MARKET STUDY ON CANADA'S AIRLINE INDUSTRY

SUBMISSION TO COMPETITION BUREAU

AUGUST 31, 2024

CANADIAN AIRPORTS COUNCIL

Submission

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1. Overview

Canada is the second largest country in the world by land area with a population of over 40 million. As our population centres are widely disbursed across the country, it is essential that our many communities have access to affordable and dependable transportation options.

This is a critical role that air transportation plays. Our air transportation infrastructure comprises a crucial network of local, regional and international airports. They are essential for linking the country's expansive and diverse regions, promoting economic development, stimulating tourism, and ensuring that even the most remote communities have access to essential services and economic opportunities.

Competition Bureau Canada is laying the foundation for a comprehensive market study of competition in Canada's airline industry, beginning with an understanding of the current state of domestic air travel.

Domestic air travel is more competitive today than it was pre-COVID in 2019. Back then, our country's top two air carriers accounted for 86% of domestic capacity. Today, in 2024, they account for 76%.[1] The growth of carriers such as Porter and Flair has made air travel in Canada more competitive as they are flying a higher portion of Available Seat Miles.

We know competition is growing and there is a lot of seat capacity; the question we should be asking ourselves is: "Is seat capacity deployed where it is needed most for Canadians, and what is the role of government?" Air travel is not a luxury in this country, it is an essential service and communities need to be connected by air to participate in today's global economy. No matter where they live, Canadians need reliable, affordable air service.

Our federal government plays a vital role in establishing policies, regulations, and programs that support a thriving and sustainable air sector in Canada. In this submission, the Canadian Airports Council provides insight into the domestic air travel situation and puts forth several policy recommendations aimed at creating the optimal public policy environment for air travel to flourish.

[1] *Source: Innovata Schedules via Cirium, InterVISTAS Analysis*

2. Canadian Airports Council

The Canadian Airports Council (CAC) is the national trade association that represents Canada's airports. Established to advocate for the interests of its members and enhance the development and operations of airports across the country, the CAC plays a crucial role in shaping the landscape of Canadian aviation.

Mission and Objectives

The CAC's primary mission is to promote the growth and development of safe, secure, and sustainable airports in Canada. We aim to ensure that Canadian airports operate efficiently and effectively, meeting the needs of passengers and other stakeholders. The council works to inform government policies and regulations that impact the aviation industry, striving to create a favourable environment for airports to maximize a positive traveller experience.

Membership and Representation

The CAC's membership represents more than 100 airports, ranging from major international hubs to many smaller regional airports. This diverse membership allows the council to address a wide array of issues relevant to different types and sizes of airports. The CAC represents its members' interests at both the national and international levels, ensuring their voices are heard in policy discussions and regulatory developments.

Advocacy and Policy Influence

A key function of the CAC is advocacy. The council engages with federal, provincial, and municipal governments to advocate for policies that support the airport sector's growth, sustainability, and a positive traveller experience. The CAC also works on issues such as airport financing, environmental sustainability, passenger facilitation and technological advancements.

Collaboration and Best Practices

The CAC fosters collaboration among its members by providing a platform for sharing best practices, knowledge, and expertise. We organize conferences, workshops, and seminars where airport professionals can network and discuss emerging trends and challenges. This collaborative approach helps airports improve their operations and adopt innovative solutions to enhance operational efficiency and the passenger experience.

Industry Partnerships

The CAC is the Canadian division of ACI North America (ACI-NA) and maintains strong partnerships with other industry organizations, including Airports Council International World (ACI), and various government agencies. These partnerships allow the CAC to stay informed about global aviation trends and ensure that Canadian airports remain competitive on the world stage.

Economic Impact

By supporting the growth and development of airports, the CAC contributes to the broader Canadian economy. Airports are vital economic engines, generating employment, facilitating trade, and promoting tourism. The CAC's efforts to enhance airport infrastructure and services have a ripple effect, boosting economic activity and connectivity across the country.

3. Role of Airports in Canada's Air Travel Industry

Canada's airports play a pivotal role in our country's air travel industry, serving as essential hubs for both domestic and international connectivity. With more than 100 airports strategically located across our vast country, we facilitate efficient travel and transportation, contributing significantly to the economy and the mobility of people and goods.

On a commercial and leisure level, Canadian airports act as major gateways to the world. Airports such as Toronto Pearson International Airport, Vancouver International Airport, Montréal-Pierre Elliott Trudeau International Airport, and YYC Calgary International Airport are among the busiest in North America. They serve as primary entry points for international travellers, promoting tourism and fostering international trade. Furthermore, airports host a wide range of government services, including customs, immigration, and security screening, which are crucial for maintaining the security of the nation while ensuring smooth passenger flow.

In addition to international travel, Canada's airports offer vital domestic connectivity. Given our vast geography, air travel is often the most practical means of transportation between provinces and territories. Airports facilitate the rapid movement of people and goods across the country, essential for supporting regional economies. This connectivity is especially important for communities in the northern and remote regions, where alternative transportation options are extremely limited.

Over and above our commercial and leisure economies, air transportation is critical for essential goods, services and the health and safety of our society:

- Air transportation provides daily connectivity that allows perishable goods on our grocery store shelves and essential supplies to be delivered;
- Air transportation provides access to medical facilities, ambulatory care and the connectivity that allows blood samples, tissues and organs to be transported for life saving medical treatments;

- Air transportation provides vital links in the supply chain that get high value goods to market;
- Air transportation provides access to markets where ground transportation does not exist or is not available year round; and,
- Airports provide the infrastructure that allows Canadian fire fighters to fight fires from above keeping our communities safe.

It is also worth noting the overall crucial role that Canada's airports play in emergency response and disaster relief. They provide essential infrastructure for the rapid deployment of aid and emergency services during natural disasters and other crises. This capability is vital for ensuring timely assistance and support to affected areas.

Canadian airports by themselves significantly contribute to the national economy. They generate substantial employment opportunities, both directly within airport operations and indirectly through associated industries such as tourism, hospitality, and transportation. The economic impact of airports extends beyond their immediate vicinity, influencing the broader economic landscape of the regions they serve. Canada's airports directly contribute a total of $19 billion to national GDP. Including indirect and induced impacts, Canada's airports contribute an estimated $35 billion in total GDP.

Canada's airports were privatized in the early 90s to operate under an efficient and effective business model. That model is community-based, user-pay, non-share capital corporations where all operating surpluses are reinvested back into infrastructure. Having no shareholders that require dividend payments allows airports to help keep costs lower for travellers.

