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**Toronto's Pearson International Airport:
Airport Commercialization/Privatization**

by

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*A thesis submitted to the Faculty of Graduate
Studies and Research in partial fulfillment of the
requirements of the degree of Master of Laws (LL.M.)*

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May 1996

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0-612-50944-3

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Abstract

Government ownership of airports is inefficient and has led to large financial deficits in Canada. Terminals I and II at Pearson Airport are in desperate need of redevelopment. The Pearson Airport Agreements between the Federal Government and the Pearson Development Corporation ("PDC") to redevelop and operate Terminals I and II at Pearson Airport pursuant to a long term lease would have benefitted the Government through the receipt of the proceeds from the sale of the airports while being relieved of the burden of financing airport expansion. The cancellation of the Pearson Airport Agreements based on the faulty reasoning of the Nixon Report was contrary to the public interest.

The Canadian Government plans to "commercialize" Airports which involves leasing them to Airport Authorities. The federal government has reached an agreement on terms for transfer of Pearson Airport to the Greater Toronto Airport Authority ("GTAA"). Pearson airport will be one of the first airports to be transferred to local control under the Liberal governments Canadian Airport Authority model. Commercialization amounts to a transfer of Airports from one part of the public sector to another. It is plagued by many of the inefficiencies that characterize Government operated Airports.

Pearson Airport has significant market power. Pearson Airports market power can effectively be diffused by separating the airport's airside and groundside functions, and basing airside ownership on slots. Terminals I, II and III will be sold separately and will become the responsibility of several airport companies who will compete for Airlines and Passengers. Runways, taxiways and the apron would be owned and operated by a Corporation made up of investors and third party brokers.

Resumé

Au Canada, la propriété gouvernementale des aéroports est inefficace et fut la cause de déficits financiers considérables. Les terminaux I et II de l'aéroport Pearson nécessitent désespérément un développement. Les ententes signées entre le gouvernement fédéral et la Pearson Development Corporation (PDC), permettant le développement et l'opération des terminaux I et II de l'aéroport Pearson suivant un bail à long terme, auraient été bénéfiques pour le gouvernement. Ces ententes auraient permis des revenus de la vente des aéroports tout en soulageant le gouvernement du fardeau financier de l'expansion des aéroports. L'annulation des ententes touchant l'aéroport Pearson, suite au raisonnement fautif du rapport Nixon, fut contraire à l'intérêt public. Le gouvernement canadien entend, par leur location aux autorités aéroportuaires, "commercialiser" les aéroports.

Le gouvernement fédéral a d'ailleurs conclu une entente contactuelle pour le transfert de l'aéroport Pearson au "Greater Toronto Airport Authority" (GTAA). L'aéroport Pearson sera un des premiers aéroports, sous le modèle canadien d'autorité aéroportuaire du gouvernement libéral, à être transféré à une autorité locale. La commercialisation équivaut au transfert de l'aéroport d'un secteur public à un autre. Les inefficacités caractéristiques des aéroports sous contrôle gouvernemental seront donc transmises lors de la commercialisation.

L'aéroport Pearson possède une part importante de marché. L'impact sur le marché que possède l'aéroport Pearson peut être efficacement diffusée en séparant les fonctions "airside" et "groundside" de l'aéroport, et en accordant la propriété des fonctions "airside" selon des "slots". Les terminaux I, II et III seront vendus séparément et deviendront la responsabilité de plusieurs compagnies aéroportuaires, qui se feront concurrence pour les compagnies aériennes et les passagers. Les pistes d'atterrissage, les chemins réservés pour le taxi entre le terminal et la piste d'atterrissage et les "stationnements" pour avions seraient opérés par une corporation formée d'investisseurs et de courtiers.

Acknowledgements

I gratefully acknowledge the constant encouragement and intellectual stimulation with which Professor Richard Janda provided me during the writing of this thesis. The support given by Professor Janda as my thesis supervisor and as Professor of Government Regulation of Air Transport at the Institute of Air and Space Law was most appreciated.

I had the opportunity to interview many experts in the Airport industry. In this regard I would like to thank David Emerson, President and C.E.O. of the Vancouver International Airport Authority; Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority; Gordon R. Baker, Q.C., Counsel for Matthews Investments and the Paxport Group; Victor W. Barbeau, Assistant Deputy Minister of Transport - Airports; and David Carr of Toronto's Consumer Policy Institute. Mr. Carr, in particular provided me with material and information which was indispensable.

In addition, I greatly appreciated the assistance of Senator Finlay MacDonald, Chairman *of the Special Senate Committee on the Pearson Airport Agreements*. Senator MacDonald provided many unique insights into the events leading up to the cancellation of the *Pearson Airport Agreements*.

Thank you all!

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Introduction

Government ownership of airports in Canada has led to large financial deficits and chronic inefficiencies produced by extensive government involvement. The time has come to privatize Canada's major airports including Toronto/Pearson International Airport ("Pearson Airport"). Rather than privatization however, the Federal Government plans to "commercialize" Airports which entails leasing them to Airport Authorities. Commercialization amounts to a transfer of Airports from one part of the public sector to another. It is plagued by many of the inefficiencies that characterize Government operated Airports.

Much of the rest of the industrialized world is headed to full privatization. BAA plc owns most of Great Britain's largest airports including London's Heathrow Airport. Both Austria and Italy have privatized small portions of their principle air transport hubs. Australia will privatize its major Airports in 1996. Airport privatization is likely in Germany, South Africa and New Zealand. In Canada, Pearson Airport's Terminal III which opened on February

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21st, 1991, was financed without taxpayers money and has a yearly capacity for 10 million arriving and departing passengers.

Terminals I and II at Pearson Airport are in desperate need of redevelopment. Clearly the Federal government is not willing or able to finance such redevelopment due to budgetary pressures. The Pearson Airport Agreements between the Federal Government and the Pearson Development Corporation ("PDC") to redevelop and operate Terminals I and II at Pearson Airport pursuant to a long term lease would have generated significant revenues for the government from the sale of the airports while relieving them of the burden of financing airport expansion. The decision of Prime Minister Chretien to cancel the Pearson Airport Agreements, based on the advice in the Nixon report has in the words of the majority report of the Special Senate Committee on the Pearson Airport Agreements "...achieved nothing positive for Canadians."¹

Airports as traditionally run constitute monopolies or oligopolies. Pearson Airport possesses significant market power. The Federal Government owns the airport. It operates the Airside business and Terminals I and II. In addition, it collects revenues as the landlord of Terminal III. The Federal Government should sell Pearson Airport to the private sector. It should not regulate decision making authority of the private owners as a private

¹ Canada, *Report of the Special Senate Committee on the Pearson Airport Agreements, Final Report* (Ottawa: Queen's Printer, December 1995) (Chairman: Finlay MacDonald) at 163 [hereinafter *Pearson Airport Agreements*].

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unregulated monopoly or oligopoly is preferable to a private regulated monopoly or oligopoly or to government ownership. Dynamic changes in the transportation industry are highly likely to undermine the existence of a monopoly or oligopoly and there is at least some chance that these will be allowed to have their effect.

Nevertheless, Pearson Airports' market power can effectively be eliminated. Separating the airport's airside and groundside functions, and basing airside ownership on slots will eliminate Pearson Airport's market power. Terminals I, II and III should be sold separately. They would become the responsibility of several airport companies who will compete for Airlines and Passengers. Runways, taxiways and the apron would be owned and operated by a Corporation made up of the Airlines, other investors and third party brokers.

This Thesis starts out with an overview of the traditional economic approaches to Airports. Airport monopoly power is identified and analyzed in this chapter (Chapter 1). This is followed by a discussion of the traditional policy approach of the Canadian government to the ownership and operation of Airports (Chapter 2). The growing shortfall in Airport capacity and the urgent need for Financing airport expansion at Pearson (Chapter 3) leads on to a detailed review of government policy as it adapts to develop alternate methods to fund airport expansion at Pearson in the wake of conservative fiscal policy culminating in the decision to redevelop terminals I & II at Pearson Airport with the private sector is discussed in Chapter 4. Discussion then shifts to the Pearson Airport Agreements. The

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process of requesting private sector proposals and selecting the "best overall acceptable proposal" is discussed in this Chapter. In addition, the negotiations which led to the eventual conclusion of the Pearson Airport Agreements on October 7, 1993 are considered (Chapter 5). The eventual cancellation of the Pearson Airport Agreements resulting from a change in Federal government who based their decision on the Nixon Report is examined in Chapter 7. Deliberations of The Special Senate Committee on the Pearson Airport Agreements is analyzed in this chapter. The Federal Governments National Airports Policy and the federal governments decision to transfer Pearson Airport to the Greater Toronto Airport Authority is then briefly outlined (Chapter 7). The proposed transfer of Pearson Airport to an Airport Authority under the National Airports Policy will raise a number of Constitutional issues (Chapter 8).

The Analysis of Pearson Airport would not be complete without a comparison to ownership and operating structures of Airports in other jurisdictions (Chapter 9) The United Kingdom was the first European country to fully privatise its major airports. A discussion of the structure of the British Airport Authority plc. is undertaken. Airports in the United States have their own particular system of funding which makes privatization difficult. Nevertheless the trend towards privatization of Airports throughout the industrialized world is outlined in this Chapter.

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A critical assessment of Canada's new policy of Airport "commercialization" is undertaken in Chapter 10. An Analysis of landing fees and slot allocation rules presently used in the United States and Canada is discussed in Chapter 11. The preceeding discussion has led to the adoption of a recommendation for an Airside corporation which will effectively eliminate the monopoly character of Pearson Airport (Chapter 11).

Chapter 1

Airport Monopoly

Government Ownership

Pearson Airport has been historically owned by the Federal government and operated by Transport Canada officials. These officials are mandated to operate these facilities in a manner that furthers the public interest.² Since the government does not respond to the profit maximization motive of private firms, it will not be tempted to abuse its monopoly power by raising prices while reducing services.³

However, since "government decision-makers have little incentive to respond to market forces, they also have little incentive to innovate or to minimize costs."⁴ The purpose of Pearson airport was to serve the local community and provide adequate levels of service

² Rigas Doganis, *The Airport Business* (London and New York: Routledge, 1992) at 51 [hereinafter Doganis].

³ Ernest Gellhorn and Richard J. Pierce, *Regulated Industries*, 2nd Ed. (St. Paul, Minnesota: West Publishing Co., 1987) at 321 [hereinafter Gellhorn].

⁴ Gellhorn, *supra*, note 3 at 321.

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regardless of whether the cost of providing these services could be recovered from Airport users.⁵

Natural Monopoly

A natural monopoly exists because of the combination of market size and industry cost characteristics. "It exists when economies of scale available in the process of manufacturing a product are so large that the relevant market can be served at the least cost by a single firm".⁶ It would be inefficient to serve the market with more than one firm.⁷ Because of the enormous capital outlay required to provide airport services, the marginal costs of supplying these services decreases with traffic throughput.⁸

Airport operations are characterized by significant economies of scale.⁹ "This means that as an airport increases its traffic throughput the cost per unit (marginal cost) of traffic declines."¹⁰ Therefore, smaller airports will have higher unit costs than larger airports.

⁵ Doganis, *supra*, note 2 at 25.

⁶ Gellhorn, *supra*, note 3 at 44.

⁷ Stephen Breyer, *Regulation and its Reform* (Cambridge, Massachusetts, and London, England: Harvard University Press, 1982) at 15 [hereinafter Breyer].

⁸ Doganis, *supra*, note 2 at 48-51.

⁹ Doganis, *supra*, note 2 at 48.

¹⁰ Doganis, *supra*, note 2 at 48.

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Communities and regions are better served by one or more larger airport as opposed to many smaller airports.¹¹

Competition in a monopoly market would drive the price down below each airports average costs.¹² This would lead to a situation where neither airport would earn enough money to cover its fixed costs..¹³ If market forces are allowed to function, one airport would eventually drive the other out of business. Eventually, the natural incentives to take advantage of available economies of scale would lead back to a situation in which a single airport provided services for the entire market.¹⁴

Risks of an Unregulated Private Monopolist

One of the largest concerns in airport privatization is that private operators will use monopoly pricing to abuse the public interest.¹⁵ In the competitive market, airports will attempt to service a greater number of aircraft, airlines and passengers and, if necessary, to expand facilities to meet increased usage up to the point where marginal revenue equals

¹¹ Doganis, *supra*, note 2 at 50.

¹² Gellhorn, *supra*, note 3 at 48.

¹³ Gellhorn, *supra*, note 3 at 48.

¹⁴ Gellhorn, *supra*, note 3 at 49.

¹⁵ William H. Payson and Steven A. Steckler, "Expanding Airport Capacity: Getting Privatization Off The Ground" *Reason Foundation Policy Insight*, Number 141 (Los Angeles: Reason Foundation, July 1992) at 11 [hereinafter Payson].

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marginal cost - the cost of servicing an additional passenger, aircraft, or airline.¹⁶ Airports will continue to provide services "as long as the last unit (i.e. the marginal unit) of production increases the firm's profits. And this occurs if the marginal, or last, unit adds more to revenue than it does to costs - namely, as long as the marginal revenue exceeds or equals marginal costs".¹⁷ In a competitive market an Airport could not effect the demand for airport services. If an airport raised its price above where marginal revenue equals marginal costs than passengers, airlines and aircraft will abandon the airport in favour of a competitors facility.¹⁸

An airport monopolist will limit the quantity of airport services made available to the passenger in order to raise prices (i.e. landing fees, handling fees, hangar fees, passenger facilitation fees, etc.).¹⁹ Higher prices mean less demand, but an airport monopolist willingly forgoes increased usage, to the extent he can more than compensate for the lost

¹⁶ Breyer, *supra*, note 7 at 15.

¹⁷ Gellhorn, *supra*, note 3 at 25.

¹⁸ Interview with Richard Janda, Professor at McGill University Institute of Air and Space Law. (February 23, 1996) Montreal, Quebec.

¹⁹ According to Gellhorn, *supra*, note 3 at 35: "The monopolist... finds marginal revenue always less than price because his demand curve is downwardly sloping. If only a single price is charged, every expansion of output reduces average revenue and, therefore, the last unit sold produces less revenue than the preceding sale. The central point is that a monopolist who expands output will have to accept a lower price, not just on the additional units, but on all units sold. Additional charges may be obtained only by lowering the price charged on the monopolist's entire output".

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revenues (from less facility usage) by gaining revenue through increased prices charged to airlines, aircraft and passengers that still use the airport.²⁰

Airport monopolists do not have "sufficient incentive to hold facility costs at low levels".²¹ They do have some incentive to lower costs, since lower costs will increase their profits.²² Airports do not feel the pressures of a competitive market. In a competitive environment Airports would strive to lower costs in order to lower their prices, and thereby attract aircraft, airlines and passengers to their facility.²³

There are constraints on the power of an airport monopoly to set prices. "Price elasticity refers to the responsiveness of the quantity demanded to a change in price."²⁴ The value of airport services is different to different classes of customers.²⁵ Business travellers tend to value airport services more than casual travellers. The more inelastic the demand the more freedom airports have in setting prices. The high monopoly price of airport services

²⁰ Allan Stone, *Regulation and its Alternatives* (Washington: Congressional Quarterly Press, 1982) at 69-70 [hereinafter Stone]. According to Stone in a natural monopoly "...an industry's average costs inherently tend to decrease with increasing rates of output due to high fixed costs relative to total costs. Thus, the greater the number of output units over which these fixed costs may be amortized, the greater the tendency for average cost per output to decline"; Breyer, *supra*, note 7 at 15-16.

²¹ Breyer, *supra*, note 7 at 16.

²² Breyer, *supra*, note 7 at 16.

²³ Breyer, *supra*, note 7 at 16.

²⁴ Gellhorn, *supra*, note 3 at 30.

²⁵ Alfred E. Kahn, *The Economics of Regulation* (Cambridge, Massachusetts: The MIT Press, 1988) at 163-64.

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will drive many potential customers out of the market. For the passenger, the decision is whether to use the airport facilities, use alternative methods of transportation, or forego travel altogether.²⁶

The role of government - To regulate or not

Where economies of scale render competition wasteful in the airport industry, government regulators may try to set the price for airport services near marginal cost in order to induce the airport monopolist to expand its services to a "socially preferred level".²⁷

Where a natural monopoly exists, there is a choice amongst private unregulated monopoly, private monopoly regulated by the state, or government operation.²⁸ The "great disadvantage of either governmental regulation or governmental operation of a monopoly is that it is exceedingly difficult to reverse".²⁹ If technological advances or changes in the market make competition sustainable governmental regulation and governmental operation of a monopoly will be less responsive to these changes.³⁰

²⁶ Breyer, *supra*, note 7 at 16.

²⁷ Breyer, *supra*, note 7 at 16.

²⁸ Milton Friedman, *Capitalism and Freedom* (Chicago and London: The University of Chicago Press, 1982) at 28 and 128 [hereinafter Friedman].

