicated that it has no mandate to negotiate '8th freedom' or 'cabotage' which would allow EU carriers to operate domestic flights within Canada. The EU delegation is seeking the removal of all traffic restrictions.

On ownership the Canadian Transportation Act stipulates that whilst there is no limit on the total equity ownership which can be held by foreigners, at least 75% of the voting stock of an air carrier must be owned and controlled by Canadian nationals, limiting controlling foreign ownership to 25%. This is currently under review within Canada and it is high likely that the limit will be raised, perhaps to 49%. This would be a prerequisite to furthering the conclusion of an OAA with Canada.

A third round of talks, starting at the end of April 2008, will aim to find an acceptable compromise on these issues.

From the outset both parties have been optimistic that the agreement can be negotiated and finalised in a short space of time. A Commission sponsored study by Booz Allen Hamilton identified multiple benefits from the implementation of an OAA with Canada. In the first full year of application an additional half million passengers could be expected, reaching a cumulative 9 million extra passengers in the first five years. The liberalisation of the air transport market is also likely to increase competition with a subsequent fall in fares to the benefit of the passenger, amounting to between EUR 72 million and EUR 178 million in the first year. The additional traffic should also generate more employment in the sector, estimated at 3,700 additional jobs in the first year. It would furthermore strengthen the economic ties between the EU and Canada in particular and, in conjunction with an EU-US Open Aviation Area agreement, with North America in general. *[SL]*