The Canadian airport model has operated efficiently for 30 years with a passenger-first business mindset. With the black-swan exception of the pandemic, it has worked very well for Canadians. We welcome government investment, better access to capital and certain changes to ground leases, and the model should be examined for improvements, but not necessarily revolutionized. This privatized hybrid community approach ensures the efficient business operation of airports while keeping community needs at the forefront. It allows airport authority business corporations to address the needs of various stakeholders, including governments, airlines, passengers, and the local community through a governance structure with Public Accountability Principles.

It is a model that has worked well for Canadians, but after 30 years it also needs to evolve to meet the future demands of a growing aviation sector in Canada as well as ensuring air connectivity for all regions of Canada.

4. The State of Airline Competition in Canada

What is the state of competition in the Canadian airline industry, how can we achieve greater airline competition, and what are the benefits for Canadians?

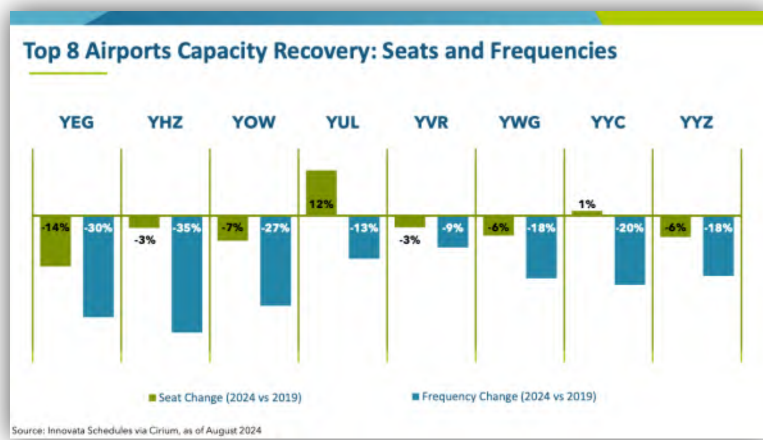
The state of airline competition in Canada is shaped by several factors, including market structure, regulatory environment, aviation supply chain, availability of skilled labour, economic conditions, and consumer preferences. The industry in Canada is characterized by a mix of major carriers, regional airlines, and low-cost competitors, each vying for market share in an environment where carriers are striving to optimize key operating metrics (Revenue Passenger Miles (RPM), Available Seat Miles (ASM), Passenger Load Factor (PLF), Yield, Revenue per Available Seat Mile (RASM), Cost per Available Seat Mile (CASM).

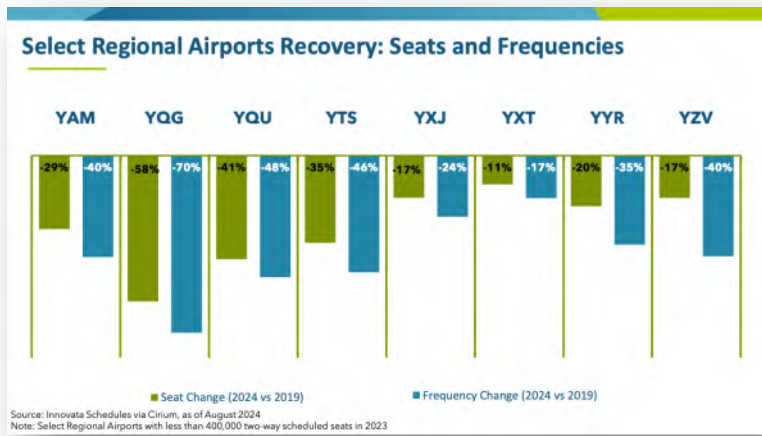
Within this overarching environment, the air transport industry has changed significantly in the last five years. We are facing a new market demand environment, shaped by shifting demographics, consumer preferences and the geopolitical landscape.

Travel patterns have changed, particularly in the business travel segment, which has not returned to pre-pandemic levels. This is due to a combination of advancements in videoconferencing technology; a cultural shift as the workforce has become increasingly comfortable conducting business virtually versus in-person meetings; corporate greenhouse gas (GHG) reduction goals; and clear operating cost savings for businesses.

The industry saw a 'revenge travel' bubble after the pandemic, but we are starting to see signs that it is now slowly deflating. While carriers continue to forecast strong demand through this summer across North America, there are reasons for caution as we look forward into the fall. This includes increasing pressures on household disposable income in the face of slowing economic growth and uncertainties.

In 2023, 7% fewer passengers moved through Canadian airports than in 2019. And relative to the size of our economy the real demand for air travel is actually down by 12% versus 2019. In other words, we are flying fewer passengers per unit of economic activity than in 2019. This is a global trend as Australia is consuming 16% less air travel relative to the size of its economy, and we see similar numbers in western Europe. This speaks to the possibility of deeper structural change in demand post-pandemic, exacerbated by factors such as the decline in aircraft production and delivery schedules.





Overall, changes in the Canadian airline competitive environment have generally resulted in route and route frequency changes as airlines look to optimize load factors and minimize costs. The clear trend is toward the utilization of larger aircraft with high seat density, while route frequency has been reduced. Intra-region capacity remains below pre-COVID levels, which is resulting in fewer regional feed flights. These reductions in connectivity and frequency have also contributed to higher air travel costs. The charts to the right highlights the shifts in frequency by airlines at Canada's large airports versus the major impact of smaller regional airports. While seat capacity has only declined slightly at large airports, due to upgauging and seat densification, service frequency is down -3 to -35%. This is a substantial change in capacity deployment strategy. You can see the trend impact is magnified at smaller airports where frequency is down between -17 and -70%. It is driven by various factors including a decline in availability of skilled labour but also the fact that the supply side of aviation remains very challenged by ongoing aircraft delivery delays impacting Boeing and Airbus.

Airlines are currently reporting very high load factors overall across domestic, transborder and international sectors. But the relative weakness of new aircraft delivery schedules is restricting carrier ability to put additional capacity into the marketplace, contributing to the upward pressure on air fares we've seen in 2023 and within Canada this summer.

Major Players

The two major players in the Canadian airline industry are Air Canada and WestJet. Air Canada, the country's largest airline, operates extensive domestic and international networks, serving over 200 destinations across six continents. As a member of the Star Alliance, Air Canada benefits from a vast global network and numerous partnerships.

WestJet, originally established as a low-cost carrier in 1996, has evolved into a full-service network carrier with an expanding international footprint and a fleet of both narrow-body and wide-body aircraft.