²⁹ Friedman, *supra*, note 28 at 128.

³⁰ Friedman, *supra*, note 28 at 28.

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The least of the evils is private unregulated monopoly.³¹ "Dynamic changes are highly likely to undermine the existence of a monopoly and there is at least some chance that these will be allowed to have their effect. And even in the short run, there is generally a wider range of substitutes than there seems to be at first blush, so private enterprises are fairly narrowly limited in the extent to which it is possible to keep prices above costs".³²

The conditions making for a natural monopoly frequently change. In the United States intercity telephone transmission was "governed by natural monopoly cost considerations".³³ The technological innovations associated with microwave technologies has altered average costs to a "level low enough to accommodate several competitors".³⁴ Cable Companies provide one of the historical examples of a natural monopoly. However, in recent years direct to home satellite providers, telephone and computer companies have entered the market to provide cable services to the public. Transforming cable services into a competitive market is still in process in Canada.

In the Aviation industry the new generation of Short take off and landing jet aircrafts have brought certain airports into the market for long distance travellers. For example Toronto's

³¹ Friedman, *supra*, note 28 at 28.

³² Friedman, *supra*, note 28 at 128.

³³ Stone, *supra*, note 20 at 71.

³⁴ Stone, *supra*, note 20 at 71.

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Island airport can now service jets. Many business travellers use Toronto's Island airport as it is more convenient than Pearson Airport from downtown Toronto. In the early 1990's Toronto's Island airport serviced over three hundred thousand passengers on a yearly basis.³⁵ However, since City Express has gone bankrupt these numbers have substantially fallen.³⁶

It may be argued that Consumers need protection from the prices which an unregulated private airport can charge airlines for the use of its facilities which would be subsequently passed on to passengers. The conditions which made Airports natural monopolies have changed. With respect to the shipping of goods, the emergence of efficient road and rail services has reduced the monopoly element in airport services to "negligible proportions".³⁷ In addition, airports from different cities must compete in order to attract airlines to their facilities. It seems certain that, in this day and age airports would be a "competitive industry with little or no remaining monopoly" element if governments were not involved in the ownership and regulation of airport facilities.³⁸

³⁵ Interview with David Carr, Author at Toronto's Consumer Policy Institute (February 11, 1996) Toronto, Ontario.

³⁶ Interview with David Carr, Author at Toronto's Consumer Policy Institute (February 11, 1996) Toronto, Ontario.

³⁷ Friedman, *supra*, note 28 at 29.

³⁸ Friedman, *supra*, note 28 at 29.

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The fact is that airports do compete, especially for transfer traffic. Vancouver International Airport competes with Seattle, Los Angeles, San Francisco and even Denver as a pacific gateway to North America for transfer traffic.³⁹ Approximately 25 per cent of Pearson Airports passenger volume constitutes transfer traffic.⁴⁰ In addition Pearson Airport has three terminals which could be developed as separate businesses in competition for airlines and passengers. Terminal III is operated by ADC, a private profit seeking corporate entity. Terminals I and II are Government owned and operated. Government involvement tends to distort the competitive forces of the market. Nevertheless, Terminal III does compete for business with the other Pearson Terminals.

Pearson Airport

The demand for airport services (i.e., passengers) in Southern Ontario is limited. In 1989 Pearson airport serviced approximately twenty-one million passengers.⁴¹ As noted earlier the enormous capital outlay required to provide airport services means that the marginal

³⁹ Interview with David Emerson, President and C.E.O. of the Vancouver International Airport Authority (February 16, 1996) Vancouver, British Columbia.

⁴⁰ David Carr and Lawrence Solomon, "Benefitting Consumers and the Economy through Airport Privatization" (Toronto: The Consumer Policy Institute, 1995) at 23-24 [hereinafter *Benefitting Consumers and the Economy through Airport Privatization*].

⁴¹ Doganis, *supra*, note 2 at 17

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costs of supplying these services decreases with traffic throughput. However, as traffic reaches approximately three million passengers marginal costs seem to flatten out.⁴²

Southern Ontario's demand for airport services could support more than one major facility. If two major airports existed in Toronto, each could provide airport services at the optimal marginal cost level of a competitive market. Each could take full advantage of the available economies of scale.⁴³ Therefore, no natural monopoly exists with respect to airport services in Toronto. The federal government seemed to recognize this with an attempt, subsequently aborted due to financial constraints and local community opposition, to build a new International Airport for the region in Pickering Ontario.⁴⁴

Pearson Airport, however, has substantial market power. Pearson Airport can impose a "unilateral non-transitory price increase".⁴⁵ Thus Pearson Airports market power is a concern for those who favour strong competition in the market for Airport services. The existence of Airport market power in Toronto would be diffused if the Federal government were to privatize Pearson Airport and deregulate the Airport business in Southern Ontario.

⁴² Doganis, *supra*, note 2 at 49.

⁴³ Geilhorn, *supra*, note 3 at 48.

⁴⁴ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 6

⁴⁵ Interview with Richard Janda, Professor at McGill University Institute of Air and Space Law, (February 27, 1996) Montreal, Quebec.

Chapter 2

The Traditional Approach to Airport Operations in Canada

The Canadian Government has traditionally viewed Airports as instruments of public policy with the full cost of development and expansion financed through government revenues. "This view of airports emphasizes levels of service and economic spin-offs to the community above the cost associated with operating the airport".⁴⁶ Up until 1992 (when the federal government began leasing airports to local authorities) decisions for the 150 Canada owned and operated airports were made by the department's central Airport Authority Group ("AAG").⁴⁷

The costs associated with building and operating Canada's transport infrastructure have never been linked to revenues generated by the system. According to the 1985 Auditor General's Report overstaffing, bad planning and poor marketing resulted in an increase of 163 per cent in Transport Canada's operating deficit for airports and related services over

⁴⁶ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 1.

⁴⁷ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 2.

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five years.⁴⁸ The Auditor General compared operating costs at Transport Canada airports with comparable U.S. airports. Costs per passenger were higher in Canada.⁴⁹

Since there is no link between airport expenses and revenue, there seems to be no motivation to make existing airports more efficient or to justify the cost of new development on commercial principles.⁵⁰ For example, Mirabel, the international airport 80 km outside Montreal was built in the early 1970s at the cost of \$500 million.⁵¹ Dorval airport could have been expanded to handle 20 million passengers.⁵² It was anticipated that Mirabel would serve 30 million passengers a year by the year 1990. Today, Mirabel and Dorval combined handle less than 9 million passengers. "With compound interest, Mirabel accounts for about four billion of the national debt and, at prevailing rates, is slated to cost Ottawa another \$400 million this coming year".⁵³ According to the Consumer Policy Institute:

⁴⁸ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 2.

⁴⁹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 4.

⁵⁰ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 2-3.

⁵¹ Terence Corcoran, "Only Way To Improve Airports is To Sell Them" *The Globe and Mail* (25 February 1995).

⁵² David Carr, "Answers Lie in the Pockets of Passengers" *Jane's Airport Review*, Vol. 6, Issue 10 (Surrey, United Kingdom: International Thomson Publishing Company, December, 1995) at 27; Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 3.

⁵³ Terence Corcoran, "Only Way To Improve Airports is To Sell Them" *The Globe and Mail* (25 February 1995).

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"In airline economics, an aeroplane seat is considered to be a perishable commodity. If the aircraft takes off with that empty seat, the value of the seat on that particular flight is lost forever. The same principle applies to overbuilt airports. The initial capital cost coupled with the ongoing higher operating and maintenance costs will never be recovered."⁵⁴

The Federal Government had prime agricultural land in Pickering, Ontario expropriated for an aborted second Toronto airport that was never needed at a cost of approximately \$260 million.⁵⁵

The Federal Governments inefficient operation of airports coupled with chronic overbuilding inevitably led to financial strains. In 1982, the federal government cancelled a needed third terminal at Pearson Airport.⁵⁶ In addition, staff was reduced inside the nation's air traffic control centres. The government decided to scale back services rather than look for commercially feasible alternatives to provide funding because such alternatives would result in a loss of government control over these facilities. As a result, Pearson Airport was plagued by insufficient airside capacity for more than a decade.⁵⁷

⁵⁴ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 5.

⁵⁵ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 6.

⁵⁶ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 6-7.

⁵⁷ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 6-7.

Chapter 3

Airport Capital Investments

Runway Shortages

"Airports airside availability (number of runways and taxi strips) is a key determinant of an airport's physical capacity. Access to the airside is measured in slots - the term given to an aircraft's right to land or take off once during a specified hour. Pearson Airport, for example, can accommodate up to 86 aircraft movements, or slots, every hour".⁵⁸ Each movement represents a take-off or a landing.

The Federal Aviation Administration ("FAA") has predicted that runway shortages will cause unacceptable levels of delays at approximately thirty U.S. airports by 1996.⁵⁹ An International Air Transport Association ("IATA") study of twenty-seven large European Airports found that eleven would have inadequate runway capacity by 1995.⁶⁰ "Estimates suggested a net increase, after retirements, of between 4,000 and 4,500 jet aircraft by the

⁵⁸ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 32.

⁵⁹ Doganis, *supra*, note 2 at 33.

⁶⁰ Doganis, *supra*, note 2 at 33.

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year 2000 compared to 1989-90 fleet levels. Much additional runway capacity and apron space would be needed to handle these aircraft".⁶¹

Very few new runways are being built or are planned.⁶² A survey of Airport expansion programmes "indicates that only a fraction of the US \$122 billion to spent on airport development over the next 20 years will be dedicated to new or extended runways".⁶³ In addition continued public hostility towards airside development will only worsen the problem.⁶⁴ For example, Montreal's Dorval Airport planned to open a new runway in the summer of 1995. ADM reversed this decision after West Island residents complained about the resulting noise increase.⁶⁵ Environmental opposition to runway expansion has also caused problems.⁶⁶ "Violent opposition" to runway expansions occurred at Frankfurt and Tokyo/Narita.⁶⁷

⁶¹ Doganis, *supra*, note 2 at 33-34.

⁶² Doganis, *supra*, note 2 at 34.

⁶³ David Carr and Lawrence Solomon, "Why it Makes Sense to Privatise Airside Business" *Jane's Airport Review*, Vol. 6, Issue 2 (Surrey, United Kingdom: International Thomson Publishing Company, March, 1995) at 39 [hereinafter *Why it Makes Sense to Privatise Airside Business*].

⁶⁴ *Why it Makes Sense to Privatise Airside Business*, *supra*, note 63 at 40.

⁶⁵ "Should Dorval Take Over as Montreal's Sole Airport?" *The Montreal Gazette* (18 February 1996) at B-3.

⁶⁶ Doganis, *supra*, note 2 at 34.

⁶⁷ Doganis, *supra*, note 2 at 34.

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The need for Financing airport expansion at Pearson

Airport expansion and development will significantly push up marginal costs if traffic needs do not warrant the increased capacity.⁶⁸ This occurs because Capital costs and operating costs (heating, lighting, maintenance etc.) rise.⁶⁹ Therefore, airports should wait till traffic needs warrant airport development before investing. Montreal's Mirabel Airport provides an example of unwarranted airport development.⁷⁰ Montreal is served by Dorval and Mirabel airports. Aeroports de Montreal ("ADM"), the LAA that runs both airports has announced that it will shift all scheduled domestic and International flights to Dorval.⁷¹ Mirabel was built in the mid 1970's at a cost of over \$500 million. Prime Minister Jean Chretien and Montreal Mayor Pierre Bourque have acknowledged that the city has one airport too many.⁷² The Prime Minister stated that he "won't be crying" if Mirabel is closed.⁷³

⁶⁸ Doganis, *supra*, note 2 at 49.

⁶⁹ Doganis, *supra*, note 2 at 50.

⁷⁰ Doganis, *supra*, note 2 at 51.

⁷¹ André Picard, "Mirabel flights shifted to more central Dorval" *The Globe and Mail* (21 February 1996) at A1.

⁷² Barrie McKenna, "Mirabel Poised for Downgrading" *The Globe and Mail* (14 February 1996) at A1-2.

⁷³ Barrie McKenna, "Mirabel Poised for Downgrading" *The Globe and Mail* (14 February 1996) at A1-2.

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If traffic increases beyond a certain level then congestion and overloading of the airport terminal will lead to an increase in marginal costs.⁷⁴ Terminals I and II had been designed to handle up to twelve million passengers per year. In 1990 twenty million passengers passed through these terminals.⁷⁵ Terminal III which opened on February 21st, 1991, has a yearly capacity for 10 million arriving and departing passengers.⁷⁶

The increased capacity provided by Terminal III was exhausted virtually from the day it opened.⁷⁷ The useful life of Terminal I has expired and should be closed. Southern Ontario will suffer "economic penalties" as a result of congestion at the Pearson Airport Terminal buildings without redevelopment.⁷⁸ Traffic needs at Pearson Airport warrant airport development and significant investment. Terminal I should be replaced and Terminal II should be renovated.⁷⁹ In addition, an increase in the number of air traffic controllers and two new runways are needed for Pearson Airport.⁸⁰

⁷⁴ Doganis, *supra*, note 2 at 51.

⁷⁵ Pearson Airport Agreements, *supra*, note 1 at 22.

⁷⁶ Pearson Airport Agreements, *supra*, note 1 at 17.

⁷⁷ Doganis, *supra*, note 2 at 17.

⁷⁸ Transport Canada, *Aviation in Southern Ontario - A Strategy for the Future* (Ottawa: Queen's Printer, 1990) at 9 [hereinafter *Aviation in Southern Ontario*]; Pearson Airport Agreements, *supra*, note 1 at 22.

⁷⁹ Pearson Airport Agreements, *supra*, note 1 at 13.

⁸⁰ Pearson Airport Agreements, *supra*, note 1 at 13.

Chapter 4

Airports' Policies in Canada

Mazankowski Task Force

In October 1985, the Minister of Transport (from Sept. 1984-April, 1986), Donald Mazankowski established a Task Force to examine the role of government in the "funding, management and operation of airports".⁸¹ The Task Force concluded in its 1986 Report that:

"government ownership of airports was subject to three major problems: large and growing financial deficits, limited responsiveness to local and regional needs, and inefficiencies produced by extensive government involvement".⁸²

⁸¹ Transport Canada, *Report of the Airports Task Force, "The Future of Canadian Airport Management"* (Ottawa: Queen's Printer, 1986) at 2 [hereinafter *The Future of Canadian Airport Management*]

⁸² Pearson Airport Agreements, *supra*, note 1 at 10.

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The Task Force considered four possible airport ownership/operating structures: "private ownership, Crown Corporations, locally established airport management authorities, and a commercialized version of public ownership and Transport Canada management."⁸³ The Task Force recommended management by locally established airport management authorities (known as Local Airport Authorities ("LAA's")).⁸⁴ Their second choice was management by Crown Corporations. The Task Force eliminated Private sector ownership for a variety of reasons, "including its potential lack of sensitivity to various publics, inadequate guarantees of increased public responsiveness, potential criticism of government subsidies, difficulties in using profitable airports to subsidize others, and difficulties in implementing federal policies such as cost reduction and bilingualism."⁸⁵

1987 Airport Transfer Policy

The Mazankowski Task Force recommendations were to a great extent encompassed by the 1987 Airport Transfer Policy. ("1987 Policy") (Officially titled "A New Policy Concerning a Future Management Framework For Airports in Canada."⁸⁶ The Minister of Transport

⁸³ Pearson Airport Agreements, *supra*, note 1 at 10.

⁸⁴ Pearson Airport Agreements, *supra*, note 1 at 10.

⁸⁵ Pearson Airport Agreements, *supra*, note 1 at 10.

⁸⁶ Pearson Airport Agreements, *supra*, note 1 at 11.

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would consider proposals for the "ownership and/or management and operation of airports".⁸⁷ Eligible bodies included "provinces, municipalities, local authorities or commissions authorized by Federal/Provincial legislation. In addition, private sector leasing would be considered".⁸⁸

"The 1987 policy reflects the devolutionary sympathies of the Mazankowski task force, with the exception that it puts forward an unranked range of devolution options (including leasing airports to private sector lessors) in place of the ranked options and exclusion of private sector ownership recommended by the Task Force".⁸⁹ The 1987 policy focused on regional management, commercial orientation and private sector involvement to provide solutions to the monetary constraints and other concerns of the Federal government.⁹⁰

The basic principles that were to govern the transfer of airports to LAA's in conjunction with the 1987 policy were established in June 1989 by the Department of Transport.⁹¹ The Federal Government required the Board of Directors of LAA's to be appointed through a

⁸⁷ Pearson Airport Agreements, *supra*, note 1 at 11.

⁸⁸ Pearson Airport Agreements, *supra*, note 1 at 11; The Future of Canadian Airport Management, *supra*, note 81 at 1.

⁸⁹ Pearson Airport Agreements, *supra*, note 1 at 12.

