



**A brief submitted in response to the Competition Policy  
Review Panel Consultation**

January 10, 2007

*Expanding Our International Base*

## Introduction

The Federal Government announced in July 2007 an independent panel review of government policies and initiatives that affect Canada's ability to compete - domestically and on the international stage. A consultation document released October 30, 2007 provides the framework for this consultation process and outlines questions of topical importance to Canada's business sector. Transat recognizes the importance of this panel process and looks forward to its recommendations in June 2008.

Transat is Canada's leading integrated travel and tourism company. With annual turnover of over \$ 3 billion CDN, we rank among the world's top five largest such holdings. Our strategic and long-term focus is international leisure travel serving primarily the tourist/package tour and visiting friends and relatives (VFR) market segments. Our vertically-integrated or "top down" approach in developing products and services is driven by Canada's largest national travel wholesaling and retail distribution network. Our principal air transport asset, Air Transat, of which we are the sole and controlling shareholder, is Canada's second largest operator of international passenger air services and provides our group with mission-critical airlift support, as well as with high-level visibility and brand recognition.

Transat employs over 6000 people in all major regions in Canada, as well as in several other countries including France, the United Kingdom, the Netherlands, Greece, Mexico, Cuba and the Dominican Republic. Air Transat operates from nine Canadian gateways including its bases in Vancouver, Toronto and Montreal providing international passenger service to 92 destinations and 31 countries worldwide. Along with its other airlift providers, Transat offers package tour products and air services from a total of 21 Canadian cities to holiday destinations on four continents.

While Transat is a Canadian-owned and based company, our operations and commercial interests are multinational in nature. Indeed, over 30% of our revenues are currently derived from foreign sources including some of our key wholesaling and retail distribution assets in Europe. These include *Canadian Affair* and *Vacances Transat France*, which specialize in selling Canada as a destination from their respective territories in the United Kingdom and France, as well as *Look Voyages*, a major French travel wholesaler which sells package tours from France to holiday destinations in Europe, northern Africa, Mexico and the Caribbean. Our various divisions combined have enabled Transat to become, by far, the second largest Canadian operator on the transatlantic sector and a significant player in the EU-third country leisure travel segment. In total, these activities represent just over half of our current operating revenues.

Transat recently extended its vertical integration model through the conclusion of a joint venture with H10 Hotels based in Barcelona, Spain. As a result of this new partnership, Transat now owns a minority position in a number of H10 properties in Mexico and the Dominican Republic.

This international market composition indeed dictates our strong interest in the results of this review process. Thematically calibrated against the consultation document, Transat's area of particular concern is *Promoting Canadian Direct Investment Abroad* and the broader issue of Canada's domestic tax platform which drives international expansion decisions.

## **Expanding Our International Base**

The panel consultation document poses some specific questions regarding the ability of Canadian companies to increase their foreign investment and compete internationally. This is a useful point to begin a discussion concerning international market expansion strategies. However, for Transat the most significant barriers in considering expanded global activities and development are the result of Canadian domestic policies. Specifically, Transat's most important impediment to continued international expansion is the contradiction between efforts to pursue air liberalization on the one hand, and the onerous domestic tax and fiscal platform from which we must launch such efforts.

Transat's international operating model dictates that significant strategic growth must come from our ability to service additional international locations through our principal supplier of air seats, Air Transat. Announced in November 2006, the federal government's *Blue Sky* policy provides the framework for continued liberalization of air markets. This framework has set the stage for Open Skies arrangements with Ireland, Iceland and New Zealand with expanded bilateral service in a host of additional countries. Negotiations with the European Union are ongoing and we expect discussions to proceed with partner countries in the Caribbean and Asia in 2008. Transat is clearly supportive of these efforts to increase market development potential for Canadian carriers.

Transat is willing to take the risk to compete in these international markets. However, to do so there must be a domestic tax platform that is on a level playing field with other international carriers.

## **Air Sector Domestic Cost Base**

Reducing the operating cost base is one of the fundamental tenants of success in the international market. Airlines in Canada have become world leaders in achieving and perpetuating the lowest and most competitive controllable seat-mile costs. While the industry has been successful in reducing controllable cost, the single largest threat to our viability and competitiveness are externally imposed third-party costs.

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 directly and indirectly producing over \$67 billion<sup>1</sup> annually in economic output. Canadian air carriers and their customers are also, by far, the biggest financial supporters of this country's aviation infrastructure.

In many countries, including the United States and several European Union countries, air transport industries are supported through direct or indirect subsidy. Canada has undertaken the opposite approach motivated in the 1990s by federal deficit reduction objectives. During this period the government began moving aviation infrastructure assets such as airports and air traffic control services off of its balance sheet and established them as standalone, unregulated monopolies through a nominal not-for-profit model. The negative impact of this on the airline sector cannot be overstated.