Post-pandemic both airlines have undertaken material changes in marketplace positioning with WestJet placing increased focus on western markets and Air Canada into the east.

Regional Carriers

Larger regional carriers such as Porter Airlines (arguably a national carrier today), WestJet Encore and Air Canada Express play a crucial role in connecting smaller communities to major hubs. Porter, known for its high-quality service and convenient operations out of their hub in Billy Bishop Toronto City Airport, has carved out a niche in the short-haul market, particularly in Eastern Canada. WestJet Encore, with a focus on a small number of western hubs, operates turboprop services to smaller communities as well as Class 1 airports. Air Canada Express consists of Air Canada Express branded smaller regional airlines servicing regional feeder flights for Air Canada under capacity purchase agreements (CPAs).

WestJet Encore routes and fares are directly controlled by the parent company, WestJet, while Air Canada directly controls routes and fares under its CPAs.

Several smaller airlines serve more remote destinations including key connections to southern hubs:

- Air North: Primarily serves the Yukon Territory and Northwest Territories, with some routes to British Columbia and Alberta.
- Air Inuit: Operates in Nunavut and Northern Québec.
- Pascan Aviation: Québec-based airline offering scheduled and charter flights within Québec and now in Atlantic Canada.
- Air Liaison: Operates in Québec, connecting smaller communities to major hubs.
- Air Creebec: Serves Indigenous communities in northern Québec.
- Air Saint-Pierre: Connects Saint-Pierre and Miquelon to mainland Canada.
- PAL Airlines: Offers regional service in Atlantic Canada, including Newfoundland and Labrador and Québec.
- Pacific Coastal: Operates scheduled, charter and cargo services to destinations in British Columbia.
- Air Borealis: Provides scheduled and charter flights mainly in Labrador.

- Canadian North: A wholly-owned Inuit company servicing Canada's northern territories with connections to southern hubs (Ottawa, Montreal, Edmonton).
- Perimeter/Bearskin Airlines: Scheduled and chartered service with a focus on Northern Ontario and Northern Manitoba communities and connecting with southern hubs.
- Calm Air: Services include scheduled passenger transportation to remote communities in Northern Manitoba, Northern Ontario and Nunavut with connections to Winnipeg.

There is limited competitive overlap among the smaller regional airlines. The primary challenge is a sustainable business model that can counter high operating costs for fuel, maintenance and personnel, and, in many cases, aging fleets.

Leisure and Low-Cost and Ultra-Low-Cost

The emergence of several low-cost and ultra-low-cost carriers (LCCs and ULCCs), such as Flair Airlines, Swoop (once a subsidiary of WestJet), Canada Jetlines and Lynx Air brought increased competition to the market of the Canadian leisure and sun market incumbents Sunwing (a subsidiary of WestJet) and Air Transat.

Canadians embraced LCCs/ULCCs and we were seeing travellers through our airports that have never flown before or haven't flown in decades. LCCs/ULCCs clearly stimulated new travel, giving more Canadians access to affordable airfare to visit friends and family.

However, the thriving LCC and ULCC presence was short-lived as the business model has proven to be a considerable challenge. Some of the key challenges faced by this segment include:

a. Operational Efficiency and Cost Control

Maintaining Low Costs: LCCs and ULCCs must keep operating costs exceptionally low to offer competitive fares. Industry staffing pressures resulting in higher wage costs and fuel costs have had considerable negative impacts on profitability.

Fleet Utilization: Maximizing aircraft utilization is crucial, but high utilization has been negatively impacted by several factors, of which weather is particularly notable, leading to flight delays, cancellations, restaging challenges and overall reduced operational efficiency.

Stage Length: Route distances have considerable impact on operational efficiency and costs and Canadian LCCs/ULCCs have unique stage lengths for the business model. This is discussed in more detail further on.

b. **Revenue Management:** LCCs and ULCCs rely heavily on ancillary revenue (e.g., baggage fees, seat selection, onboard sales) to boost revenue and profitability. Effectively managing and maximizing these revenue streams is a constant challenge.

c. **Customer Service:** Managing customer expectations and maintaining a basic level of service quality is essential.

Canada's LCC and ULCC challenges were also arguably compounded the high-risk nature of start-up airline investments; the pandemic impact; financial and capitalization constraints, and early-stage expansion strategies to capture more market share and address funding challenges.

At present, the LCC/ULCC business model is most sustainable financially in Europe due to population density and relatively short route distances. The Australian and United States LCC/ULCC markets are a mix of strengths and challenges.

Typically, a low-cost carrier seeks to drive profitability by flying a schedule made up of relatively short flights between reasonably high-density city pairs, frequently using secondary airports with lower fee structures, thus maximizing aircraft utilization and sales volume, and supporting a consistently high on time performance (OTP) which in turn supports higher utilization, lower operating costs, and, in turn, lower fares.

As an example, we can look at Lynx, which began operations in April 2022, and compare it to Avelo Airlines, a U.S. low cost airline that started in April 2021. Both airlines entered the market in the midst of the pandemic. Avelo operates a fleet of 18 aircraft (mix of 737-7s and 737-8s) serving the U.S. domestic market and Lynx operated nine (9) aircraft serving the Canadian market with some selected U.S. destinations.

As the table below indicates, Avelo's average stage length is 798 miles versus Lynx at 1,315 miles. Lynx's scheduled stage length was 40% longer than Avelo and Lynx On Time Performance (OTP) was 49% in 2023 compared to Avelo's OTP of 82.9%. Lynx OTP was well below Canadian carriers and the North American industry average.

For further illustration, the chart below also captures the average stage length for Lynx, Flair and various other LCC/ULCC carriers in the U.S. and globally. What is apparent is the difference in average stage length between these other carriers and their Canadian counterparts, reflecting the population density and city-pair dynamics of their respective marketplaces. The two LCC/ULCC carriers with the longest stage lengths – Frontier and Spirit – have recently sought mergers with each other/other carriers in response to competitive forces and a shifting demand environment.

Carrier	Country	Seats	Fleet	Destinations	Avg stage length (miles)	Load Factor (2023)
Lion Air	Indonesia	29,903,779	74	47	581	83%
IndiGo	India	122,510,608	301	122	681	84%
Southwest	US	233,165,693	818	122	736	76%
Easyjet	UK	97,285,917	182	157	752	86%
Ryanair	UK	188,751,989	305	235	776	86%
Avelo	US	2,859,182	18	41	798	80%
Allegiant	US	20,428,746	126	124	898	87%
Volaris	Mexico	38,547,497	96	69	978	78%
Frontier	US	38,267,838	147	120	1,006	82%
Spirit	US	55,585,316	190	91	1,015	81%
Flair	Canada	5,316,003	20	29	1,163	83%
Lynx	Canada	1,659,125	9	18	1,315	78%

It has been widely reported that a myriad of factors impacted the viability of Lynx, and Lynx has publicly outlined various reasons for its failure. It must be noted that the complexity of the schedule a carrier offers in the marketplace and its ability to consistently operate that schedule (on time performance), are foundational to any notion of medium- to long-term carrier success.