⁹⁰ Pearson Airport Agreements, *supra*, note 1 at 19.

⁹¹ *Proceedings of the Special Senate Committee on the Pearson Airport Agreements*, (Ottawa: Queen's Printer, July 11, 1995) (Chairman: Finlay MacDonald) at Issue number 2, page 37 [hereinafter *Proceedings*, July 11, 1995 at 2:37].

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process "acceptable to municipalities."⁹² In early 1990, Transport Canada made it clear that Local Airport Authorities would not be recognized by the Federal Government unless each of the principal local governments in the regions served by the airport passed a resolution endorsing the structure of the prospective LAA.⁹³

Pearson Airport - Terminals I and II

Two basic issues faced the Federal Government with respect to Terminals I and II at Pearson airport. The first issue was whether these terminals needed redevelopment. If they did, how should this redevelopment be financed.

By April, 1988 the Federal Government had concluded a development agreement with ADC to build Terminal III using only private sector finances and had signed long-term leases in conformity with the Development Agreement.⁹⁴

Air Canada was the main occupant of Terminal II. Air Canada officials believed occupants of Terminal III would have a competitive edge.⁹⁵ Air Canada developed a two-phase

⁹² Pearson Airport Agreements, *supra*, note 1 at 12.

⁹³ Pearson Airport Agreements, *supra*, note 1 at 12-13.

⁹⁴ Pearson Airport Agreements, *supra*, note 1 at 17.

⁹⁵ Pearson Airport Agreements, *supra*, note 1 at 22.

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master plan to redevelop Terminal II. Phase 1 was to be co-financed by Air Canada and Transport Canada. Transport Canada was not able to provide funding for the second phase. Unsolicited proposals from private sector developers were reviewed by Air Canada.⁹⁶

According to Mr. Glen Shortcliffe (Deputy Minister of Transport April, 1988-1990), despite the pending opening of Terminal III, "Pearson in the late 80's-I am talking in the period 1988, 89, running into 90 in particular-Pearson was a mess. It was a disgrace. And worst of all, it was not working".⁹⁷ Mr. Shortcliffe continued:

"...Terminal 1, by 1988-89, I can best describe as a slum. Anybody whoever had to travel through it at that period or, for that matter who has to travel through it today, would very quickly come to appreciate that its useful life and its once cutting-edge technology had then rendered it into the one-horse shay which had collapsed....Terminal 2 was...clearly suffering from an inadequacy of gates. Our perception was that inadequacy was going to increase very quickly as the years unfolded".⁹⁸

⁹⁶ Pearson Airport Agreements, *supra*, note 1 at 22.

⁹⁷ Proceedings, *supra*, note 91, July 13, 1995 at 4:64.

⁹⁸ Proceedings, *supra*, note 91, July 13, 1995 at 4:65.

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In April, 1988 (when Mr. Shortcliffe became Deputy Minister of Transport) "the policy positions of successive governments, regardless of party, had been to avoid policy decisions with respect to Pearson and its future".⁹⁹

The Transport Department undertook a policy review on Airport development in Southern Ontario. The policy review focused on setting out options for Government consideration.¹⁰⁰ Terminals I and II had been designed to handle up to twelve million passengers per year. In 1990 twenty million passengers passed through these terminals.¹⁰¹ A range of on-ground delays resulted including "difficulties in obtaining cabs, line-ups at Customs desks and general overcrowding".¹⁰²

In August 1989, Benoit Bouchard the Minister of Transport (from April, 1988 - February, 1990) announced the Federal governments decision to develop Pearson Airport to its "maximum capacity, so that it could serve as a primary hub of the National Air Transportation System".¹⁰³ The Federal government announced an intention to renovate

⁹⁹ Proceedings, *supra*, note 91, July 13, 1995 at 4:66.

¹⁰⁰ Proceedings, *supra*, note 91 July 13, 1995 at 4:67.

¹⁰¹ Pearson Airport Agreements, *supra*, note 1 at 22.

¹⁰² Pearson Airport Agreements, *supra*, note 1 at 22.

¹⁰³ Pearson Airport Agreements, *supra*, note 1 at 13.

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Terminals I and II at Pearson on a "priority basis".¹⁰⁴ In addition, an increase in the number of air traffic controllers and two new runways were planned for Pearson Airport.¹⁰⁵ In a Transport Canada policy document dated January 1990, the government reasoned that Southern Ontario would suffer "economic penalties" as a result of congestion at the Pearson Airport Terminal buildings and parking garages without such redevelopment.¹⁰⁶

Pearson Airport was the "central hub" of the air transportation system in Canada.¹⁰⁷ A delay at Pearson will "back up" traffic at other Canadian airports and possibly at some International airports.¹⁰⁸ Successive governments tried to circumvent market forces establishing Pearson as the "central hub" by forcing international airlines that wanted to go to Toronto to go through Mirabel Airport in Montreal first.¹⁰⁹ However, such arrangements were the subject of bilateral air transport agreements and "...the capacity of Canada to successfully negotiate access to markets that we wanted to get into eroded our capacity to force airlines to go through Mirabel".¹¹⁰ "The decision to develop Pearson

¹⁰⁴ Pearson Airport Agreements, *supra*, note 1 at 13.

¹⁰⁵ Pearson Airport Agreements, *supra*, note 1 at 13.

¹⁰⁶ Aviation in Southern Ontario, *supra*, note 78 at 9; Pearson Airport Agreements, *supra*, note 1 at 22.

¹⁰⁷ Proceedings, *supra*, note 91, July 13, 1995 at 4:86.

¹⁰⁸ Proceedings, *supra*, note 91, July 13, 1995 at 4:86.

¹⁰⁹ Proceedings, *supra*, note 91, July 13, 1995 at 4:91.

¹¹⁰ Proceedings, *supra*, note 91, July 13, 1995 at 4:91.

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Airport was a move to stop avoiding decisions and respond to the pressures of burgeoning air traffic volumes of the late 1980's".¹¹¹

Private Sector Redevelopment at Pearson Airport

The immediate issue facing the Federal government, once the need for terminal redevelopment at Pearson had been recognized, was how to finance it.¹¹² Clearly the Federal government was not willing or able to finance such redevelopment.¹¹³ Transport Canada was under "severe budgetary pressure, as a result of broader government deficit-reduction initiatives".¹¹⁴

The Federal Government began receiving unsolicited proposals from the private sector in 1989 to redevelop Pearson Airport.¹¹⁵ Air Canada, the Airport Development Corporation ("ADC") (the firm that had built Terminal III), Paxport Inc., and Canadian Airports Limited (associated with British Airports Authority PLC) all submitted proposals.¹¹⁶ Clearly, the

¹¹¹ Pearson Airport Agreements, *supra*, note 1 at 17.

¹¹² Pearson Airport Agreements, *supra*, note 1 at 31.

¹¹³ Pearson Airport Agreements, *supra*, note 1 at 31.

¹¹⁴ Pearson Airport Agreements, *supra*, note 1 at 31.

¹¹⁵ Pearson Airport Agreements, *supra*, note 1 at 23.

¹¹⁶ Pearson Airport Agreements, *supra*, note 1 at 23.

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private sector perceived that Pearson required immediate repair and development and that the Federal government had no interest in financing such a project.¹¹⁷

The 1987 Policy on Local Airport Authorities left it to local groups to obtain the official support of the necessary municipal governments.¹¹⁸ In 1990 attempts to establish an LAA in Toronto had not yet succeeded.¹¹⁹ In contrast, local groups had been established and recognized by Transport Canada for negotiation purposes in Edmonton, Calgary, Montreal and Vancouver.¹²⁰

In the early fall of 1990, Doug Lewis, the Minister of Transport (February 1990 - April 1991) felt that tenants and users alike believed that Pearson was "out-stressed, unsafe, unreliable and an embarrassment to Canada."¹²¹

The Canadian government decided that, since the local Airport Authority option was not attainable at the time, a private sector option to lease, renovate and operate should be

¹¹⁷ Pearson Airport Agreements. *supra*, note 1 at 23.

¹¹⁸ Pearson Airport Agreements. *supra*, note 1 at 25.

¹¹⁹ Pearson Airport Agreements. *supra*, note 1 at 26.

¹²⁰ Pearson Airport Agreements. *supra*, note 1 at 25-26.

¹²¹ Pearson Airport Agreements. *supra*, note 1 at 27-28.

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considered.¹²² This option would resolve the problems of Terminals I and II at Pearson Airport. However, the Federal Government made it clear that if the proposed Toronto Region LAA could obtain the agreement of all necessary municipalities a bid from them would have been welcomed.¹²³

The announcement that the government would seek private sector proposals for the refurbishment of Terminals I and II was made on October 17th, 1990.¹²⁴ Terminal III, which, "didn't cost the Canadian taxpayer a dime" was near enough to completion to support the view that a public sector/private sector partnership model was workable.¹²⁵

The private sector, redeveloping terminals I and II at Pearson Airport under the discipline of market forces would ensure "enhanced market responsiveness".¹²⁶ Redevelopment would be provided as it was needed by airport users and supported by the revenues generated by passenger volume.¹²⁷ "The nature and scope of development would be determined by the marketplace, rather than by planners in Ottawa".¹²⁸

¹²² Pearson Airport Agreements, *supra*, note 1 at 28.

¹²³ Pearson Airport Agreements, *supra*, note 1 at 43.

¹²⁴ Pearson Airport Agreements, *supra*, note 1 at 29.

¹²⁵ Pearson Airport Agreements, *supra*, note 1 at 18 and 29.

¹²⁶ Pearson Airport Agreements, *supra*, note 1 at 32.

¹²⁷ Pearson Airport Agreements, *supra*, note 1 at 32.

¹²⁸ Pearson Airport Agreements, *supra*, note 1 at 32.

Chapter 5

The Pearson Airport Agreements

The Request for Proposals

The initiative was handed over to Department of Transport officials who were to develop a formal request for proposals (RFP) document setting out what the government was seeking and the criteria for evaluating proposals.¹²⁹

All projects, including the redevelopment of terminals I and II at Pearson airport, which involve the long-term leasing of federal lands and buildings are reviewed by the Treasury Board.¹³⁰ Treasury Board reviews look for adherence to four principles:

- (i) fair return to the Crown based on the market value of the leased property;
- (ii) the private sector should have a fair and equitable opportunity to bid over a reasonable period of time;

¹²⁹ Pearson Airport Agreements, *supra*, note 1 at 29.

¹³⁰ Pearson Airport Agreements, *supra*, note 1 at 33-34.

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- (iii) the government should accept the highest offer or best value possible from the public tendering process (best value can include more than just return); and
- (iv) the length of the leases should be the shortest term consistent with the need to obtain financing of the lease.¹³¹

An unexpected delay occurred in obtaining an environmental assessment study necessary to proceed with runway development. In the summer of 1991, the Federal Government, therefore, decided to detach terminal redevelopment from runway development and proceed on them separately.¹³²

Inside the Department of Transport a small steering committee had been established.¹³³ Among its tasks, the steering committee prepared draft RFP documents.¹³⁴ Transport Department officials identified Policy issues and referred them to the Minister of Transport, Jean Corbeil (April 1991 - November, 1993) for consideration. It was the responsibility of

¹³¹ Proceedings, *supra*, note 91, July 12, 1995 at 3:6; Pearson Airport Agreements, *supra*, note 1 at 34.

¹³² Pearson Airport Agreements, *supra*, note 1 at 36.

¹³³ Pearson Airport Agreements, *supra*, note 1 at 35.

¹³⁴ Pearson Airport Agreements, *supra*, note 1 at 36.

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the Minister to determine how the public interest could be served by the requirements of the RFP.¹³⁵

The Minister of Transport believed that the many unsolicited proposals received by the Department of Transport demonstrated significant interest from the private sector. Therefore, unlike the Terminal III redevelopment project which followed a two-stage process (EOI and RFP) the Terminal I and II redevelopment required only a one-step process in which developers would respond only to a detailed RFP.¹³⁶

In January, 1992 Mr. Ron Lane, then Regional Director of Airports in Atlantic Canada, was selected to head an evaluation committee which worked separately from those officials who prepared other parts of the RFP. The Committee's first task was to establish evaluation methodology, evaluation criteria and to prepare the evaluation documentation.¹³⁷ Ministerial approval was obtained by Mr. Lane throughout the process.¹³⁸

¹³⁵ Pearson Airport Agreements, *supra*, note 1 at 37.

¹³⁶ Pearson Airport Agreements, *supra*, note 1 at 38.

¹³⁷ Pearson Airport Agreements, *supra*, note 1 at 40.

¹³⁸ Pearson Airport Agreements, *supra*, note 1 at 41.

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The RFP was released on March 16th, 1992. The bid submission deadline was 93 days later on June 19th, 1992.¹³⁹ Chapter 7 of the RFP contained the evaluation criteria which were grouped into three classes: those of "primary importance", those of "marginally less, but substantial importance" and those of "lesser but significant importance".¹⁴⁰

The fifty page RFP "provided a detailed review of development objectives, considerations and requirements established by the government in some 12 areas, ranging from traffic forecasts and plans for runways to the various parts of the terminal buildings. The Request also set out the structure of management and operations that would apply, the business arrangements, and eligibility requirements. Finally, it described the structure and content that would be required in proposals..."¹⁴¹

¹³⁹ Pearson Airport Agreements, *supra*, note 1 at 39.

¹⁴⁰ Pearson Airport Agreements, *supra*, note 1 at 40 and 48.

¹⁴¹ Pearson Airport Agreements, *supra*, note 1 at 55.

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Selecting A Proposal

The selection process involved two phases. First, Transport Canada Officials provided advice and guidance to potential proponents. Second, the proposals were evaluated and a recommendation was provided to the Minister of Transport. Finally, the Federal Government determined a "Best Overall Acceptable Proposal."¹⁴²

The bid submission deadline was initially June 19th, 1992.¹⁴³ This deadline was subsequently extended till July 13, 1992 at the request of one of the proponents, Claridge (known as the "Airport Terminals Development Group").¹⁴⁴ The three proponents who submitted proposals were Paxport, Claridge/Airport Terminals Development Group and Morrison Hershfield Group.¹⁴⁵ The Morrison Hershfield proposal did not qualify for Transport Canada review as they failed to provide the one million dollar deposit required under the RFP guidelines.¹⁴⁶

¹⁴² Pearson Airport Agreements, *supra*, note 1 at 63.

¹⁴³ Pearson Airport Agreements, *supra*, note 1 at 39.

¹⁴⁴ Pearson Airport Agreements, *supra*, note 1 at B-8 and 64.

¹⁴⁵ Pearson Airport Agreements, *supra*, note 1 at B-8.

¹⁴⁶ Pearson Airport Agreements, *supra*, note 1 at 65.

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From March till June, 1992 the evaluation committee headed by Ron Lane worked to finalize evaluation methodology, evaluation criteria and their numerical weightings.¹⁴⁷ During this preparation period the evaluation committee decided that two months was the appropriate time frame for the evaluation of the proposals.¹⁴⁸

Both the Claridge/Airport Terminals Development Group proposal and the Paxport proposal called for the eventual replacement of Terminal I, the extension of Terminal II and creation of a new pier where Terminal I is presently located.¹⁴⁹ The proposals differed somewhat in the return provided to the Crown.¹⁵⁰

The Committee submitted its recommendations to the Department of Transport on August 28, 1992. "The Committee concluded that the Paxport proposal qualified as the Best Overall Acceptable Proposal ("BOAP"), having obtained 577 rating points over 497 points for the Claridge proposal".¹⁵¹ The Paxport proposal was determined to have a superior

¹⁴⁷ Pearson Airport Agreements, *supra*, note 1 at 66.

¹⁴⁸ Pearson Airport Agreements, *supra*, note 1 at 67.

¹⁴⁹ Pearson Airport Agreements, *supra*, note 1 at 70-71.

¹⁵⁰ Pearson Airport Agreements, *supra*, note 1 at 70-71.

¹⁵¹ Pearson Airport Agreements, *supra*, note 1 at 73.

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development plan, business plan, management and operations plan, and to provide superior industrial benefits.¹⁵²

On December 9, 1992 the Minister of Transport announced that Paxport Inc. had submitted the Best Overall Acceptable Proposal.¹⁵³ The Major concern for the Federal Government was the financial viability of Paxport Inc. The solvency of Paxports largest shareholder was at issue.¹⁵⁴ The Financial viability of the Paxport proposal was to be demonstrated to the Government of Canada before the commencement of negotiation of a formal agreement.¹⁵⁵ The Claridge/Airport Terminals Development Group proposal was still on the table after December 9, 1992 and could be resurrected should negotiations with Paxport fail to proceed.¹⁵⁶

¹⁵² Pearson Airport Agreements, *supra*, note 1 at 73.

¹⁵³ Pearson Airport Agreements, *supra*, note 1 at B-9.