Numerous studies in recent months have highlighted the consequences of these commercialization efforts of critical air infrastructure. A study entitled "*The Role for Government Policy in the Cost Competitiveness of Canadian Aviation: Impacts on Airports and Airlines*" by

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<sup>1</sup> Statistics Canada, National Tourism Indicators

Intervistas Consulting identifies three main factors when examining the cost burden in comparison to other jurisdictions:

1. *Fiscal Penalties* – differences in the tax systems of Canada and the United States as these policies relate to the air sector. Critical Examples: Airport Rent, PILT, GST, Fuel Tax.
2. *Investment and Operating Penalties* – which result from policy based differences in investment into infrastructure and its operating environment.
3. *Additional Air Transportation Cost Disadvantages* – which include several forms of non-financial and financial aid from governments in the United States, but not in Canada<sup>2</sup>.

While this is a relatively complicated set of fiscal penalties and cost disadvantages, the bottom line remains that the aggregate of these cost imposing measures translates into a fiscal expenditure of between \$20 - \$25 per passenger.<sup>3</sup> Moreover, the impact of airport fee increases across Canada over the past decade and the aggravating role played in this regard by the federal governments annual \$300 million take in crown rents is well documented.

In isolation it can perhaps be argued that this fiscal and tax framework is simply the cost of doing business in Canada, to which the industry can and has adapted. However, as the federal government continues to pursue efforts to liberalize international air markets through its *Blue Sky* policy, the negative impacts of this domestic cost burden will be truly felt by Canadian carriers.

There are some acute examples within the European Union. The EU has made significant progress in the last decade nurturing a fair competitive environment and level playing field through continuing privatization efforts and a reduction in formal state aid and subsidy programs for airlines. There remain, however, a few anomalies to these trends. Transat's airline division is the sole operator of services between Canada and Greece. Our principal competitor in this market is a wholly state-owned airline. Although the Greek government has made efforts in the past to privatize this entity, all efforts to date have failed. A chronic money losing operation, this entity operates as a government policy instrument supported by the Greek and European Union taxpayer. Similar observations can be made in Italy although privatization undertakings are fortunately more advanced.

On the cost side, Air France enjoys the benefits of dramatically reduced charges at its base of Paris Charles-de-Galle airport as one of Air Transat's major competitors. Air France is currently charged approximately \$3500 CDN to land an A330-200 at its hub and use the terminal facilities. Air Transat must pay almost \$11, 000 CDN to do the same 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. Evidently, Air France enjoys a substantial proportional airport cost advantage in relation to Air Transat and can use this to cross-subsidize its operations on the Canada-France services.

While these are clear distortions of the free market, other examples exist when examining the substantially lower cost burden provided to other European and Middle Eastern carriers.

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<sup>2</sup> InterVISTAS Consulting: "The Role for Government Policy in the Cost Competitiveness of Canadian Aviation: Impacts on Airports and Airlines" October 17, 2007, Page II

<sup>3</sup> InterVISTAS Consulting: "The Role for Government Policy in the Cost Competitiveness of Canadian Aviation: Impacts on Airports and Airlines" October 17, 2007, Page VI

*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.*

### **Foreign Investment Policies and Promoting Canadian Investment Abroad**

As outlined earlier, Transat generates a substantial proportion of its operating revenues from offshore investments and operating units. Our clearly stated goal is to maintain and build on our position as one of the world's largest integrated leisure travel companies. To this end, we are moving forward on our strategic development plan which involves organic growth initiatives and, most notably, domestic and foreign travel industry acquisition objectives. Consequently, we strongly support any measures which are designed to facilitate such investment and growth.

Canada's current policy with respect to foreign investment in the air travel sector limits foreigners to a maximum of 25% of the voting stock of Canadian air carrier licensees. The Governor-in-Council has legislative authority to increase this threshold to a percentage not exceeding majority control.

As the sole owner of Air Transat's outstanding shares, Transat and its entire corporate holding is subject by extension to the 25% foreign voting share ownership limit. However, we do not at this time consider this as an impediment to our efforts to attract capital and to finance ongoing operations and our strategic development plan. Indeed, Transat was one of the pioneers in the Canadian travel industry in developing and implementing a variable voting share system, which has been fully approved and endorsed by the appropriate regulatory authorities, and which theoretically allows for no limit on foreign equity investment in our company while respecting the restriction on voting share rights. We believe that this system is satisfactory for our foreseeable capitalization needs within the current regulatory context.

Notwithstanding, Transat is fully mindful that this view may not be shared by other stakeholders in the travel industry and that the Panel may see value in moving towards a more liberal foreign ownership regime for the Canadian air transport sector. While we offer no position one way or another in this respect, we would nevertheless strongly urge that any such initiative not be taken in a vacuum or in a manner which would essentially result in unilateralism and the creation of investment opportunities *solely* for foreign interests. Specifically, Transat recommends that any move to increase the foreign ownership limit in Canada be undertaken *concurrently and in conjunction* with government diplomatic and international negotiation efforts to achieve corresponding opportunities for Canadian investors abroad. This is especially critical for some of our major foreign trade and travel markets such as the United States, the European Union and Mexico, where Transat sees some very interesting potential investment opportunities.