Though it is not a low-cost carrier, Porter Airlines is an example of airline successful expansion through its business model illustrating how a regional airline can expand by leveraging a distinctive value proposition and maintaining service excellence. Success factors include:

- a unique value proposition;
- premium-like service at competitive prices;
- a customer-centric approach that prioritizes the passenger experience;
- substantial initial 'patient' seed capital to finance start-up and early-stage operations;
- strategic hub location beginning with Billy Bishop Toronto City Airport and expanding at Toronto Pearson International Airport with 67% YOY growth in 2023;
- streamlined operations;
- initial strategic focus on regional routes and the use of efficient turboprops that provided a competitive edge in terms of operating costs and efficiency;
- strategic growth and market adaptation first in regional service, then national and international, including the addition of jet aircraft and ever increasing stage lengths.

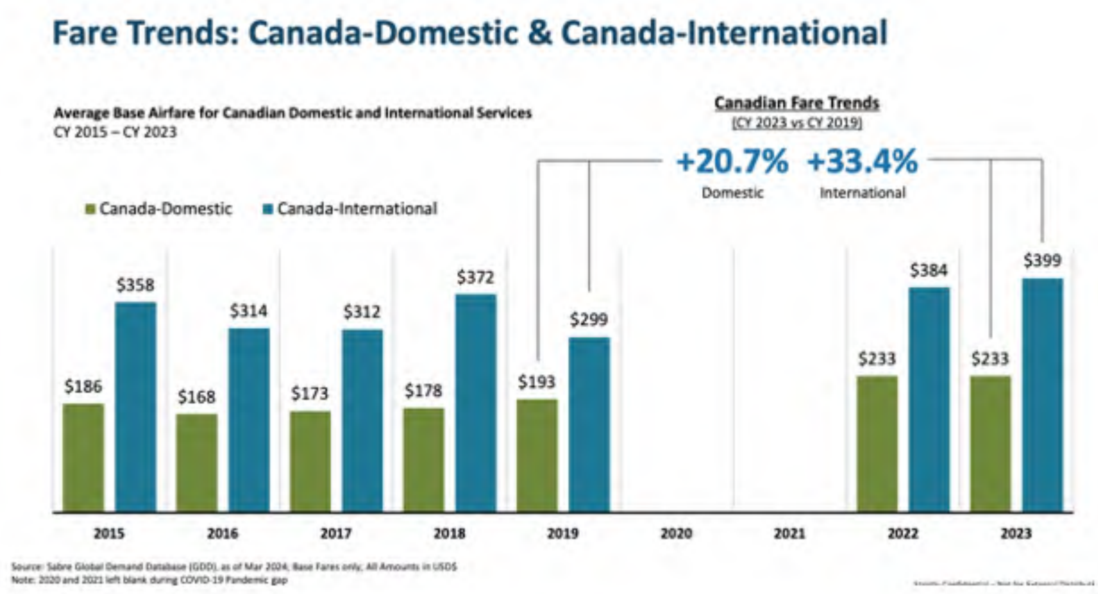
How is the industry evolving in terms of consumer preferences and airline operations, e.g. demand for direct flights, demand for domestic vs international flights, passengers' willingness to use secondary or more distant airports, and business models?

The Canadian airline industry is evolving significantly in response to changing consumer preferences and shifting dynamics in airline operations. Within North America, full-service network carriers are generally now performing better financially than lower cost carriers. This is due to various factors including cost-convergence between full-service and low cost carriers, resource constraints for aircraft and shifting consumer priorities.

With costs increasing across the industry, particularly for highly skilled employee positions, low cost carriers are losing some of the competitive cost advantage they previously held, and their ability to generate strong returns off lower airfares is being impacted. In addition to cost-convergence, full-service airlines have been densifying their cabins and offering a wider set of fare categories capturing business class, premium economy, flexible economy, leisure and "no-frills."

As the competitive landscape changes, we are seeing changes to the low cost model in response. In the Unites States, low cost pioneer Southwest recently announced that beginning next year it will sell assigned seating as it seeks to access additional revenue by utilizing revenue management practices long established within the full-service carrier segment.

Another big picture trend at play over the past several years has been the move to increasing seat capacity per aircraft. This trend will continue, not only through cabin reconfiguration of existing fleets, but by the ongoing entry into service of higher seat capacity narrow body aircraft like the 737-MAX-9, 737-MAX-10 and A321, as fleets roll over and airlines pursue more segmentation of cabin and fare types to service wider portions of market per aircraft. With aircraft movements in decline, it has resulted in higher load factors for airlines and increased cost of travel. These market conditions, combined with inflation, higher fuel costs, labour increases and other cost increases among all air travel service providers including government agencies, airports, Air Traffic Control and airline third party suppliers, resulted in domestic fares increasing 20% in 2023 compared to 2019 and international up 33%.



However, marketplace dynamics are everchanging: As we look to the fall there are strong signs that yield pressures are increasing and domestic airfares declining significantly, as highlighted on second quarter airline earnings calls.

Other key areas of evolution include the demand for direct flights, growth in demand for international flights as immigration and visiting friends and relatives (VFR) tourism are driving new growth and the adaptation of business models. The following is an overview of notable trends:

Demand for Direct Flights

Consumer Preference: There is a definite preference among passengers for direct flights due to their convenience and time-saving benefits. Travellers are increasingly seeking non-stop options to avoid the general inconvenience of layovers and connecting flights and to minimize the risk of flight disruptions negatively impacting connecting flights.

Impact on Airlines: In response to this demand, airlines are expanding direct routes targeting popular and high-traffic routes. This trend is evident in the number of direct flights available between major Canadian cities and key international destinations.

Domestic vs. International Flights

Domestic Demand: The Canadian domestic market is currently robust and demand is exceeding pre-COVID levels, driven by leisure and an expanded segment of business/leisure (bleisure) travel. However, as evidenced in second quarter airline earnings calls, pressures are increasing on domestic airfares as the industry faces increased airline seat capacity against softening passenger demand this fall.