¹⁵⁴ Pearson Airport Agreements, *supra*, note 1 at 76.

¹⁵⁵ Pearson Airport Agreements, *supra*, note 1 at 79 and B-9.

¹⁵⁶ Pearson Airport Agreements, *supra*, note 1 at 82 and 89.

Negotiating The Agreements

In January, 1993 Transport Canada retained the consulting firm of Deloitte & Touche to assess the financeability of Paxports proposal.¹⁵⁷ In its first report to Transport Canada, dated March 15, 1993 Deloitte & Touche listed a number of concerns that needed to be resolved by Paxport. failing such resolution, "we cannot provide assurance to the Crown that this project can be financed".¹⁵⁸

The issue of the financeability of Paxports proposal led, in part, to discussions about the possibility of a merger between the more financially sound Claridge (owned by Mr. Charles Bronfman) and Paxport.¹⁵⁹ On January 14, 1993 Claridge and Paxport signed a binding letter of agreement outlining in detail how the groups will work to conclude a 50/50 joint venture for the redevelopment of Terminals I and II.¹⁶⁰ On February 1, 1993 Paxport and Claridge/Airport Terminals Development Group announced a joint venture partnership which became T1/T2 Limited, later known as Mergco and later the Pearson Development Corporation.¹⁶¹

¹⁵⁷ Pearson Airport Agreements, *supra*, note 1 at 87.

¹⁵⁸ Pearson Airport Agreements, *supra*, note 1 at 88.

¹⁵⁹ Pearson Airport Agreements, *supra*, note 1 at 90 and 92.

¹⁶⁰ Pearson Airport Agreements, *supra*, note 1 at 90-91 and B-9.

¹⁶¹ Pearson Airport Agreements, *supra*, note 1 at 9 and B-9.

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In an advisory memorandum to the Deputy Minister of Transport, it was argued that the merger should be seen "simply as corporate restructuring".¹⁶² It should not be seen as a "violation of the process" unless collusion existed at an earlier stage in the proposal process.¹⁶³

In its final report to Transport Canada, dated August 17, 1993 Deloitte & Touche gave a favourable assessment of the financeability of the Pearson Development Corporation (PDC), proposal.¹⁶⁴ In August, 1993 the Treasury Board gave the negotiated agreement approval which was forwarded to cabinet.¹⁶⁵ On August 27, 1993, cabinet authorized the Minister of Transport to enter into the final lease and development agreements with PDC.¹⁶⁶ On August 30, 1993, the Minister of Transport, Jean Corbeil publicly announced that an agreement was reached with PDC to redevelop and operate Terminals I and II at Pearson Airport.¹⁶⁷ The Closing date for the agreements had been set for October 17, 1993.¹⁶⁸

¹⁶² Pearson Airport Agreements, *supra*, note 1 at 91-92.

¹⁶³ Pearson Airport Agreements, *supra*, note 1 at 91.

¹⁶⁴ Pearson Airport Agreements, *supra*, note 1 at 100-101 and B-15.

¹⁶⁵ Pearson Airport Agreements, *supra*, note 1 at 104 and B-15.

¹⁶⁶ Pearson Airport Agreements, *supra*, note 1 at 104 and B-15.

¹⁶⁷ Pearson Airport Agreements, *supra*, note 1 at 106 and B-15.

¹⁶⁸ Pearson Airport Agreements, *supra*, note 1 at 100 and B-16.

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The agreement called for a 37-year lease, with a 20-year renewal option which could be bought out by the government.¹⁶⁹ "The formula governing rental payments to the government guaranteed a minimum payment of \$28 million during the first year ... contrasted with \$23.6 million in net revenue then being received by the government ..." ¹⁷⁰

The overall dollar value of the development plan was announced as \$700 million to take place in four phases.¹⁷¹ In addition, a passenger facilitation charge could not be implemented without government approval.¹⁷²

On September 9, 1993 a Federal election was called.¹⁷³ The Pearson Airport agreements became an issue in the election campaign. The leader of the Liberal Party of Canada declared that an elected Liberal government would review the deal.¹⁷⁴ The Progressive Conservative Government of Prime Minister Kim Campbell decided to proceed with closing of the deal as scheduled.¹⁷⁵ It was the Minister of Transports opinion that a legally enforceable agreement had come into force in August, 1993 when Cabinet and Treasury

¹⁶⁹ Pearson Airport Agreements, *supra*, note 1 at 106.

¹⁷⁰ Pearson Airport Agreements, *supra*, note 1 at 106.

¹⁷¹ Pearson Airport Agreements, *supra*, note 1 at 107 and 124.

¹⁷² Pearson Airport Agreements, *supra*, note 1 at 107.

¹⁷³ Pearson Airport Agreements, *supra*, note 1 at B-15.

¹⁷⁴ Pearson Airport Agreements, *supra*, note 1 at 112-114.

¹⁷⁵ Pearson Airport Agreements, *supra*, note 1 at 115.

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Board approval had been obtained.¹⁷⁶ The October closing represented a "legal formality".¹⁷⁷ The final nineteen documents were signed on October 7, 1993 at which time the Pearson deal closed.¹⁷⁸

¹⁷⁶ Pearson Airport Agreements, *supra*, note 1 at 113.

¹⁷⁷ Pearson Airport Agreements, *supra*, note 1 at 113.

¹⁷⁸ Pearson Airport Agreements, *supra*, note 1 at 112.

Chapter 6

The Cancellation

The Nixon Report

The Federal election occurred on October 25th, 1993. The Liberal Party of Canada lead by Jean Chretien was victorious. In accord with his campaign promise Prime Minister designate Jean Chretien moved to review the Pearson Airport Agreements and the process that had produced them.¹⁷⁹ In order to facilitate the review the Pearson Development Corporation agreed to postpone the commencement date until December 15, 1993.¹⁸⁰

On October 27, 1993 Mr. Robert Nixon, former leader of the Ontario Liberal Party and Cabinet Minister in the Ontario provincial government of David Peterson, was requested to review the Pearson Airport Agreements and the process that had produced them and provide a personal opinion to the Prime Minister within a month.¹⁸¹ Mr. Nixon and his staff decided that the first three weeks would be used for interviews and reviews of

¹⁷⁹ Pearson Airport Agreements, *supra*, note 1 at 129.

¹⁸⁰ Pearson Airport Agreements, *supra*, note 1 at B-16.

¹⁸¹ Pearson Airport Agreements, *supra*, note 1 at 129.

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information, and the last week would be used for writing the final report. The one month time limit would not be extended.¹⁸²

Mr. Nixon's most significant concern was that the Pearson Airport Agreements were signed in the midst of an election campaign:

"In my view, such an event flew in the face of normal and honourable democratic practice."¹⁸³

Mr. Nixon concluded that the process to privatize Terminals I and II, was inconsistent with the 1987 policy which emphasized the importance of LAA's.¹⁸⁴ In addition, the process of having only a single stage process (RFP) to be responded to by proponents within a 90 day period was insufficient.¹⁸⁵ No financial pre-qualification was required of the proponents.¹⁸⁶ Mr. Nixon concluded that turning over Terminals I and II at Pearson Airport to the PDC for a 57 year period was excessive. "The length of this obligation does

¹⁸² Pearson Airport Agreements, *supra*, note 1 at 129.

¹⁸³ Proceedings, *supra*, note 91, September 26, 1995 at 25:10; Pearson Airport Agreements, *supra*, note 1 at 131.

¹⁸⁴ Proceedings, *supra*, note 91, September 26, 1995 at 25:12-13.

¹⁸⁵ Proceedings, *supra*, note 91, September 26, 1995 at 25:11.

¹⁸⁶ Proceedings, *supra*, note 91, September 26, 1995 at 25:11.

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not serve the public interest".¹⁸⁷ Mr. Nixon believed that to contemplate the privatization of the remaining two terminals of this public asset with such a large direct economic impact on the economy of the province of Ontario was contrary to the public good.¹⁸⁸

Mr. Nixon was of the opinion that the revenue stream provided to the Government of Canada was insufficient and the Rate of return provided to PDC was excessive under the agreements.¹⁸⁹ Mr. Nixon did not like that the agreements contained a constraint on alternative airport development within a 75 kilometre radius of Pearson, including Hamilton until Pearson is processing 33 million passengers per year.¹⁹⁰

Mr. Nixon raised the issue of patronage citing Donald Matthews, a principle of Paxport as a possible beneficiary:

"While I did not draw any definitive conclusion, I observed that, in my opinion, one was left with a suspicion that patronage may have had a role in the selection of Paxport Incorporated as the preferred proponent".¹⁹¹

¹⁸⁷ Proceedings, *supra*, note 91, September 26, 1995 at 25:11-12.

¹⁸⁸ Proceedings, *supra*, note 91, September 26, 1995 at 25:12.

¹⁸⁹ Proceedings, *supra*, note 91, September 26, 1995 at 25:12.

¹⁹⁰ Proceedings, *supra*, note 91, September 26, 1995 at 25:12-13.

¹⁹¹ Proceedings, *supra*, note 91, September 26, 1995 at 25:13.

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Mr. Nixon raised the issue of the role of Lobbyists:

"I formed the conclusion that this climate of pressure resulted in some civil servants being reassigned or requesting transfer from the project".¹⁹²

Mr. Nixon concluded that the RFP implicitly indicated competition between the lessee of Terminals I and II and Claridge, the lessee of Terminal III, was desirable. However, after succeeding in the competition, Paxport could proceed only after Claridge took over financial responsibility for the project resulting in the loss of competition.¹⁹³

Mr. Nixon's advice to the Prime Minister was to favour the cancellation of the Pearson Airport Agreements. At a November 29th, 1993 meeting attended by Mr. Nixon and Prime Minister Jean Chretien, and various other officials including Douglas Young, Minister of Transport. Mr. Nixon submitted his report.¹⁹⁴

¹⁹² Proceedings, *supra*, note 91, September 26, 1995 at 25:13.

¹⁹³ Robert Nixon, *Report prepared for Prime Minister Chretien on the Pearson Airport Agreements* (Delivered: November 29, 1993, Made Public: December 3, 1993) reproduced in the *Pearson Airport Agreements*, *supra*, note 1 at Appendix E-7 [hereinafter Nixon Report]; Proceedings, *supra*, note 91, September 26, 1995 at 25:13-14.

¹⁹⁴ Nixon Report, *supra*, note 193, at E-7; *Pearson Airport Agreements*, *supra*, note 1 at 131.

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On December 3rd, 1993, Prime Minister Chretien announced that the Pearson Airport Agreements would be cancelled. "The advice in the Nixon report was presented as the central basis for this decision, and the conclusions and recommendations in the report were quoted in the press conference accompanying the announcement:

My review has left me with but one conclusion. To leave in place an inadequate contract, arrived at with such a flawed process and under the shadow of possible political manipulation, is unacceptable. I recommend to you that the contract be cancelled."¹⁹⁵

On April 13, 1994 the Liberal government introduced in Parliament, legislation known as Bill C-22 nullifying the Pearson Airport Agreements.¹⁹⁶ Bill C-22 sought to deny the very existence of the Pearson Airport Agreements. In addition, Bill C-22 sought to limit compensation for out-of-pocket expenses at \$30 million.¹⁹⁷ In February, 1996 Bill C-22 died on the Senate order papers when the Parliamentary session closed prior to its passage.¹⁹⁸

¹⁹⁵ Nixon Report. *supra*, note 193, at E-9; Pearson Airport Agreements. *supra*, note 1 at 131.

¹⁹⁶ Pearson Airport Agreements. *supra*, note 1 at B-20.

¹⁹⁷ Murray Campbell, "Consortium seeks up to \$662-million over Pearson" *The Globe and Mail* (13 February 1996) at A3 [hereinafter Campbell].

¹⁹⁸ Campbell. *supra*, note 197 at A3.

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The Federal Government may re-introduce this legislation at the next session of Parliament. In January, 1996 Prime Minister Chretien shuffled his cabinet. Douglas Young was replaced as Minister of Transport. The new Minister of Transport, David Anderson has confirmed that no decision has been reached on whether Bill C-22 will be re-introduced.¹⁹⁹ The Ministry of Transport, has stated that the federal government was considering re-introducing Bill C-22.²⁰⁰ The Liberals now constitute a Senate majority. If Bill C-22 is re-introduced it will pass into law quickly.

On September 16, 1994 nine members of the PDC initiated a lawsuit against the Federal Government for breach of contract.²⁰¹ On May 23, 1995 the Ontario Court of Appeals dismissed the government appeal of the lower court ruling of the Ontario Court, General Division that the Federal Government was legally liable for the cancellation of the Pearson Airport Agreements.²⁰² On February 12, 1996 the civil trial began in the Ontario Court General Division to determine the issue of damages. The PDC is seeking up to \$662 million in damages from the Federal Government.²⁰³ PDC's damage claim is "based on expert

¹⁹⁹ Campbell, *supra*, note 197 at A3.

²⁰⁰ Alan Toulon, "Ottawa Ready to Bring Back Pearson Airport Bill" *The Financial Post* (10 April 1996) at 3.

²⁰¹ Pearson Airport Agreements, *supra*, note 1 at B-20.

²⁰² Pearson Airport Agreements, *supra*, note 1 at B-20.

²⁰³ Campbell, *supra*, note 197 at A3.

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evaluations of the revenue potential of the 57-year deal that then were adjusted to take into account such factors as the dollar's exchange rate, inflation and capitalization costs."²⁰⁴

Reviewing the Decision to Cancel the Pearson Airport Agreements

The Special Senate Committee on the Pearson Airport Agreements

On May 4, 1995 the Senate adopted a motion to establish a special committee on the Pearson Airport Agreements.²⁰⁵ The Special Senate committee began hearings on July 11, 1995. The Senate committee heard over 130 hours of sworn testimony by 65 witnesses.²⁰⁶ The report of this committee was released in December, 1995.²⁰⁷

The process Mr. Nixon followed was criticized in the majority report by the Special Senate Committee on the Pearson Airport Agreements (the "Majority Report"). The tight time frame and the failure to meet key witnesses was criticized:

²⁰⁴ Campbell, *supra*, note 197 at A3.

²⁰⁵ Pearson Airport Agreements, *supra*, note 1 at B-20.

²⁰⁶ Pearson Airport Agreements, *supra*, note 1 at vii and 132.

²⁰⁷ Pearson Airport Agreements, *supra*, note 1 at B-20.

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"Having spent over three months holding intensive hearings on this matter, we are unable to understand how a fact-finding and analysis phase lasting only three weeks could possibly have been adequate for Mr. Nixon's task ..."²⁰⁸

Mr. Nixon failed to meet or communicate with Victor Barbeau who was the Assistant Deputy Minister, Airports and very much involved in this file who stated that "to the best of my knowledge...Lobbyists did not interfere in the evaluation process".²⁰⁹ Mr. Nixon failed to meet or communicate with Mr. Gerald Berigan (Regional Director Airports, Atlantic Division) who testified that he did not feel any undue pressure from the minister to organize the RFP in a way that would favour one proponent over the other.²¹⁰

In addition, Mr. Nixon failed to meet or communicate with Ron Lane, who headed up the evaluation process; Ministers of Transport, Mr. Doug Lewis and Mr. Jean Corbeil; Treasury Board officials Al Clayton, Mel Cappe or Sid Gershberg; Harry Swain, the Deputy Minister of Industry; Mr. Robert L'Abbée from the firm of Raymond Chabot Martin Paré who were involved in the evaluation; John Simke, who was at Price Waterhouse, Mr. Raymond

²⁰⁸ Pearson Airport Agreements, *supra*, note 1 at 133.

²⁰⁹ Proceedings, *supra*, note 91, September 26, 1995 at 25:34.

²¹⁰ Proceedings, *supra*, note 91, September 26, 1995 at 25:35-36.

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Hession, president of Paxport; and Mr. Shortcliffe, former Deputy Minister of Transport.²¹¹

Mr. Nixon's "most significant" concern was that the Pearson Airport Agreements were signed in the midst of an election campaign. The Majority report of the Special Senate Committee, based on testimony from academic authorities, concluded that "no constitutional convention restricts government decision-making during the period between the issue of the Writs of Election and the vote."²¹²

October 7th, 1993 constituted the long scheduled closing date, of a "protracted process in which the critical decisions had all been made well before the issue of the writ of the election".²¹³ The Pearson Airport Agreements had been reached prior to the call of the election campaign and failure to close the transaction would have led to government legal liability.²¹⁴

The majority report of the Special Senate Committee on the Pearson Airport Agreements concluded that the "insinuation of preferential treatment contained in the Nixon report is

²¹¹ Proceedings, *supra*, note 91, September 26, 1995 at 25:36-46.

²¹² Pearson Airport Agreements, *supra*, note 1 at 123.

²¹³ Pearson Airport Agreements, *supra*, note 1 at 160.

²¹⁴ Pearson Airport Agreements, *supra*, note 1 at 159-160.

