



## EUROCANADA:

### TIME FOR THE PROMISED OPEN AVIATION AREA

Ever since the European Union established its Open Aviation Area (OAA) in 2003, removing national and bilateral restrictions on airline ownership and control within Europe, it has been promoting expansion of the OAA beyond Europe. A true OAA with the USA remains intractable, the USA being unlikely to lift its own national ownership and control provisions. But an OAA encompassing Europe and Canada is much more feasible and could be a game changer, for the North Atlantic and well beyond.

As US carriers continue to consolidate, with implications for global alliances – American Airlines' oneworld membership questionable if it is purchased by Delta or US Airways – a EuroCanada OAA could provide a western geographic nucleus of strength as the global economy and aviation markets shift east and south.

#### Some context

In 2007 the EU and the USA signed an agreement to replace all existing bilateral air services agreements between each of the EU Member States and the USA. It included recognition of all European airlines as 'Community air carriers' by the USA and provided the possibility for any Community carrier or any US carrier to fly between any point in the EU and any point in the USA without restrictions on pricing or capacity.

This so-called 'open skies' deal went into effect in 2008. However, the retention of national air carrier ownership and control in the United States and 'Community' ownership and control in Europe was deferred to a second stage of negotiations. That failed to make any significant progress on this fundamental issue.

Thus the collective EU-USA skies cannot be described as an OAA *per se*. Consequently, other than simplifying and reducing the bureaucracy of air services negotiation the 'open skies' agreement has had limited impact in practice, apart from helping the airline alliances to consolidate their positions.

With the first stage of the EU-USA agreement in place, the EU opened negotiations with Canada. In 2009 the parties signed what was described by the Commission as 'so far the most ambitious air transport agreement between the EU and a major partner in the world'. The provisions are similar to those in the EU-USA agreement but notably include an article on investment to the effect that 'each party shall permit full ownership of its airlines by nationals of Canada or a Member State or States' [of the EU].

There is a kicker. This is 'subject to...'. Ownership of a party's airlines by nationals of all other parties is allowed 'to the extent permitted by Canada's domestic laws and regulations for foreign investment in

airlines'. At present, Canada only allows 25% of the voting equity to be held by foreign interests, with the maximum single holding in Air Canada limited to 10%. There's the rub. Canada has proposed raising the limits to 49% but has not yet done so. It could be done quickly.

When announcing their agreement, the EU and Canada stated that it "will finally establish a full Open Aviation Area between the EU and Canada. EU nationals will be able to establish operations in Canada and freely invest in Canadian airlines and vice versa". The time is ripe to take this step, to establish a 'EuroCanada' OAA.

### **Why now?**

Air Canada, despite a dominant market share (currently 40% of the domestic market and 80% of Canadian carriers' international traffic), went through the Canadian equivalent of Chapter 11 in 2003/4. It flirted with this again in 2009, before being given a helping hand by the government. The airline continues to struggle with its legacy baggage. Its unit costs are significantly higher than almost every other North American carrier and it is cash strapped.

Air Canada is part of the Star Alliance. It works closely with Lufthansa on streaming Middle East and Asian traffic to and from North America. Westjet, a no-frills carrier founded in Calgary in 1996 on the back of the booming oil business, has expanded to eastern Canada and into the US, chipping away at Air Canada. Westjet has a growing network of codeshare partners, including American Airlines and Japan Airlines (of oneworld) and Delta and KLM (of Skyteam).

If Canada were to allow increased foreign ownership, what would happen? Air Canada's Star Alliance partners, notably Lufthansa and United Airlines, each more healthy than it and wishing to protect and develop their market, may consider playing a greater role in AC's strategy. Other carriers may also be interested in Westjet as well as in Air Canada.

The economic downturn has significantly affected several major European carriers and on their side of the Atlantic the outlook remains particularly weak. There is increasing concern at the rise of the Gulf carriers and, in the longer term, Chinese airlines. The benefits for European carriers of improved market access to Canada, the USA and beyond, are substantial.

In brief, a EuroCanada OAA should:

- Make airlines more robust and boost industry confidence in both Canada and Europe in this era of economic uncertainty
- Provide wider access to capital (notably for Canada)
- Provide wider access to markets
- Supply some counter-leverage to ongoing consolidation in the USA and the rise of Gulf and Chinese carriers
- Increase competition within Canada.

## Some regulatory practicalities

From a third party regulatory perspective there are two primary considerations, both relating to the USA.

First, Annex 6 of the EU-USA agreement allows for services by airlines owned by third parties 'provided that the third country in question has established a record of cooperation in air services relations with both Parties'. Needless to say, Canada has been recognized as having done so. In other words the USA would accept operations to its territory by a European carrier owned and controlled by Canadians.

Second, the USA-Canada bilateral, an open skies agreement from 2007, contains a traditional national ownership and control clause. But the USA, in the light of Annex 6 and its long-standing and wide-reaching waiver policy, should accept a 'EuroCanada Community air carrier' clause. Even if there were to be a potentially significant incursion into the USA by a Canadian carrier owned by European interests, that carrier would very likely be one in an alliance with a US carrier. Competition law would also apply.

There would also be a need to amend the 'horizontal agreements' which the EU has negotiated with third parties to accommodate community ownership and control of air carriers, as well as some bilateral agreements by Canada and European States with third parties. But, as in the past, this could be undertaken progressively as the occasion arises.

## Launch time

Studies on both sides of the Atlantic have demonstrated major economic benefits from a EuroCanada OAA. These benefits would be boosted given the OAA complementing and providing a catalyst for a comprehensive EU-Canada economic and trade agreement, which is presently at an advanced stage of negotiations. The rationale has been established. The time is now propitious to kickstart the process.

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