International Demand: International travel from Canada has shown a strong recovery post-pandemic, with significant passenger traffic to destinations such as the U.S. and Europe. Statistics indicate a robust rebound in travel volumes and a growing interest in diverse international destinations. Growth in immigration and visiting friends and relatives (VFR) travel is driving new international travel.

When comparing origin and destination flights (city pairs), Canada/U.S. route offerings are back at par with pre-pandemic levels. International is lagging by 5%, mainly due to the slow recovery of the Asia market and challenges related to the closure of Russian airspace. Airlines have indicated on recent earnings calls that the competitive environment on transatlantic markets has increased significantly this summer as airlines have increased capacity. In response, capacity has been moved over to the Pacific.

Impact on Airlines: Airlines are balancing their routes between domestic and international services, with some focusing more on international expansion to capture new markets, growth opportunities and higher profitability.

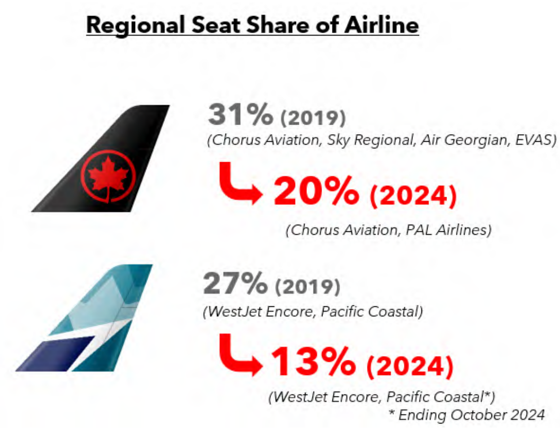
Passenger Willingness to Use Secondary or More Distant Airports

Accessibility and Convenience: Passengers are increasingly open to using secondary airports if they offer lower costs. Secondary airports often provide a simpler travel experience and can be convenient for travellers living in suburban or outlying areas. The appeal of secondary airports was clearly shown with the entry of LCCs/ULCCs to the Canadian market.

Airlines' Strategies: The use of secondary/distant airports has primarily been a characteristic of LCCs/ULCCs. The reduction in LCC/ULCC carriers in Canada has resulted in reduced use of secondary/distant airports as larger airlines follow their hub strategies and typically have not increased routes to these communities.

Challenges Serving Regional, Rural, Remote and Northern Communities

A confluence of factors have combined so that many regional, rural, remote and northern airports are still operating at 50 to 60% of their pre-pandemic traffic volumes. While there are numerous reasons for this – pilot shortages, flight duty hours, aircraft availability, aircraft type, etc. – the effect is that many communities across this country no longer have affordable and reliable air service for travel, essential medical service, cargo, tourism, and economic development.



The chart to the right shows that the seat share of Air Canada and WestJet's regional carriers has declined since 2019 and will be declining further looking at projected seat capacity.

A growing concern across industry, is where will the next generation of 70-80 seater aircraft and below come from? While there are interesting new e-enabled/hybrid aircraft technologies in development, they appear to be a long way off from being certified and/or supported by the infrastructure that would be required.

Given this reality and the challenging economics for regional aviation, new strategies for enabling connectivity and supporting our regional system should be explored. Various jurisdictions are looking towards multimodal solutions, including rail, ferries and bus services, that when implemented well can provide similar/better passenger experiences, particularly when integrated with air service through code-sharing and/or interlining.

Recently, Air Canada has joined a consortium bidding on Via Rail's High-Frequency Rail project to establish high-speed passenger rail service in the Toronto-Québec City corridor. This strategic direction aligns with global trends of airlines partnering with railways for intermodal travel, aiming to integrate rail connections into their service offerings and ensuring airport connections to the rail network. The potential benefits of HFR include reduced travel times and environmental advantages, while helping to address the concerns raised above.

Evolving Business Models

Marketplace Presence: The challenges faced by the LCC/ULCC segment were discussed earlier. Among full-service carriers, WestJet's realignment to focus on Western Canada, including transborder and international destinations has changed the competitive landscape in Eastern and Atlantic Canada. WestJet has also adopted a hybrid model by discontinuing Swoop ULCC and combining elements of both the low-cost and full-service approaches within the WestJet brand.

Porter's business model continues to evolve with domestic and international route expansion, fleet expansion, and strategic partnerships and alliances.

Air Canada has optimized its route network, focusing on high-demand and high-yield routes. Post-pandemic, the airline resumed and expanded services to key international destinations, leveraging its strong position in the transatlantic and transpacific markets. At the same time, Air Canada's reduced focus on some parts of western Canada has changed the competitive scene on these routes with WestJet adding routes and gaining marketplace presence.

Ancillary fees: The growth of airline ancillary fees has become a significant trend globally in the aviation industry, transforming how airlines generate revenue. Over a relatively short period of time, the number of services now being charged fees has increased considerably as the fees themselves have escalated.

Generally speaking, baggage handling, check-in, meals, entertainment are now considered 'optional' parts of the airline passenger experience to be monetized. Baggage fees themselves were a USD$33 billion profit centre for global airlines in 2023. In 2024, Air Canada's financial results highlight the ongoing importance of these additional revenues. Although ancillary fees currently contribute less than 10% of the airline's total revenue, they have been instrumental in stabilizing earnings amid fluctuating passenger demand and rising operational costs.

What can we learn from recent market events, including the entry of ultra low-cost carriers, Porter Airlines' expansion, and the reduction in regional service by WestJet and Air Canada?

Recent market events may reflect historical aviation competition cycles. These cycles are typically characterized by phases that include expansion, intense competition, consolidation, stabilization, and potential contraction or retrenchment. These cycles are clearly influenced by economic conditions, market dynamics, regulatory changes, and technological advancements.

Without a doubt, COVID-19 had an historically unprecedented impact in modern times on air travel. For example, Air Canada's financial performance in 2019 was characterized by record revenues and strong profitability from strong passenger demand and efficient operations. In contrast, 2023 marked a period of recovery with revenue and profitability from the pandemic lows. However, the financial metrics for 2023 were still in the process of stabilizing and had not yet reached the levels of 2019.

As of August 2024, Air Canada's post-COVID rebound remains incomplete four and a half years later compared to 2019's performance, with the air carrier itself stating that the business is still not back to 2019 levels in terms of scale and the size of the airline.

Canadians, without question, embraced Canada's LCC/ULCC offerings when they came to market. Even today with one budget carrier remaining we are seeing travellers in our airports that have never flown before or haven't in decades. Clearly LCC/ULCC service stimulated new travellers, giving more Canadians access to affordable airfare to visit friends and family.