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not merely groundless; it is disgraceful".²¹⁵ On the role of lobbyists, it was concluded that any pressures felt by individuals involved with the Pearson Airport agreements was "entirely routine":

"Indeed, the comments in the Nixon report on the impact of the lobbying are so utterly vague that our primary feeling is one of embarrassment for its author."²¹⁶

Mr. Nixon believed that the RFP implicitly indicated competition between the lessee of Terminals I and II and Claridge, the lessee of Terminal III, was desirable.²¹⁷ The RFP does not state that competition was a goal of the process.²¹⁸

Mr. Nixon claimed that the revenue stream provided to the Government of Canada was insufficient and the Rate of return provided to PDC was excessive under the agreements.²¹⁹ In their civil suit against PDC "lawyers for the government are prepared to argue exactly the opposite - that privatization would have been a financial dud - in an

²¹⁵ Pearson Airport Agreements, *supra*, note 1 at 139.

²¹⁶ Pearson Airport Agreements, *supra*, note 1 at 141-142.

²¹⁷ Nixon Report, *supra*, note 193, at E-7; Proceedings, *supra*, note 91, September 26, 1995 at 25:13-14.

²¹⁸ Pearson Airport Agreements, *supra*, note 1 at 143-144.

²¹⁹ Proceedings, *supra*, note 91, September 26, 1995 at 25:12.

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effort to limit damages."²²⁰ Mr. Ronald Slaght, a PDC lawyer stated that "Crown lawyers will call a series of expert witnesses who will argue that Pearson Development would have found itself in financial straits from the \$686-million capital program it had planned."²²¹

Mr. Nixon concluded that turning over Terminals I and II at Pearson Airport to the PDC for a 57 year period was excessive. "The length of this obligation does not serve the public interest".²²² The industry standard lease term according to the National Capital Commission is "twice the length of a normal mortgage, plus a few years".²²³ "A lease in the sixty-to seventy-year range would be considered appropriate."²²⁴ A lease of this length would provide the security required by financial institutions in order for them to provide financing on favourable terms and at favourable rates.²²⁵

Mr. Nixon argued that the importance of Pearson airport in the Ontario economy requires that the terminals should be owned and operated by an entity responsive to the "broadly defined public interest".²²⁶ The majority report concluded that Mr. Nixon failed to

²²⁰ Campbell, *supra*, note 197 at A3.

²²¹ Campbell, *supra*, note 197 at A3.

²²² Proceedings, *supra*, note 91, September 26, 1995 at 25:11-12.

²²³ Pearson Airport Agreements, *supra*, note 1 at 34.

²²⁴ Pearson Airport Agreements, *supra*, note 1 at 34.

²²⁵ Pearson Airport Agreements, *supra*, note 1 at 34.

²²⁶ Pearson Airport Agreements, *supra*, note 1 at 149.

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explain why private sector/public sector partnerships could not meet public interest objectives while obtaining private sector advantages of efficiency and market responsiveness.²²⁷ Specifically, Mr. Nixon failed to demonstrated that the \$750 million in redevelopment investment in Terminals I and II, at no cost to the Canadian taxpayer, was contrary to public interest.²²⁸

As a result of the cancellation PDC has launched legal proceedings against the Federal government seeking up to \$662 million in damages.²²⁹ The Matthews Groups went out of business and approximately 750 people lost their jobs.²³⁰ The anticipated employment of up to 1,000 people during the redevelopment process did not occur.²³¹

The decision to cancel the Pearson Airport Agreements was made in the name of public interest. The majority report of the Special Senate Committee concluded that "the decision to cancel the Pearson agreements has achieved nothing positive for Canadians. We think it reflects an unaccountable lapse in judgement."²³²

²²⁷ Pearson Airport Agreements, *supra*, note 1 at 150.

²²⁸ Pearson Airport Agreements, *supra*, note 1 at 150.

²²⁹ Campbell, *supra*, note 197 at A3.

²³⁰ Pearson Airport Agreements, *supra*, note 1 at 163.

²³¹ Pearson Airport Agreements, *supra*, note 1 at 163.

²³² Pearson Airport Agreements, *supra*, note 1 at 163.

Chapter 7

The National Airports Policy

Canadian Airport Authorities

LAA's became operational in 1992 in Vancouver, Edmonton, Calgary and Montreal. Following the 1993 election the Liberal Government reviewed Canada's Airports Policy. On July 13, 1994 the National Airports Policy ("NAP") was established.²³³ Pursuant to the NAP, Canada's major airports now comprise the National Airport System ("NAS"). LAA's have been replaced by the Canadian Airport Authority ("CAA"). The Liberal government modified the accountability model established by the 1987 policy by adding local and federal government representatives to Local Airport Authority Boards.²³⁴ CAA's, like LAA's, are non-profit corporations which may lease Airports from the Federal Government.

²³³ Pearson Airport Agreements. *supra*, note 1 at 16.

²³⁴ Pearson Airport Agreements. *supra*, note 1 at 16.

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The 7 to 15 individuals appointed to the Board of Directors must be representatives of the community and have experience in various professions.²³⁵ The federal government has the power to nominate two directors and the provincial government has the power to nominate one director.²³⁶ The majority of the directors must be nominated by the three levels of government.²³⁷

The Liberal government has rejected privatization of our airports under the National Airports Policy in favour of publicly owned Canadian Airport Authorities. CAA's are required to enhance the public's general benefit rather than pursue profits.²³⁸

Greater Toronto Airport Authority

The federal government has reached an agreement on terms for transfer of Pearson Airport to the Greater Toronto Airport Authority ("GTAA"). Pearson airport will be one of the first airports to be transferred to local control under the Liberal governments CAA model. The terms of the agreement reached are "confidential".²³⁹

²³⁵ Transport Canada, News Release, "Comprehensive Air Transport Strategy for Canada", No. 75/94 (July 13, 1994).

²³⁶ Transport Canada, News Release, "Comprehensive Air Transport Strategy for Canada", No. 75/94 (July 13, 1994).

²³⁷ Transport Canada, News Release, "Comprehensive Air Transport Strategy for Canada", No. 75/94 (July 13, 1994).

²³⁸ Transport Canada, News Release, "Comprehensive Air Transport Strategy for Canada", No. 75/94 (July 13, 1994).

²³⁹ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

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The GTAA plans to replace both Terminals I and II with one new Terminal Building.²⁴⁰ The plans for the new building show a horseshoe shape with a 150 gates and a central parking garage.²⁴¹ The design can handle up to fifty million passengers per year or four-hundred thousand per gate.²⁴² The plan calls for development in three stages all of which will be completed anywhere from the year 2011 to 2017. The development schedule has not been finalized.²⁴³

Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority does not believe that the Pearson Airport should compete with one another. According to Mr. Turpen "It doesn't make any sense at all to take a public utility - Pearson - and fracture it to destroy the synergy".²⁴⁴ When Terminal III's lease comes up for renewal Mr. Turpen does not envisage that it will be renewed.²⁴⁵

²⁴⁰ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

²⁴¹ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

²⁴² Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

²⁴³ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

²⁴⁴ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

²⁴⁵ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

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The GTTA plans to finance Pearson Airport development by borrowing long term debt.²⁴⁶ In contrast to the Vancouver International Airport Authority the GTAA does not intend to implement a passenger facilitation charge.²⁴⁷

²⁴⁶ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

²⁴⁷ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

Chapter 8

Constitutional Considerations

From an operational perspective airports are subject to virtually exclusive federal regulation. Pearson Airport is scheduled to be transferred to the Greater Toronto Airport Authority ("GTAA"). A Constitutional challenge to the authority of the GTAA. It may be argued that provincial statutes creating LAA's or CAA's infringe upon exclusive Federal jurisdiction over aeronautics pursuant to s.92 of the *Constitution Act, 1867*. It makes no difference whether the airports are inter-provincial, or international in character, or intra-provincial only, because exclusive federal jurisdiction applies in any event.²⁴⁸ In contrast if Pearson Airport were to be privatized no Constitutional concerns would arise.

In *Johannesson v. West St. Paul*²⁴⁹, the Supreme Court of Canada held that a Manitoba municipal act authorizing municipal corporations to pass by-laws for licensing, regulating and, within certain areas, preventing the erection, maintenance and continuance of airports or places where airplanes are kept for hire or gain was *ultra vires*. The principal reason for the decision was that it was impossible to separate intra-provincial flying from inter-provincial

²⁴⁸ *Jorgenson v. North Vancouver Magistrates* (1959) 28 W.W.R. 265 (B.C.C.A.).

²⁴⁹ [1952] 1 S.C.R. 292.

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flying and, therefore, the location and regulation of airports could not be identified with either or separated from aerial navigation as a whole. The Court concluded that legislation which is in "pith and substance" in relation to the larger subject of aeronautics is beyond the competence of the provincial legislatures.

In *Johannesson v. West St. Paul*²⁵⁰, it was held that the "peace, order and good government" power gave the federal government exclusive jurisdiction over aeronautics. This jurisdiction has been subsequently interpreted by the courts in a very broad manner, whereby federal control has been held to extend to all services incidental to the operation of an airport facility.

The Relevant parts of Section 4 of the *Aeronautics Act*, R.S.C. 1985,²⁵¹ provide as follows:

4.2 The Minister is responsible for the development and regulation of aeronautics and the supervision of all matters connected with aeronautics and, in the discharge of those responsibilities, the Minister may...

(b) construct, maintain and operate aerodromes and establish and provide other facilities and services relating to aeronautics;

4.4(2) The Governor in Council may make regulations, or may, by order, subject to and in accordance with such terms and

²⁵⁰ [1952] 1 S.C.R. 292.

²⁵¹ *Aeronautics Act*, R.S.C. 1985, c. 33 (1st Supp.) as amended, ss. 4.2, 4.4, and 4.9.

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conditions as may be specified in the order, authorize the Minister to make regulation prescribing charges

- (a) for the use of
 - (i) any facility or service provided by or on behalf of the Minister for or in respect of any aircraft, whether or not, where the facility or service is provided during flight, the flight originates or terminates in Canada or any portion of the flight is over Canada,
 - (ii) any other facility or service provided by or on behalf of the Minister at any aerodrome, or
 - (iii) any aerodrome operated by or on behalf of Her Majesty in right of Canada;...

4.9 The Governor in Council may make regulations respecting aeronautics and, without restricting the generality of the foregoing, may make regulations respecting...

- (e) activities at aerodromes and the location, inspection, certification, registration, licensing and operation of aerodromes;...

It can be seen from these sections that while the federal government has a statutory power to construct, maintain and operate aerodromes, it is not expressly provided that the federal government must be the entity which directly does so. Furthermore, the federal government may make regulations prescribing charges for the use of airport facilities and services provided by or on behalf of the federal government, but it is not obliged to do so.

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*In Air Atonabee Ltd. v. Toronto Harbour Commissioners*²⁵² the Plaintiffs argued that the imposition of a passenger user fee at Toronto Island Airport is contrary to section 4.4 of the *Aeronautics Act*. The Plaintiffs contend that section 4.4 reserves the ability to impose charges for the use of Airports to the Minister of Transport.²⁵³ The Court concluded that while the legislation authorizes the Governor-in-Council to impose user charges, it does not reserve to the Governor-in-Council the "exclusive right" to do so.²⁵⁴

The right of Minister to impose fees under this provision is not exclusive. Section 4.4 does not preclude imposition of user fees by provincial operator to meet costs of airport facilities expansion under agreement with minister.

The scope of any special provincial statute creating a LAA or CAA is limited strictly to establishing a formal corporate structure, and endowing the Airport Authority with the capacity or power of any natural person, in much the same way as any other provincially (or federally) incorporated corporation.²⁵⁵

²⁵² 35 F.T.R. 206 at 212 (T.D.), rev'd on other grounds 135 N.R. 118 (C.A.).

²⁵³ 35 F.T.R. 206 at 212 (T.D.).

²⁵⁴ 35 F.T.R. 206 at 212 (T.D.).

²⁵⁵ Bruce Welling, *Corporate Law in Canada*, (Toronto: Butterworths, 1991) at 2-4.

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In 1992, the Federal government passed the *Airport Transfer (Miscellaneous Matters) Act* which authorizes the transfer of an airport to a local authority by an order of the Governor in Council who may:

"...designate any corporation or other body to which the Minister is to sell, lease or otherwise transfer an airport as a designated airport authority..."

In 1992 the Minister of Transport leased the airports in Vancouver, Calgary, Edmonton and Montreal to locally controlled LAA's.

Section 92(11) of the *Constitution Act, 1867* gives the provincial Legislature the power to make laws in relation to "the incorporation of companies with provincial objects."²⁵⁶ No equivalent Federal power of incorporation of companies is enumerated in section 91 of *Constitution Act, 1867*. The Federal power of incorporation has been held to fall within the residuary character of the "peace, order and good government" power.²⁵⁷

²⁵⁶ Peter W. Hogg, *Constitutional Law Of Canada*, 3rd Ed. (Toronto: Carswell Thomson Professional Publishing, 1992) at 439 [hereinafter Hogg].

²⁵⁷ Hogg, *supra*, note 256 at 439 and 603.

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The phrase "with provincial objects" has been defined to constitute a territorial limitation on the provincial power to incorporate companies.²⁵⁸ This territorial limitation allows a province to incorporate any company regardless of its business. However, the corporation would not have any legal existence outside the province.²⁵⁹ Therefore, a provincial statute which incorporates an Airport would not be *ultra vires* provincial jurisdiction.

Professor Hogg in *Constitutional Law of Canada* stated that a "functional limitation would confine the power to the incorporation of companies whose objects were within provincial legislative authority: for example, a school or a shop or an insurance company, but not a ferry between two provinces or an airline".²⁶⁰ It is not clear whether an airport would violate a functional limitation. But such provincial incorporation of an airport would "raise the spectre of an *ultra vires* challenge" every time Airport activity "strayed outside the regulatory authority of the jurisdiction of incorporation."²⁶¹ Professor Hogg concluded that no functional limitation on the provincial power of incorporation exists.²⁶²

²⁵⁸ Hogg, *supra*, note 256 at 604.

²⁵⁹ Hogg, *supra*, note 256 at 604.

²⁶⁰ Hogg, *supra*, note 256 at 606.

²⁶¹ Hogg, *supra*, note 256 at 606-607.

²⁶² Hogg, *supra*, note 256 at 606.

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A corporation has been created as the legal operating entity of each LAA. The Regional Airports Authorities Act²⁶³ ("RAAA") was enacted in Alberta in 1989. Local Airport Authorities were incorporated in Calgary and Edmonton pursuant to the RAAA. No provincial incorporating statute was established in British Columbia and Quebec. Rather, LAA's have been incorporated to operate the Montreal's Dorval and Mirabel airports and Vancouver International Airport under the Canada Corporations Act ("CCA").²⁶⁴

In *Construction Montcalm v. Minimum Wage Commission* the Supreme Court of Canada considered whether a company involved in the construction of airport runways was subject to provincial minimum wage laws.²⁶⁵ The court reasoned that the physical construction of an airport is not an integral part of aeronautics. Therefore the minimum wage law in question was valid.²⁶⁶

The GTAA will lease the land and buildings from the federal government. They will operate the airport and charge fees for services. However, they will not have responsibility for or control over the services retained by the federal government. The manner in which

²⁶³ S.A. 1989, Chap. R-9.05.

²⁶⁴ S.C. 1970, c.32, Part II.

²⁶⁵ Hogg, *supra*, note 256 at 588.

²⁶⁶ Hogg, *supra*, note 256 at 588.

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the GTAA operates its "airport business" will be governed by its license from the ministry of transport and the lease under which it operates.

Any required Ontario provincial legislation will take a form similar to Alberta's RAAA. This legislation will not regulate aeronautics or prescribe the fees to be charged by the Pearson Airport Authority. The only provincial legislative involvement shall be in constituting a provincial entity with sufficient capacity to fulfil its intended purpose. The legislation will not in any way specifically direct itself to the operation of the airport.²⁶⁷

The arrangements detailed above would not constitute an infringement upon Federal jurisdiction over aeronautics. The case law makes it clear that Federal control over aeronautics is broad. However, there is no prohibition of the establishment of an entity such as an LAA or CAA. Nor is there any restriction on the operation of an airport by some entity other than the federal government, if properly licensed.²⁶⁸

Municipal airports, licensed by the federal government but under the control of municipalities have existed for many years. If this limited provincial involvement was determined to be provincial regulation of aeronautics (and therefore, *ultra vires* the provincial legislature), then the same would have to be said of any airport which is owned

²⁶⁷ Hogg, *supra*, note 256 at 497.

²⁶⁸ Hogg, *supra*, note 256 at 587-588.

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and/or operated by private persons or entities. The case law has not developed in this direction.²⁶⁹

A provincial statute which incorporates an Airport would not be *ultra vires* provincial jurisdiction. The Aeronautics act does not restrict the operation of an airport by some entity other than the Federal government. Therefore, the Pearson Airport whether operated by the GTAA, a provincially incorporated Airport Authority or by a Private corporation would not be *ultra vires* the Provincial legislature.

²⁶⁹ Hogg, *supra*, note 256 at 495-498.

Chapter 9

Airports in Other Jurisdictions

British Airport Authority plc

The airport commercialization era began in 1965 with the *British Airports Authority Act*.²⁷⁰ This Act created a non-profit corporation called the British Airports Authority ("BAA") to operate certain airports. The Secretary of state had the power to appoint the Board of directors of the corporation including the Chairman.²⁷¹ The Act required the board members to have significant experience and expertise in fields related to air transport.²⁷² The Government retained the power to direct the members of the of the board of directors on matters which appeared "to affect the national interest..."²⁷³ "As a statutory corporation, BAA had a degree of independence from government, but it remained accountable to government for its finances including borrowing and capital expenditures".²⁷⁴

²⁷⁰ *Airports Authority Act* (U.K.), 1975, c.78.

²⁷¹ *Airports Authority Act* (U.K.), 1975, c.78, s.1(2)(3)(4).

²⁷² *Airports Authority Act* (U.K.), 1975, c.78, s.1(2)(3)(4).

²⁷³ *Airports Authority Act* (U.K.), 1975, c.78, s.2(7).

²⁷⁴ Richard L. Everitt. "The Pros and Cons of Airport Privatisation in the EEC after 1992" *Air Law*, Vol. XV, no.5/6 (Deventer: Kluwer Law and Taxation Publishers, 1990) 327 [hereinafter Everitt].

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In June 1983, the Conservative party of Great Britain was re-elected. In the Queen's speech the government announced its intention to privatize as many of Britain's airports as possible.²⁷⁵ In July 1986 the *Airports Act of 1986* received Royal assent.²⁷⁶ On July 16th, 1987 one hundred per cent of the ordinary shares in BAA plc were offered for sale to the public and trading in BAA plc shares commenced on the London Stock Exchange on July 28th, 1987.²⁷⁷ BAA plc was privatized through a 2.7 billion share flotation.²⁷⁸ The United Kingdom was the first European Union member state to transfer ownership of a major airport to the private sector.²⁷⁹

BAA plc owns and operates a number of airports in the United Kingdom including Glasgow, Edinburgh, Aberdeen and Southampton Airports in Scotland and Heathrow, Gatwick and Stanstead airports, each of which are situated around London.²⁸⁰ These airports are used by over 70% of airport passengers in the U.K.²⁸¹

²⁷⁵ John B. Heath, "Privatisation: The Case of BAA PLC" in V.V. Ramanadham, *Privatization in the U.K.* (London: Routledge, 1988) 173 at 173 [hereinafter Heath].

²⁷⁶ Heath, *supra*, note 275 at 173.

²⁷⁷ Heath, *supra*, note 275 at 173.

²⁷⁸ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 20.

²⁷⁹ Everitt, *supra*, note 274 at 327.

²⁸⁰ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 20.

²⁸¹ Everitt, *supra*, note 274 at 327.

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The remaining airports in Britain are owned by municipal governments or have been privatized.²⁸² For example, the British Aerospace Establishment (BAe), owns Liverpool Regional Airport.²⁸³ BAe plans to develop Liverpool Airport as a major hub.²⁸⁴ In 1987, a new airport opened in London's docklands.²⁸⁵ Mowlen, a private construction company financed and owns this airport.²⁸⁶

Those who favoured an Airport ownership and operation scheme which fostered competition argued for selling each BAA airport separately.²⁸⁷ This proposal would have minimized the need for government regulation. The Government rejected this approach in favour of increased regulation over BAA plc to ensure that as a private sector monopoly it does act in ways contrary to the public interest as the government defines such interest.²⁸⁸ It is evident from the BAA plc example that the government did not wish to surrender its ability to control many of the functions of the airport.²⁸⁹

²⁸² Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 20.

²⁸³ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 20.

²⁸⁴ Doganis, *supra*, note 2 at 28.

²⁸⁵ Doganis, *supra*, note 2 at 28.

²⁸⁶ Doganis, *supra*, note 2 at 28.

²⁸⁷ Heath, *supra*, note 275 at 178.

²⁸⁸ Heath, *supra*, note 275 at 179 and 190.

²⁸⁹ Heath, *supra*, note 275 at 190.

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BAA plc's airports have benefitted in 1.4 billion in capital improvements between 1991 and 1994.²⁹⁰ BAA plc plans to invest \$3 billion to expand retailing space and construct a railway link between London-Heathrow airport and Paddington Station over the next three years.²⁹¹ The projects will be financed through profits and capital raised on financial markets and will not cost the taxpayer any money.²⁹²

Under privatization models Governments "receive the proceeds from the sale of the business and are relieved of the burden of financing airport expansion".²⁹³ The level of investment is currently over 200 million pounds per annum which has required borrowing by BAA Plc of over six hundred million pounds.²⁹⁴ As a government entity, this level of borrowing may not have been possible given budgetary restrictions.

Privatization of airports in the U.K. has led to more stringent criteria being employed in assessing the required return on investment.²⁹⁵ "The benefits of this discipline are that projects are assessed against their financial liability rather than on extraneous objectives

²⁹⁰ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 23.

²⁹¹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 23.

²⁹² Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 23.

²⁹³ Everitt, *supra*, note 274 at 329-330.

²⁹⁴ Everitt, *supra*, note 274 at 330.

²⁹⁵ Everitt, *supra*, note 274 at 330.

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which often result from political concerns".²⁹⁶ Privatization has offered airports the opportunity to access private sector capital to meet investment demands.²⁹⁷

United States

Most of the worlds largest airports are located in the United States.²⁹⁸ U.S. airports are generally publicly owned. "Most are owned by cities and counties although a few are under state or federal ownership".²⁹⁹ Many municipally or county owned airports such as Baltimore, Chicago, and Houston are run by departments responsible to city councils.³⁰⁰

In the United States Airport Authorities have been common for many decades.³⁰¹ Authorities sometimes referred to as "sub-governmental entities" seem to have prevailed as the most common type of Airport management structure.³⁰² In 1947, the Port of New

²⁹⁶ Everitt, *supra*, note 274 at 330.

²⁹⁷ Everitt, *supra*, note 274 at 330.

²⁹⁸ Doganis, *supra*, note 2 at 188.

²⁹⁹ Doganis, *supra*, note 2 at 109.

³⁰⁰ Doganis, *supra*, note 2 at 11.

³⁰¹ Doganis, *supra*, note 2 at 12.

³⁰² L.E. Gesell, *Aviation and the Law* (Arizona: Coast Aire Publications, 1987) at 11-1.

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York Authority was authorized to run New York's Airports and its port facilities.³⁰³ Massport in Massachusetts is also a dual purpose authority.³⁰⁴

On April 30, 1992 President George Bush signed an executive order which allows expanded authority of states and municipalities to privatize airports.³⁰⁵ The executive order assigns the majority of proceeds from the sale of Airports to the state and local governments despite significant Federal investment through grants.³⁰⁶ The executive order provides that "the normal common-law rule that would say there should be full recoupment of federal investment does not necessarily apply".³⁰⁷ Federal recoupment would only occur if there are sufficient proceeds to cover grants. In addition State and local authorities get to keep excess proceeds.³⁰⁸

³⁰³ Doganis, *supra*, note 2 at 13.

³⁰⁴ Doganis, *supra*, note 2 at 13.

³⁰⁵ James Ott, "Bush Order Opens Door For Airport Privatization" *Aviation Week & Space Technology* (Washington, D.C.: McGraw Hill, May 11, 1992) at 3 [hereinafter Ott].

³⁰⁶ Ott, *supra*, note 305 at 3.

³⁰⁷ Ott *supra*, note 305 at 3.

³⁰⁸ Ott, *supra*, note 305 at 3.

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Australia

In 1988, the Australian government transferred the title of 16 major airports to the wholly owned Federal Airports Corporation ("FAC").³⁰⁹ The FAC bought an additional 5 airports in 1989. Australia will sell 50 year leases to private sector operators beginning in 1996, with priority given to privatizing Brisbane, Melbourne, Perth and Sydney airports.³¹⁰

Preparation for the sales has commenced with the objectives of seeking expressions of interest in early to mid 1996, followed by a formal sales process and culminating in sales by the end of 1996.

Austria

In 1992 the Austrian government sold 27% of the Vienna International Airport through a public share floatation. Approximately 50% of the shares were sold abroad.³¹¹

³⁰⁹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 33.

³¹⁰ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 33.

³¹¹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 33.

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France

Airports in France are operated by Aéroport de Paris, an Airport Authority like the former BAA. Aéroport de Paris estimates that it can finance 45% of its planned \$2.5 billion in capital spending through cash flow.³¹² "The remainder would come from France's cash strapped treasury (considered unlikely even under the present government); loans that would boost the authority's debt/asset ratio; or, private investors."³¹³ Aéroport de Paris estimates that a cash injection of \$466 million will be necessary before any privatization can take place.³¹⁴

New Zealand

Airports in New Zealand receive no subsidies or grants. They pay taxes and dividends to the federal government and finance their own expansion.³¹⁵ "The New Zealand model is very similar to Canada's approach, except that in New Zealand, shares in airports are expected to be sold within the next two years."³¹⁶

³¹² Everitt, *supra*, note 274 at 34.

³¹³ Everitt, *supra*, note 274 at 34.

³¹⁴ Everitt, *supra*, note 274 at 34.

³¹⁵ Everitt, *supra*, note 274 at 35.

³¹⁶ Everitt, *supra*, note 274 at 35.

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Germany

Frankfurt, Munich, Berlin, Tegel and Berlin-Schoenefeld airports are operated by a corporation in which the shares are owned entirely by the various governments.³¹⁷ Germany urgently needs to build a new Berlin airport to accommodate rapidly increasing traffic. Required spending on airport capital improvements in Germany is estimated at \$10.9 billion by 2010.³¹⁸

It has been reported that Hamburg airport will be privatised.³¹⁹ It will be the first large German airport to opt for full privatisation.³²⁰ Hamburg City Council currently owns 64 per cent of the airport.³²¹ The federal government owns twenty-six per cent of the airport and ten per-cent is owned by the government of Schleswig Holstein.³²² The policy of privatisation has been agreed to by all necessary parties.³²³ The airport's controlling

³¹⁷ Everitt, *supra*, note 274 at 34.

³¹⁸ Everitt, *supra*, note 274 at 34.

³¹⁹ "Hamburg is First on the List for Privatisation" *Jane's Airport Review*, Vol. 6, Issue 10 (Surrey, United Kingdom: International Thomson Publishing Company, March, 1996) at 3 [hereinafter *Hamburg*].

³²⁰ *Hamburg*, *supra*, note 319 at 3.

³²¹ *Hamburg*, *supra*, note 319 at 3.

³²² *Hamburg*, *supra*, note 319 at 3.

³²³ *Hamburg*, *supra*, note 319 at 3.

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company is considering whether to sell shares in the airport company to the public or to sell the airport as a single entity to a single or group of purchasers.³²⁴

³²⁴ Hamburg, *supra*, note 319 at 3.

Chapter 10

A Critical Assessment of Airport Policy in Canada

General

The NAP, established in July 1994, rejects full scale privatization of Canada's 26 NAS airports in favour of "commercialization".³²⁵ Airport Authorities (LAA's and CAA's) are generally better than Transport Canada officials at responding to market trends.³²⁶ "Business plans, for example, can be drawn up with the confidence that decisions will be made internally rather than nationally, thereby avoiding the federal political baggage of system-wide considerations that such an obsolete process entails".³²⁷ Airports operated by Airport Authorities are plagued by many of the structural shortcomings that made Transport Canada airports inefficient.³²⁸

³²⁵ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 12.

³²⁶ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

³²⁷ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 7.

³²⁸ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

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The board of directors of CAA's (as opposed to LAA's) will involve a greater concentration of political nominations from up to four levels of government.³²⁹ The board of directors will be stacked with political nominees. Thus, up to four levels of government would be in a position to impose their will on CAA's.³³⁰

Taxing Authority of Airport Authorities

Airport Authorities have in practice replaced the Federal Government as a tax collector subsidizing inefficient Airports. "In fact, commercialization merely amounts to a transfer of airports from one part of the public sector to another, and from a national tax base to a local one".³³¹ The board of directors of Airport Authorities can tax the local public at will by an increase in user fees and imposition of passenger facilitation charges.³³² This taxing authority will be used by Airport Authorities to finance expansion and capital improvements. Equity financing which might be used by a private airport is not available to Airport

³²⁹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 12.

³³⁰ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 15.

³³¹ David Carr, "Airport Policy in Canada" *The Beacon*, Volume 1, No.3 (Atlantic Institute for Market Studies) at 8 [hereinafter Airport Policy in Canada].

³³² Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

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Authorities.³³³ For example, the GTTA plans to finance Pearson Airport development by borrowing long term debt.³³⁴ According to the Consumer Policy Institute:

"As a non-profit authority without any regulatory restrictions on what it can charge airlines to use the runways or gates, or passengers to use the terminal facilities, an LAA does not have the healthy constraints of a private company accountable to a number of stakeholders, not the least being the shareholders".³³⁵

The Vancouver International Airport Authority ("VIAA") implemented a passenger facilitation fee of \$5, \$10 or \$15 per departing passenger depending on whether the destination is inter-provincial, intra-provincial or international.³³⁶ The revenues obtained are intended to provide 40.8 per cent of the \$398 million terminal and runway expansion plan.³³⁷

³³³ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 17.

³³⁴ Interview with Louis Turpen, President and C.E.O. of the Greater Toronto Airport Authority (March 24, 1996) Toronto, Ontario.

³³⁵ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

³³⁶ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

³³⁷ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

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The Calgary Airport Authority has increased user fees by 3.9% within the first 6 months of taking over the airport.³³⁸ The cost to financially troubled Canadian Airlines International was approximately \$261,100 per year.³³⁹

On February 21, 1996 Aéroports de Montreal ("ADM") announced that it will transfer all regularly scheduled flights from Mirabel to Dorval effective April 1997.³⁴⁰ A new International terminal will be built at Dorval. In total the move is estimated to cost \$185 million Canadian.³⁴¹ This amount will be raised by an Airport maintenance fee which will be implemented at Dorval in October, 1996.³⁴² Passengers departing for Canadian destinations will be charged \$5; for U.S. destinations \$10; and for European destination \$15.³⁴³

The Federal Government could limit the ability of the Airport Authorities to tax the local public through regulation. In the United States, airports must apply to the Federal Aviation Authority ("FAA") to get permission to implement a Passenger Facility Fee ("PFC"). The

³³⁸ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

³³⁹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

³⁴⁰ André Picard, "Mirabel flights shifted to more central Dorval" *The Globe and Mail* (21 February 1996) at A1.

³⁴¹ André Picard, "Mirabel flights shifted to more central Dorval" *The Globe and Mail* (21 February 1996) at A1.

³⁴² James Mennie, "Mirabel Keeps Cargo, Charter" *The Montreal Gazette* (21 February 1996) at A1-2.

³⁴³ James Mennie, "Mirabel Keeps Cargo, Charter" *The Montreal Gazette* (21 February 1996) at A1-2.

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PFC cannot exceed \$3 US and can only be collected over a defined collection period.³⁴⁴ For every dollar collected by the Airport Authority a corresponding increase in Transport Canada's revenues results.³⁴⁵ The Federal Government is caught in a conflict between its economic interests and its role as a regulator of monopoly power.

Incentive to Overbuild

Airport Authorities have an incentive to overbuild the system. Certain LAA lease agreements contain specific minimum capital expenditures requirements. If the minimum is not spent during a specified period, the difference is transferred to Transport Canada in the form of additional rent.³⁴⁶ In contrast, the private sector financed Terminal III development was designed in consultation with the airlines with due consideration for ADC's recoverable costs. For example, one airline negotiated with ADC to provide two lounges for their first class and business class clients.³⁴⁷ The price charged this airline reflected ADC's increased capital costs in providing these lounges.

³⁴⁴ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 18.

³⁴⁵ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 20.

³⁴⁶ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 9.

³⁴⁷ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 25.

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"The report by the Royal Commission on National Passenger Transportation identified the government's budgetary situation as a barrier to realizing physical progress in implementing an airport's national environmental action plan as part of the overall Federal Green Plan".³⁴⁸ The Federal Government is caught in a conflict between its economic interests and its environmental obligations.

"At Toronto/Pearson International Airport's third terminal, however, the private developers/operators installed an underground collection system designed to prevent chemical contaminants (glycol from de-icing fluids, fuel spills, etc.) from seeping into a nearby creek by diverting these contaminants into one of two holding tanks."³⁴⁹ Logically, Government should be a much more vigilant regulator of private sector interests than of itself.