Porter Airlines' business success was discussed earlier and they are an established entity that started small and well-financed and have strategically built up and expanded further. In many respects Porter is similar to the WestJet model some 28 years ago...well-financed for start-up and early stage growth and a strategic business approach of gradually building market share and staged expansion.

5. How Can Policymakers Support Aviation?

What are the major barriers to entry and expansion and how can policymakers lower them to stimulate competition?

There is no question that the pandemic impact is still relevant as the entire aviation ecosystem is still recovering from the financial impact. That in-and-of-itself creates significant challenges to entry and expansion.

The overarching policy platforms that inform government's decision-making approach to the air sector are aging and are no longer reflective of modern competitive realities. This is especially true of the National Airports Policy. While these policies have served Canada well, at nearly three decades old, the government should look at refurbishing its policy approach to the aviation sector with a new National Aviation Strategy. It is important that our aviation sector and airports are treated as economic drivers for all Canadians and not a profit center for government.

The airline industry is historically characterized by significant barriers to entry and expansion, which can limit competition and innovation. The following are some of the major barriers and suggested potential policy measures that could lower them to stimulate competition:

High Capital Requirements

Barrier	Policy Measures
Aircraft Acquisition Costs: Acquiring a fleet of aircraft requires substantial capital investment, whether through purchasing or leasing.	**Access to Financing:** Governments could provide loan guarantees, subsidies, or low-interest loans to new entrants to help them secure the necessary capital.
Infrastructure Investments: New entrants need to invest in maintenance facilities, ground handling equipment, and other necessary infrastructure.	**Foreign Investment:** Modifications to foreign investment limitations in airlines may serve as a catalyst for broader investment options for new entrants or to strengthen existing carriers. While any modifications would need to

	be researched extensively to ensure they preserve Canada's strategic and national interest considerations for air service to communities across this vast country. Removing the limitation cap of 25% for any single foreign investor up to the 49% maximum should only be done on a bilateral and reciprocal basis through air service agreement negotiated between Canada and foreign countries.

Regulatory and Bureaucratic Needs and Hurdles

Barrier	Policy Measures
Lack of Protection of Canada's Airspace: One emerging, and urgent, issue is the ability of the Government of Canada to ensure the competitiveness and sustainability of the aviation sector through protection of the Canadian air space from interference. The more interference, the less capacity for expanded flights and new entrants. Buildings, structures and objects near an airport can become an obstacle to air navigation if they intrude into air space used for flight, emit signals that interfere with communications equipment or generate steam, smoke or wind that can impact visibility and create turbulence. Obstacles around airports can create safety hazards in certain conditions, and also limit operations where a safe approach or departure path for aircraft cannot be achieved. Both international and Canadian regulation and standards specify criteria to be followed in aerodrome and air navigation design to ensure that aircraft maintain certain vertical and/or horizontal clearance from obstacles in order to facilitate the safe operation during all phases of flight, including the critical phases of departure and arrival, and where emergency procedures must be used. Canada's current site-specific Airport Zoning Regulations (AZR) protect some parts of approach and departure paths from the intrusion of obstacles in the more immediate vicinity of an	**New Federal Regulation:** We must protect the integrity of Canada's vital airspace through strong federal regulation (ie. protecting the Instrument Flight Procedures) to provide a means for airports and Nav Canada to ensure construction development does not intrude on aircraft instrument approach and departure surfaces at all airports. A process must be put in place so NAV Canada and airports will be made aware of proposed objects that may cause an intrusion to the approach and departure surfaces, in advance of construction, to determine if they will be an obstacle to air navigation.

airport. However, the nature of departures and arrivals at airports has changed from what was envisioned at the time that AZRs were established, and the obstacle clearances required do not always align with those protected by the AZRs. The air space required for outside the AZR, is susceptible to being compromised by obstacles of significant height and other incompatible land uses for which there is no legal restriction. At present developers and municipalities are encouraged to submit applications to NAV CANADA's Land Use Program to ensure that development plans do not impact safety. However, a legal obligation to complete this application does not exist. An intensification of housing development increases the likelihood of new developments unknowingly piercing the airspace.	
Complex Regulatory Environment: Navigating through aviation regulations, including safety, security, and environmental standards, can be considerable, time consuming and costly.	**Simplifying Regulations:** Streamlining regulatory processes and reducing bureaucratic red tape for all parts of the aviation eco-system could lower entry barriers (including CATSA, CBSA, airlines, aerospace, etc.). This could include simplified licensing and certification (faster approvals, less paperwork), lower compliance costs (reduced fees, more efficient submission processes and streams), predictable and transparent clarity in regulations, or reduced uncertainty in an applicant's ability to meet all regulatory requirements.

Dominance of Established Airlines

Barrier	Policy Measures
Market Power: Established airlines have significant market power, loyalty programs, and established customer bases that can be difficult for new entrants to compete with.	**Supporting Underserved Markets:** Government supports could be focused on priority underserved markets, avoiding material direct competition with established airlines and creating a service base for a new entrant.

Operational Challenges

Barrier	Policy Measures
Skilled Workforce: Securing a skilled workforce, including pilots, maintenance staff, and other operational personnel, could be challenging and costly.	**Training Programs:** Government-funded training and apprenticeship programs could help create a skilled workforce for the industry as a whole.
Supply Chain Issues: Dependence on a complex supply chain for parts, maintenance, and other operational needs can create barriers.	**Supportive Supply Chain Policies:** Encouraging the development of a robust aviation supply chain with policies that support small and medium-sized enterprises (SMEs) in the sector.

System Efficiency

Barrier	Policy Measures
Lack of Government Investment in Growth: Air travel has been growing and in new ways, the industry must do everything possible to optimize seamless passenger movement. Investment in government agencies and crown corporations that operate in airports is required; including in digital innovations and efficiencies. This is essential for modernizing the system and keeping Canada competitive.	**Digitization of our Border and the End-to-End Travel Journey:** The federal government can prioritize and invest in a national end-to-end digital travel journey to seamlessly verify and manage identity through various processes in air travel from check-in to arrival. Creating more efficiency in the travel journey in Canada means higher utilization of aircraft, which would create more business opportunities for carriers and a better return on investment.

Economic Generation

Barrier	Policy Measures
Passenger Expectations: The need to remain competitive of tourism offerings for international passengers.	**Invest in Aviation as an Economic Generator:** Federal tax regulations and Canadian custom regulations could be changed for example to allow the sale of duty-free products to all international arriving passengers. Arrivals Duty Free (ADF) is a no cost, high return proposition for the federal government. In the near-term it is estimated that implementing ADF would create 275 new full-time jobs, generate more than $13.2 million in additional

	wages, and $6.4 million in additional taxes and airport related revenue for the federal government.