Financial Performance of Airport Authorities

Airport Authorities have not provided Transport Canada with the revenues it expected. In contrast, a sale of the five airports currently operated by LAA's would provide the federal government with \$2.8 billion and a reduction in government expenditures.³⁵⁰ In addition

³⁴⁸ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 27.

³⁴⁹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 27.

³⁵⁰ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 11.

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the Federal Government could charge the private airport corporations current corporate tax rates.³⁵¹

"In 1993, BAA paid \$173 million in tax on \$679 million profit on ordinary activities (before interest). In comparison, Canada's airport authorities paid no federal and provincial income tax and can negotiate to pay grants to municipal governments in lieu of local taxes".³⁵²

³⁵¹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 28.

³⁵² Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 28.

Chapter 11

Airport Fees and Slots

Aeronautical Charges

At most airports landing fees are based on the weight of the aircraft, usually the maximum take-off weight, maximum authorized weight, or maximum landing weight.³⁵³ Charges are levied on a per unit weight basis (per tonne, per 500 kg etc.).³⁵⁴ The weight-based landing fee has been replaced at a number of airports with a single fixed charge per aircraft regardless of its size.³⁵⁵ Fees are paid upon landing and no additional fee is charged for departure of an aircraft.³⁵⁶

In February 1991, Pearson Airport charged an aircraft landing fee of US\$ 1,393.00 for a Boeing 747-300 with 280 passengers³⁵⁷. In addition, Pearson Airport charged the airline a

³⁵³ Doganis, *supra*, note 2 at 64.

³⁵⁴ Doganis, *supra*, note 2 at 64.

³⁵⁵ Doganis, *supra*, note 2 at 64.

³⁵⁶ Doganis, *supra*, note 2 at 65.

³⁵⁷ Doganis, *supra*, note 2 at 76.

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passenger charge of US\$ 4,539.00.³⁵⁸ Pearson Airport which generates sixty-eight per cent of its aeronautical revenue from passenger fees is susceptible to downturns in traffic levels. In contrast, most other major airports in the world whose revenues are more dependant on weight-based aircraft landing fees are not as susceptible to downturns in traffic.³⁵⁹

Governments have historically treated airports like public utilities. Governments have been willing to finance airport development and to subsidize operating losses when they occurred.³⁶⁰

The airlines have never been charged fees which would recoup the full capital costs associated with airside development.³⁶¹

Since 1984 when the Progressive Conservative Party of Canada was elected and formed the Federal Government of Canada, airports in Canada have been required to be much more commercial in their operations. As this commercial approach replaces the public utility approach it must be determined whether a weight-based method of airport charges should be used at all.³⁶²

³⁵⁸ Doganis, *supra*, note 2 at 76.

³⁵⁹ Doganis, *supra*, note 2 at 76.

³⁶⁰ Doganis, *supra*, note 2 at 69.

³⁶¹ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 39.

³⁶² Doganis, *supra*, note 2 at 80.

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The relationship between weight of aircraft and runway requirement no longer is valid.³⁶³ The heavier Boeing 747 has landing gear which "produces lower pressure on the runway" than many other lighter aircraft.³⁶⁴ Runway length requirements are not solely based on the weight of the aircraft.³⁶⁵

The costs imposed by a particular aircraft on terminal facilities is determined by the terminal facilities required and not by the weight of the aircraft. International passengers who use the airport facilities to connect to other flights impose terminal costs on the airport at least two times greater than domestic passengers.³⁶⁶ Weight-based landing fees amounts to an "averaging out of airport costs irrespective of the costs that individual users imposed on the airport".³⁶⁷ Cross-subsidization of runways with revenues from the terminal facilities leads to situation where landing fees often represent even less than the "average cost".³⁶⁸

An airline that is being charged a landing fee based on the weight of the aircraft will be indifferent as to whether it lands a heavier Boeing 747 or a lighter Dash 8.³⁶⁹ "But to airport

³⁶³ Doganis, *supra*, note 2 at 71.

³⁶⁴ Doganis, *supra*, note 2 at 81.

³⁶⁵ Doganis, *supra*, note 2 at 81.

³⁶⁶ Doganis, *supra*, note 2 at 81.

³⁶⁷ Doganis, *supra*, note 2 at 70.

³⁶⁸ Doganis, *supra*, note 2 at 83-84.

³⁶⁹ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

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manager anxious to maximize revenues the lightweight Dash 8 is not as valuable as a Boeing 747..."³⁷⁰ Smaller and general aviation aircraft travelling at lower speeds take longer to approach and land and require greater separation from larger aircraft.³⁷¹ Weight-based landing fees are similar at most airports regardless of demand for an airports' services. Airlines have no cost incentives to consider re-routing to alternative airports.³⁷²

There is no incentive for airlines to use aircraft which minimize the costs imposed on the airport.³⁷³ In addition a weight-based charging scheme does nothing to discourage airport use during peak periods when airport services clearly have a greater value.³⁷⁴

In 1981 the International Civil Aviation Organization ("ICAO") council stated that users should bear their share of the "full economic cost to the community of providing the airport and its ancillary services, including appropriate amounts for interest on capital investment and depreciation of assets..."³⁷⁵ According to ICAO, airports should be financially self

³⁷⁰ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

³⁷¹ Doganis, *supra*, note 2 at 83.

³⁷² Doganis, *supra*, note 2 at 83.

³⁷³ Doganis, *supra*, note 2 at 81.

³⁷⁴ Doganis, *supra*, note 2 at 81.

³⁷⁵ Doganis, *supra*, note 2 at 73.

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sufficient.³⁷⁶ Therefore, ICAO's support of weight-based landing fees is somewhat contradictory.

Commercialization/privatization dictates that Airports must move away from weight-based pricing to cost-related pricing "where the price of a good or a service was set equal to the marginal cost of providing that good or service".³⁷⁷ The commercial objectives of airport charges are; to efficiently allocate airport resources; cost recovery; and to logically determine when capital investments are necessary.³⁷⁸

Marginal-cost pricing will ensure efficiency in providing airport services.³⁷⁹ "No one will purchase a particular airport service unless they value it at least as highly as the cost of producing it."³⁸⁰ "The risk of misinvestment or over investment is reduced or eliminated ... because ...demand levels will represent true demand for that facility and will thus provide an indication of whether additional units of that facility are needed at that price."³⁸¹

³⁷⁶ Doganis, *supra*, note 2 at 73.

³⁷⁷ Doganis, *supra*, note 2 at 85.

³⁷⁸ Doganis, *supra*, note 2 at 81.

³⁷⁹ Doganis, *supra*, note 2 at 81.

³⁸⁰ Doganis, *supra*, note 2 at 81.

³⁸¹ Doganis, *supra*, note 2 at 81.

Peak charges

Most airports do not charge an increased price for access during high demand peak periods. A small number of airports including London's Heathrow airport have implemented peak charges.³⁸² This is a step in the right direction. It attempts to transfer the increased costs associated with handling aircraft traffic during peak periods to the airlines. However, at present there is no "serious attempt to defend the peak charges through any detailed costing".³⁸³ The peak surcharge has been criticized as being rather small. "It is unlikely to reflect the cost differential between peak and off-peak traffic."³⁸⁴

³⁸² Doganis, *supra*, note 2 at 73.

³⁸³ Doganis, *supra*, note 2 at 97.

³⁸⁴ Doganis, *supra*, note 2 at 98.

Airport Slots

In addition to landing fees airports could generate revenue by selling slots. Airport slots represents property rights and should be realized as such.³⁸⁵ Airports should introduce a slot auction where airlines or other interested parties bid for a pair of slots (landing and take-off) and the highest bidder would be granted those slots.³⁸⁶ The winning bid price would establish the true market value for slots.³⁸⁷ Potential buyers who would get the most value from a pair of slots would bid the most.³⁸⁸

David M. Grether, R. Mark Isaac and Charles R. Plott in *The Allocation of Scarce Resources* recommend "a primary market for slots organized as a sealed-bid, one-price auction".³⁸⁹ The primary market encompasses the initial allocation of slots to private sector interests. These auctions would be held at regular six month intervals.³⁹⁰ Potential buyers would submit a bid of the maximum price they will pay for a pair of slots. A separate bid would be submitted for

³⁸⁵ Richard Janda, "Auctioning Airport Slots: Airline Oligopoly, Hubs and Spokes, and Traffic Congestion" *Annals of Air and Space Law*, Volume XVIII-I (Montreal: Institute of Air and Space Law, 1993) at 162 [hereinafter Auctioning Airport Slots].

³⁸⁶ Doganis, *supra*, note 2 at 106.

³⁸⁷ Doganis, *supra*, note 2 at 107.

³⁸⁸ Doganis, *supra*, note 2 at 107.

³⁸⁹ David M. Grether, R. Mark Isaac and Charles R. Plott, *The Allocation of Scarce Resources* (Boulder, San Francisco, & London, 1989) at 54 [hereinafter Grether].

³⁹⁰ Grether, *supra*, note 389 at 56.

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each pair of slots desired.³⁹¹ "If x units are to auctioned, then the highest x bids are accepted. The price paid by each of the winning bidders is the value of the lowest accepted bid."³⁹² Slot values will be determined by the "least profitable flight".³⁹³

The disadvantage of this system is that some slots are sold for less than some bidders are willing to pay for them. The advantage cited is that potential buyers will "...bid the maximum that he/she is willing to pay".³⁹⁴ This maximum will be "... closely related to the profits the flight will generate".³⁹⁵ Potential buyers will bid this "maximum amount" even if the price to be paid by each of the winning bidders is the value of their sealed bid rather than the lowest accepted bid. Bids will still be reflective of a calculation by potential buyers of the value of the slots based on marginal cost criterion.

The level of demand for slots during peak periods would be greater than other periods. The price of these would reflect the increased demand. Slot "auctions are not based upon recovering the cost of airport services; rather, they attribute the rents from high value access

³⁹¹ Grether, *supra*, note 389 at 56.

³⁹² Grether, *supra*, note 389 at 54.

³⁹³ Grether, *supra*, note 389 at 54.

³⁹⁴ Grether, *supra*, note 389 at 55.

³⁹⁵ Grether, *supra*, note 389 at 55.

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rights to airports rather than to airlines and provide a basis for funding expanding infrastructure".³⁹⁶

U.S. Slot Controlled Airports

In 1986, a slot-trading system was introduced at Washington National, Chicago's O'Hare and New York's LaGuardia and Kennedy airports due to increased demand for slots.³⁹⁷ Ninety-five per cent of slots were simply allocated to existing users.³⁹⁸ The remaining five per cent which were allocated by a lottery.³⁹⁹

The Reagan Administration maintained that the buying and selling of slots would be allowed even though slots were not airline property.⁴⁰⁰ In 1991 the market rate for a slot at one these four major American Airports was US \$1.5 million.⁴⁰¹ In 1991 Eastern Airlines collapsed and its slots were sold off by public auction.⁴⁰² Slot trading allows the Airline who values the slot

³⁹⁶ Auctioning Airport Slots, *supra*, note 385 at 185.

³⁹⁷ Doganis, *supra*, note 2 at 109.

³⁹⁸ Doganis, *supra*, note 2 at 109.

³⁹⁹ Doganis, *supra*, note 2 at 109.

⁴⁰⁰ Joan M. Feldman, "Slots as Political Farce" *Air Transport World* 2/94 (New York: Reinhold Publishing Company, 1994) at p.72 [hereinafter Feldman].

⁴⁰¹ Doganis, *supra*, note 2 at 109.

⁴⁰² Doganis, *supra*, note 2 at 109.

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the most to acquire it.⁴⁰³ American Airlines agreed to pay Trans World Airlines US \$503 million over twenty years for three gates and forty slots at O'Hare airport.⁴⁰⁴

Slots owned by Northwest Airlines appear as assets on the Airline balance sheets.⁴⁰⁵ Slots are assets and banks do lend against them.⁴⁰⁶ Speculation is that United Airlines and American Airlines have standing US \$3 million offers for prime time slots at O'Hare.⁴⁰⁷

The only party not benefitting from slot trading is the airports. The airport is not collecting any money for capital investments from the transfer of slots. "At slot controlled airports, valuable access rights simply have been given away with resultant windfall to incumbent airlines and the creation of considerable entry barriers".⁴⁰⁸ The U.S. approach has been to maintain weight-based landing fees in addition to slot controls. The airports continue to generate revenue from landing fees.

⁴⁰³ Doganis, *supra*, note 2 at 109.

⁴⁰⁴ Feldman, *supra*, note 400 at 72.

⁴⁰⁵ Feldman, *supra*, note 400 at 72.

⁴⁰⁶ Feldman, *supra*, note 400 at 72.

⁴⁰⁷ Feldman, *supra*, note 400 at 72.

⁴⁰⁸ Auctioning Airport Slots, *supra*, note 385 at 165 and 193.

Canadian Landing Slots

Authority to allocate landing slots rests with the LAA's.⁴⁰⁹ The IATA rules on slot allocation are used to make allocation determinations. These rules protect historical users of slots by "grandfathering" them.⁴¹⁰ The existing user is entitled to the same slot in the next season. This policy of "grandfathering" of slots is often advocated in order to ease the transition to slot allocation systems. The IATA procedures do not convey ownership privileges in the slots.⁴¹¹

Pearson Airport uses a "schedule clearance request/reply" system.⁴¹² "The carrier makes a formal request to the airport respecting its planned take-off and landing activities and the airport authority makes a formal reply as to whether the plan is allowable".⁴¹³ This process enables Pearson Airport to avoid congestion at peak periods.⁴¹⁴ "Applications for the allocation of slots are made twice a year at Conferences held for that purpose. Allocation decisions are made by the IATA Slot Coordinator, an individual appointed jointly by Transport Canada (on behalf of the federal government) and the two major Canadian carriers..."⁴¹⁵

⁴⁰⁹ Michael K. Feldman and Michael Dunleavy, "Transferring and Taking Security Over Route Rights, Landing Slots and Gates in Canada" *International Business Lawyer* (February, 1996) at 64 [hereinafter Feldman and Dunleavy].

⁴¹⁰ Feldman and Dunleavy, *supra*, note 409 at 64.

⁴¹¹ Feldman and Dunleavy, *supra*, note 409 at 64.

⁴¹² Feldman and Dunleavy, *supra*, note 409 at 64.

⁴¹³ Feldman and Dunleavy, *supra*, note 409 at 64.

⁴¹⁴ Feldman and Dunleavy, *supra*, note 409 at 64.

⁴¹⁵ Feldman and Dunleavy, *supra*, note 409 at 64.

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Pearson Airport is congested. There is as "over-subscription for slots during peak periods".⁴¹⁶

Some carriers have been bumped from slots (slots not grandfathered) to make room for new entrants.⁴¹⁷ "Under the current system, new carriers, including the American carriers now allowed to land in Canada as a result of the Open Skies Agreement, cannot gain access to these choice slots."⁴¹⁸

Airlines cannot "assign, transfer or lease" slots at Pearson Airport which are assigned to them by the IATA Slot Coordinator.⁴¹⁹ However, Section 3.7 of the IATA Scheduling Procedures

⁴¹⁶ Feldman and Dunleavy, *supra*, note 409 at 65.

⁴¹⁷ Feldman and Dunleavy, *supra*, note 409 at 65.

⁴¹⁸ Feldman and Dunleavy, *supra*, note 409 at 65.

⁴¹⁹ Feldman and Dunleavy, *supra*, note 409 at 65.

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Guide allows for the exchange of allocated slots between airlines on a "one for one basis".⁴²⁰ The coordination of airline schedules requires such flexibility.⁴²¹ The IATA Slot Coordinator must approve all exchanges.⁴²²

⁴²⁰ Feldman and Dunleavy, *supra*, note 409 at 65.

⁴²¹ Feldman and Dunleavy, *supra*, note 409 at 65.

⁴²² Feldman and Dunleavy, *supra*, note 409 at 65.

Chapter 12

A Recommendation for Airside Ownership

The Recommendation - Eliminating the Market Power of Pearson

U.S. Slot controlled airports have implemented a dual system of weight-based landing fees in tandem with limited slot property rights. One of the benefits of a slot-trading system is that an airline can determine with certainty the value of its slots at any given moment in time on the open market. The imposition of weight-based landing fees will undermine the value the slots.

When preparing their respective bids airlines will have to consider the added costs associated with these landing fees.

This dual charging scheme destabilizes slot values. Airports will be able to exert their market power and increase landing fees at will. Airlines and airport users will never know the exact value to place on particular slots because future operating costs will be uncertain.

Toronto's Consumer Policy Institute has proposed separating the airport's airside and groundside functions, and basing airside ownership on slots in order to eliminate an airport's monopoly or market power.⁴²³ "Passenger and freight terminals could be the responsibility of

⁴²³ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 32.

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several airport companies, while runways, taxiways and the apron would be owned and operated by a corporation made up of the airlines and third party brokers".⁴²⁴ This model would eliminate all landing fees.