Lowering the Cost of Travel

Barrier	Policy Measures
Low Government Investment in Infrastructure Capacity: As clearly demonstrated in other countries, government plays a critical role in investment and facilitation of investment in essential transportation assets. Canadian government investment is not competitive globally. Canada's airports are a vital link in the country's air travel system and are inextricably linked to creating opportunities for new entrants or service expansion by the established airlines. Canada's airports, as with other segments of Canada's air travel ecosystem, are investing, but we are still recovering financially from considerable debt burdens incurred to remain operational during the pandemic. The impact of this is highlighted by the United States federal government supporting airports with more than USD$40 billion in investment support. The Canadian federal government provided CAD$1.6 billion in support, which puts Canada at a considerable cost competitiveness disadvantage. Canada loses approximately 7-million passenger annually crossing the border to fly out of US airports. The main difference in our system is that the U.S. government heavily invests in airports as they view them as critical economic drivers. The Canadian government invests as well, but to a much smaller degree. The US has 10 times the Canadian population, but their support for airports was 40 times what Canadian airports received for pandemic recovery. In addition, Canadian airports paid federal government rent totaling 487 million in 2023, this	**Federal Government Commitment to Infrastructure Support could include:** • Creating a $400 million annual fund targeting airport infrastructure capital investments; • Modifying all major federal government infrastructure programs to ensure airport eligibility; • Recapitalizing the Airport Capital Assistance Program (ACAP) to $95 million annually to meet the specific infrastructure needs of Canada's small airports; • Extending airport leases by 50 years to attract favourable long-term financing; and • Finalizing the federal government's announced intention to identify and clarify ways Canadian airports can secure infrastructure investment by attracting capital such as pension funds. Increased government funding support directly reduces the financial costs of infrastructure, which minimizes future fees increases.

Barrier	Policy Measures
is a 12% federal tax on gross revenue that does not get re-invested into the airport system. Unlike Canada, U.S. airports are primarily government owned and operated by municipalities, states and some port authorities. The U.S. government also invests in an Essential Air Service program and that has grown by 3x in investment since the 80s. It is now funded at USD$368 million annually. Canada does not have a similar program for rural and remote regions even though many depend on air service as their only mode of travel. Take for example, Nunavut, where 25 communities are only accessible by air. Air access is essential to daily life and consolidation of air service in the north has added to access challenges.	

How can government procurement or other initiatives support airline competition in remote regions, including the North?

Supporting airline service in remote regions, including the North, is essential for improving connectivity, economic development, and quality of life for residents. The federal government can potentially use various procurement strategies and initiatives to bolster airline competition and service availability in these areas, including:

Subsidies and Financial Incentives

Subsidies: Similar to the U.S. Essential Air Service program, the Canadian government could subsidize routes that are not commercially viable but essential for connectivity. This ensures that remote regions receive regular air service.

Public Service Obligation (PSO): The government could impose PSOs on certain routes, requiring airlines to operate them with sufficient financial support, thus guaranteeing regular and affordable services.

Financial Grants and Loans:

Startup Assistance: Provide financial grants or low-interest loans to airlines willing to serve remote regions. This would help cover initial operational costs and mitigate financial risks.

Operational Subsidies: Provide ongoing subsidies for airlines operating serving remote or underserved regions to cover higher operational costs due to challenging weather, limited infrastructure, and low passenger volume.

Funding for Airport Improvements: Increase investments in upgrading airport infrastructure in remote regions, including runways, terminals, and navigation aids, to support safe and efficient operations.

Subsidized Airport Fees: Reduce or subsidize airport fees for airlines operating in remote or underserved regions to lower their operational costs.

Fuel Subsidies: Provide subsidies for aviation fuel in remote areas where costs are significantly higher.

Maintenance Facilities: Invest in establishing maintenance facilities in strategic locations to reduce the need for costly and time-consuming maintenance flights to distant facilities.

Regulatory Support

Streamlined Regulations: Reduce the burden of regulations (i.e., red tape) and the resources required to meet regulatory requirements.

Simplified Licensing Processes: Simplify and expedite the licensing and certification processes for airlines operating in remote regions.

Partnerships and Collaboration

Collaborative Investments: Encourage public private partnerships (PPPs) to share the financial and operational burdens of serving remote regions. For example, the government can partner with private companies to co-invest in necessary infrastructure.

Stakeholder Engagement: Engage local communities, Indigenous groups, and regional governments in decision-making processes to ensure that services meet the needs of the residents.

Community Ownership: Support models of community ownership or co-operatives for regional airlines to ensure that local interests are prioritized.

Federal Government Procurement

Air Services Contracts: Federal, provincial and territorial governments could award air service contracts to carriers willing to serve remote or underserved regions, providing guaranteed revenue streams.

Mail and Cargo Services: Leverage government mail and cargo service contracts to support airline operations in remote areas.

Military and Emergency Services/Dual-Use Infrastructure: Invest in dual-use infrastructure that supports both military and civilian aviation needs in remote regions, enhancing overall connectivity and service availability.

Emergency Services Integration: Integrate emergency and medical air services with commercial operations to optimize resource utilization and service coverage.

Should policymakers open domestic routes to more international competition? If so, how?

Given Canada's vast landmass and disbursed population base, we do not believe international competition on domestic routes would lead to a more competitive aviation market. The connectivity benefits of cabotage are very questionable and would require extensive research to establish if there are potential meaningful benefits to domestic air travellers.

How can airport operations and other air travel services support air carrier entry and growth?

Canada is the second largest country in the world by land mass with a population of over 40 million. Our population centres are vastly disbursed across the country, making it imperative that every community across the country has access to affordable and dependable air travel options. Air travel is not a luxury, it is a necessity, and Canada's airports create the platform for competition with our infrastructure. We need gates, we need slots, we need to protect our airspace. We are looking 10 to 20 years ahead and planning for the growth. Air travel is Canadians' preferred mode of travel and like other essential modes of travel in this country, it requires government to partner and invest in this essential infrastructure. There are big opportunities in front of us – big opportunities and big growth calls for big moves and big support. This is a sector that creates a significant return for Canadian taxpayers and the economy and needs to be viewed by government as the economic enabler that it is.

Since the pandemic, airports have invested to improve our ecosystem's efficiency, transparency and communications. Airports are working with partners on data sharing, digital innovations and modernization of the traveller journey.

However, as airport access demand increases, airports must respond with the capacity to maintain high levels of service to both air carriers and travellers. This requires both regular and expanded infrastructure projects, but the value of federal government infrastructure funding support programs for airports has not changed for several decades. At the same time, increasing safety and security regulatory requirements, ever-advancing technology needs, and rapidly escalating costs for capital infrastructure projects place considerable pressure on airports to reasonably finance the necessary projects.

As identified earlier in policy measures, access to capital to continue to invest to meet the ongoing growth and demand for air travel is a critical need for airports. Federal government support can be implemented in several ways:

- Creating a $400 million annual fund targeting airport infrastructure capital investments;
- Modifying all major federal government infrastructure programs to ensure airport eligibility;
- Recapitalizing the Airport Capital Assistance Program (ACAP) to $95 million annually to meet the specific infrastructure needs of Canada's small airports;
- Extending airport leases by 50 years to attract favourable lower-cost financing; and
- Finalizing the federal government's announced intention to identify and clarify ways Canadian airports can secure infrastructure investment by attracting capital such as pension funds.

Airports are essential infrastructure in this country – the only way to get from Saskatoon to Vancouver or from Halifax to Toronto in a timely manner is by air. The majority of passengers understand and support expansion plans and upgrades to airports; 92 percent of Canadians polled recognize that airports are critical to their local economies. As costs rise across the economy, we need to do more to make air travel more affordable for Canadians.

Other jurisdictions, including the United States, are actively investing in their airport systems, recognizing the critical role airports play in connecting communities, business and attracting investment. And direct investment in airport infrastructure means lower costs for travellers.

Airport fees

Canadian aeronautical fees are about 4.3% of the domestic all-in average airfare compared to the North America average at 3.2%. Even when including Airport Improvement Fee (*which is used in Canada to fund needed infrastructure investment*), airport charges account for approximately **upwards of *12%*** of total all-in domestic airfare (including carrier ancillary fees), on the average ticket sold in 2019. Over the decade 2012 to 2022 airport fees have only increased on average by 4% per annual CAGR, with many airports holding their fees constant for most of the decade until later years due to the impacts from the pandemic.

Canadians increasingly want to travel by air, over 150 million Canadians moved through Canada's airports in 2023. Investment is key to meet passenger expectations of seamless journeys and great airport experiences, which is why airports are investing. Since the pandemic, airports have invested to improve our ecosystem's efficiency, transparency and communications. Airports are working with partners on data sharing, digital innovations and modernization of the traveller journey.

Any new financial policies and regulations must be thoughtfully considered as Canada's airports are non-share business corporations that exist for the public good. Airports generate revenues that go directly toward investment in facilities to support the communities they serve. Some sectors of the industry have called for a freeze in fees, any freeze in how airports generate revenue would impact our ability to grow or modernize to meet the demands of Canadian travellers and communities.

The airport governance model reflects the strengths and needs of the local community and aviation stakeholders through a skills matrix. Our public stakeholders have broad oversight but are removed from operational or investment decisions. Our largest private stakeholders, the airlines, have input through forums on operations, rates and capital plans and also through the Airport Improvement Fee (AIF) funding process. Our current model allows us to drive local prosperity and create good jobs, build affordable infrastructure and take a leadership role in an ecosystem with many partners. More partnership in investment from government is welcome in the aviation system to reduce the cost for Canadian travellers. Canada's airports want financial tools allowing them to choose the right form of investment in order to grow quickly and modernize to meet passenger demand.

Slot Access at Canada's Airports

In terms of welcoming new airline competitors, Canada is well positioned to accommodate new entrants as we have the infrastructure capacity and are investing in growth for future capacity needs. Slot access at level 3 airports in Canada (Toronto Pearson, Vancouver International, and Billy Bishop City Centre) is governed by the Worldwide Airport Standards Slot Guidelines (WASG). The guidelines provide the air transport community with a single set of standards for the management of airport slots and sets the foundation for global slot coordination. These guidelines set out that an air carrier that uses a slot 80% of the time holds on to the "historical" right to maintain that slot in the next equivalent season. This is an established practice across the global aviation industry. Unused slots at these airports can be, and are, re-allocated all the time. Those unused slots are held in a pool for coordinators to allocate, with 50% offered to new entrant air carriers.

The WASG is built on the pillars of transparency, flexibility, certainty, consistency, and sustainability and is a collaboration between the International Air Transportation Association (IATA), Airports Council International (ACI) and the Worldwide Airport Coordinators Group (WWACG).

The WASG creates three levels of slot controls for airports:

- **Level 1 airports** are ones where the capacity of the airport infrastructure is generally adequate to meet the demands of airport users at all times.
- **Level 2 airports** are ones where there is potential for congestion during some periods of the day, week, or season, which can be resolved by schedule adjustments mutually agreed between the airlines and facilitator. YUL, YYC and YQB are examples of Level 2 airports in Canada.
- **Level 3 airports** require slot allocation for all airlines and other aircraft operators, with slots allocated by a coordinator to arrive or depart at the airport during the periods when slot allocation occurs. Only three airports in Canada are Level 3 slot controlled: YYZ, YVR and YTZ Billy Bishop Toronto City Airport.

At Level 3 airports slot coordinators use WASG guidelines to carefully manage airport slot allocations to support airport capacity. Decisions on slot allocations are made by a coordinator based on the unique infrastructure constraints at each airport. This could include runway capacity and seasonality; passenger processing constraints at check-in, security screening and border operations; baggage system availability; and availability of aircraft stands.

Slots are also effectively available for any air carrier wishing to operate out of Level 1 and 2 airports. While level 2 airports may face constraints based on demand, slots may not be available to a new entrant air carrier at the precise desired time. However, a slot would be available, and the air carrier can work with the airport to gain access to a gate.

As Canada's major airports make significant investments to modernize and upgrade infrastructure and technology, considerations around how slots will be allocated to welcome new carriers will continue to be front of mind.

Since privatizing airport operations in the early 1990's, Canada's airports have invested more than $30 billion in infrastructure, paid the federal government $7.3 billion in rent, and currently have plans to invest more than $28 billion in the next decade to maintain and improve their infrastructure assets. Airport investment in new and improved infrastructure, with new and improved technology and processes, provides more opportunities for airlines (and associated industry) and more options for passengers at Canada's busiest airports. These investments will significantly increase airport capacity facilitating new airline entrants and expansion by existing airlines and significantly contribute to the aviation sector in Canada, and one which will enhance its overall competitiveness.