Participation in the slot auction should not be limited to airlines. Third party financial institutions, pension funds and entrepreneurs could purchase slots as an investment and for possible tax values and lease these slots to the airlines. Therefore, the increasing concentration of the airline industry should not be a concern with respect to airside ownership.

"Applying this model to an airport's airside would privatise all slots by allowing airlines and other slot holders to own their slots outright. The slot then becomes an asset that the airline can trade, lease or sell".⁴²⁵ Degree of ownership in the Corporation would be proportional to the number of slots a particular airline or other entity owned.⁴²⁶

"As with a unit owner in a condominium, the slot owner at an airport would pay a monthly fee for ongoing maintenance (snow removal, onsite emergency response crews, runway and apron repairs) and capital investment (non-navigation related systems, new taxiways and runways)".⁴²⁷ Airside condominium fees would include only those services which are common to all airside

⁴²⁴ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

⁴²⁵ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

⁴²⁶ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

⁴²⁷ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

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users. Those services which can effectively be based on a user pays principle will not be included in condominium fees. The subsidization of slots being used by aircraft which impose a disproportionate share of maintenance costs on the airside facilities by other slots will thus be limited.

"By privatising slots and deregulating their transferability, airports would no longer be monopolistic enterprises, and the true value of an airport's airside capacity at various times of the day will become known".⁴²⁸ Off-peak slots would cost less than peak slots.⁴²⁹

At U.S. slot controlled airports ninety-five per cent of slots were simply allocated to existing users.⁴³⁰ The existing user is entitled to the same slot in the next season. This policy of "grandfathering" of slots is often advocated in order to ease the transition from weight-based landing fees to slot allocation systems. In slot auctions such policies could be realized by giving incumbent carriers a right to match the highest bid received for their historical slots.

It must be determined whether the "grandfathering of slots would institutionalize the potential control that certain carriers might have over a market".⁴³¹ This modified version of grandfathering of slots would create a temporary competitive advantage for incumbent airlines

⁴²⁸ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

⁴²⁹ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 40.

⁴³⁰ Doganis, *supra*, note 2 at 109.

⁴³¹ Grether, *supra*, note 389 at 78.

at the expense of all other investors. Over time the open market would eliminate this competitive advantage as slots are resold to those who value them the most. Nevertheless, the grandfathering of slots is rejected because it would reduce the value of these slots at the initial auction and thus reduce revenues raised from this process.

The airlines have traditionally opposed slot trading.⁴³² The cross-subsidization of runways with revenues from the terminal facilities, which often leads to situation where landing fees represent only a fraction of the costs associated with this service would be eliminated.⁴³³

Airlines would be forced to pay the actual costs of their operations. Airline operating costs would probably rise. In exchange airlines and other investors would obtain assets in the form of property rights.

The only costs that would be factored into condominium fees are airside operating costs. The costs that are associated with the terminal would be the responsibility of the terminal operators.

The costs of gates, ramps and parking at the terminal facility are terminal building operating costs. In the landing and unloading phase an aircraft would move from airside corporation jurisdiction to terminal facility jurisdiction. Cross subsidization would effectively be eliminated.

⁴³² Feldman, *supra*, note 400 at 74.

⁴³³ Doganis, *supra*, note 2 at 83-84.

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An airside corporation will lead to a more efficient allocation of scarce airside resources. Airlines would be forced to "match the value of their flights with the value of their airside assets".⁴³⁴ "Airlines will be more open to placing larger aircraft on certain routes, and creating a fare structure on frequently served routes (a shuttle for example) to reflect a particular slot's value".⁴³⁵

"At the same time, the industry would demand less additional airside capacity unless it was profitable, since they would assume the economic risk for such a development. A spot market for slots would also emerge with carriers trading slots to accommodate delays, and general aviation operators seeking occasional access."⁴³⁶

In order to facilitate co-ordination between slot sellers and potential buyers an "aftermarket" will be established on much the same basis as proposed by Grether et. al. in *The Allocation of Scarce Resources*.⁴³⁷ "Each carrier would register in a central computer the maximum (minimum) price it would pay for (sell) a particular slot. ... By simply asking for a printout each carrier can see the full pattern of offerings at any given time and can activate a transaction through the computer (an 'open book' feature)".⁴³⁸

⁴³⁴ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 41.

⁴³⁵ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 41.

⁴³⁶ Why it Makes Sense to Privatise Airside Business, *supra*, note 63 at 41.

⁴³⁷ Grether, *supra*, note 389 at 56.

⁴³⁸ Grether, *supra*, note 389 at 56.

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This "open book" feature can be adopted to the condominium model proposed. All potential investors interested in purchasing a slot would register in a central computer the maximum price it would pay for a particular slot. All slot owners would register in the central computer the minimum price it would sell a particular slot. If a particular slot owner did not wish to sell that particular slot at any price such information would be recorded. Each potential investor could see the full pattern of offerings at any given time and could activate a transaction through the computer.

An "aftermarket" would also be created in long and short term slot leases. For example , a slot lease could be obtained for a single use by a general aviation operators seeking only occasional access.

Slot fees will be reflected in ticket prices.⁴³⁹ "Passengers will able to pay for the degree of convenience they want".⁴⁴⁰ Business passengers would pay more to travel at peak periods. Casual travellers may wish to travel at off-peak periods with the resultant cost savings. In addition, "some services would be diverted through under used airports based on slot fee differentials between airports".⁴⁴¹

⁴³⁹ Auctioning Airport Slots, *supra*, note 385 at 193.

⁴⁴⁰ Auctioning Airport Slots, *supra*, note 385 at 193.

⁴⁴¹ Auctioning Airport Slots, *supra*, note 385 at 193.

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Through the development of this airside corporation, Pearson Airport market power can effectively be eliminated by separating the airport's airside and groundside functions, and basing airside ownership on slots. Runways, taxiways and the apron would be owned and operated by a Corporation made up of slot owners and third party brokers. Terminals I, II and III will be sold separately and will become the responsibility of several airport companies who will compete for Airlines and Passengers. This Condominium model could be extended to the Terminal buildings. However, because Pearson Airport has three terminals sufficient competition will result if these terminals are sold separately.

Unlike slot controlled airports in the United States an airside corporation will benefit the present Airport owners. The sale of slots at Pearson Airport will generate significant revenue for the Canadian government. In addition they will be relieved of the obligation of financing capital improvements and operating costs.

Objections to an Airside Corporation

Airside Development

The recommendation for an airside corporation at Pearson Airport will have to meet the criticism that it creates a disincentive to expand airside capacity. Increasing airside capacity would flood the market with a greater supply of slots and thus reduce the market value of each individual slot. It is true that the industry would demand less additional airside capacity unless it was profitable, since they would assume the economic risk for such a development.

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However, since the existing slot owners would initially own all additional airside capacity the economic risk for such development would be weighed against projected revenues from such development.

"Bottlenecks exist where there is a vertical relationship between two markets and where monopolists or oligopolists in one market (the airside corporation) have control over access to facilities used to compete in the other market (the airline industry)."⁴⁴² Dominant airlines at Pearson Airport may attempt to limit airside expansion at the airport in order obtain competitive advantages in the airline industry.

The airside corporation is not limited to airlines. Thus, the ability of carriers to halt economically viable airside expansion will be limited. U.S airlines have sustained enormous losses since deregulation and liberalisation of the industry in the United States (1978-1993).⁴⁴³ The Canadian airline industry has also sustained losses over the last number of years leading to the investment bail-out of money losing Canadian Airlines International by U.S. based American Airlines.⁴⁴⁴ Most airlines have high debt-to-equity ratios which make it more difficult to obtain financing for asset purchases.⁴⁴⁵ A significant capital outlay will be required

⁴⁴² Richard Janda, *"The Retreat of Command-and-Control Regulation and the Hesitant Advance of Antitrust in the Airline Industry"* Contemporary Law 1994 (A Publication of the Institute of Comparative Law , McGill University, Montreal, 1994) at 632 [hereinafter *The Retreat of Command-and-Control Regulation*].

⁴⁴³ P.S.Dempsey, Airlines in Turbulence: Strategies for Survival, 23 *Transportation Law Journal* 15 (1995) at 18 [hereinafter Dempsey].

⁴⁴⁴ *The Retreat of Command-and-Control Regulation*, *supra*, note 442 at 631-7.

⁴⁴⁵ Dempsey, *supra*, note 443 at 21.

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by investors to purchase slots. Therefore, given the economic health of the airline industry, non-airline investors (financial institutions, pension funds etc.) may be in a more favourable position to participate in an airside corporation. These non-airline investors would then lease out their slots to airlines in much the same manner as non-airline investors lease out aircraft.

Risk averse non-airline investors may find investment in an airside corporation at Pearson Airport to be undesirable. If carriers are able to gain effective control over the airside corporation they may be tempted to abuse their dominant position. If they use their control over the airside corporation to halt airside expansion then strict competition law enforcement will be required.⁴⁴⁶ The Director of Investigation in Canada has been reluctant to take an aggressive stand against anti-competitive conduct at these "bottleneck" facilities.⁴⁴⁷ Structural remedies breaking up airline control over the airside corporation may be necessary.⁴⁴⁸ Antitrust law needs to develop more effective remedies against anti-competitive use of "bottleneck" facilities like airports.⁴⁴⁹

⁴⁴⁶ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 632.

⁴⁴⁷ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 635.

⁴⁴⁸ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 635.

⁴⁴⁹ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 643.

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Slot Hoarding

The recommendation for an airside corporation at Pearson Airport will have to meet the criticism that it is potentially anti-competitive. Existing airlines may try to abuse their position to keep out newcomers and potential competitors by hoarding slots. "Monopolies are effective because they withhold supply."⁴⁵⁰

Critics may argue for the inclusion of 'use it or lose it' provisions in the sales contract. These provisions require slots to be 'used' or 'lost'. These provisions can take many forms from outright surrender requirements to rules that slots not used must be offered for resale on pre-determined terms.⁴⁵¹

'Use it or lose it' provisions are inefficient. Slot owners would find ways around these nonuse rules. For example, slot owners would engage in the practice of "babysitting" whereby another user would be temporarily allowed to use a slot so that the owner would not lose it.⁴⁵²

'Use it or lose it' provisions constitute an unwarranted interference with the property rights of slot owners. They reduce the value of the slots to the airport and to the investors. Pearson Airport would generate less than optimal revenue from the sale of slots with such usage requirements.

⁴⁵⁰ Grether, *supra*, note 389 at 64.

⁴⁵¹ Grether, *supra*, note 389 at 69.

⁴⁵² Doganis, *supra*, note 1 at 110:

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`Use it or lose it' provisions impose upon airlines a bureaucratic nightmare. Rules are formulated arbitrarily by airport managers and slot co-ordinators. They impede the ability of airlines to allocate their resources in the most efficient and profitable manner. Efficiency of airline operations require aircraft, routes and slots be co-ordinated in response to market demand forces. Such an analysis may dictate a pattern of slot usage in contravention of these rules. Airlines may be forced to allocate resources to services in order to maintain access to Pearson Airport. It is entirely legitimate for airlines to maintain some excess capacity in order to plan for cyclical demand and the possibility of new markets.

`Use it or lose it' provisions, if formulated with airline participation can also be anti-competitive. These provisions will require new entrants to maintain high levels of usage immediately. A new entrant may require time to build up consumer demand for its services.

`Use it or lose it' provisions may force the new entrant to provide unprofitable services which it otherwise would not engage in until required by consumers.

Airlines would not be the only owners of slots. Third party financial institutions, pension funds and entrepreneurs etc. may also purchase slots. The increasing concentration of the airline industry should not be a concern with respect to airside ownership. The airside corporation would not suffer oligopoly characteristics assuming significant participation by intermediaries.

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Airlines are the only users of airside capacity. In one scenario a few airlines may attempt to hoard the leasehold interests in the slots at Pearson Airport. If a few airlines were able to hoard the slots by monopolizing the leasehold interests in the slots at Pearson Airport the demand for slots would increase. The market value of these slots would increase. In response to increased slot values, the non-airline controlled airside corporation would have great incentive to develop more airside capacity as the existing slot owners would initially own all additional airside capacity. The economic risk for such development would be weighed against projected revenues from such development.

Airlines would engage in a practice of slot hoarding only if such a practice were economically viable. They would only incur short term losses if a prospect for increased profits in the future resulted. Most airlines will view slot hoarding as irrational behaviour. Efficient airlines will not subject themselves to short-term losses resulting from obtaining slots which they cannot use in order to limit competition in the airline industry. New competitors would have incentive to purchase slots in order to compete in a market full of excess profits. "Monopoly is especially difficult since the act of driving up slot prices to prevent competition necessarily uses up all the presumed monopoly profits."⁴⁵³ Therefore, no single entity would be able to utilize the auction process to monopolize slots at Pearson Airport.

The expression "anti-competitive act" is defined in section 78(a) of the *Competition Act* as follows:

⁴⁵³ Grether, *supra*, note 389 at 64.

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(a) squeezing, by vertically integrated supplier, of the margin available to an unintegrated customer who competed with the supplier, for the purpose of impeding or preventing the customer,s entry into, or expansion in, a market..."

Section 78(a) describes the bottleneck monopoly situation. This definition would include a situation where a few airlines had a bottleneck monopoly over airport slots, a commodity which is needed by all airlines to compete in the airline industry.⁴⁵⁴ By squeezing the bottleneck the few airlines controlling airport access impedes the "ability of others to compete."⁴⁵⁵ Dominant airlines at Pearson Airport may attempt hoard slots at the airport in order obtain competitive advantages in the airline industry. "Section 78(a) makes it clear that only when the purpose of squeezing the bottleneck is to impede the others or prevent their entry or expansion in a market will this action be defined as an anti-competitive act. Squeezing the bottleneck for some other purpose, for example, increasing profits, is not covered even though it may have the effect of driving out or seriously impeding a customer."⁴⁵⁶ A line is thus drawn between healthy competition and anti-competitive acts.

Theoretically, the practice of slot hoarding could occur. In an extreme case slot hoarding could be profitable. If a few carriers are able to gain effective control over the airside corporation they may be tempted to abuse their dominant position. If they use their control

⁴⁵⁴ R. J. Roberts, *Roberts on Competition/Antitrust: Canada and the United States, 2nd Ed.* (Toronto and Vancouver: Butterworths, 1992) at 294 [hereinafter Roberts].

⁴⁵⁵ Roberts, *supra*, note 454 at 294.

⁴⁵⁶ Roberts, *supra*, note 454 at 294.

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over the airside corporation to hoard slots then strict competition law enforcement will be required.⁴⁵⁷ Structural remedies breaking up airline control over the airside corporation may be necessary.⁴⁵⁸ Antitrust law will need to develop more effective remedies against anti-competitive use of "bottleneck" facilities like airports.⁴⁵⁹

In short, the proposal for an airside corporation must be assessed against the backdrop of antitrust enforcement policies. If the corporation becomes a vehicle for abuse of dominant position, this is due to a failure anti-trust enforcement, and not due to an inherent problem with the airside corporation concept.

Slot Manipulation

"If new entrants do get slots, existing airlines can switch their own slots around so as to flood the new entrants' market with frequencies."⁴⁶⁰ Airlines with many slots (owned or leased) may attempt to switch their own slots around so as to compete with a new entrant in a city pair market. This practice of slot manipulation may force the new entrant to drop their service and sell their slot or risk suffering losses.

⁴⁵⁷ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 632.

⁴⁵⁸ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 635.

⁴⁵⁹ The Retreat of Command-and-Control Regulation, *supra*, note 442 at 643.

⁴⁶⁰ Doganis, *supra*, note 1 at 110:

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If airlines could engage in a practice of switching slots around so as to flood the new entrants' market with frequencies such airlines would have to be able to fill their aircraft with paying passengers in order to make such practice economically viable. These airlines would only operate the increased frequencies at a loss if a prospect for increased profits in the future resulted. However, new competitors would have incentive to purchase slots in order to compete in a market full of excess profits. By taking advantage of the "aftermarket" a new competitor could see the full pattern of offerings at any given time and could activate a transaction (purchase or lease) through the computer.

Public Interest

The recommendation for an airside corporation at Pearson Airport will have to meet the criticism that it will not be responsive to the public interest. The Canadian Government has traditionally viewed airports as instruments of public policy. "This view of airports emphasizes levels of service and economic spin-offs to the community above the cost associated with operating the airport".⁴⁶¹ Up until 1992 (when the federal government began leasing airports to local authorities) decisions for the 150 Canada owned and operated airports were made by the department's central Airport Authority Group ("AAG").⁴⁶²

⁴⁶¹ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 1.

⁴⁶² Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 2.

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Public policy objectives could be achieved through government regulation of the airside corporation. Government should logically be a much more vigilant regulator of private sector interests than of itself.⁴⁶³ For example, Professor Mervin Daub of Queen's University wrote that Ontario's privately owned gas companies are more tightly restricted and regulated than Ontario Hydro.⁴⁶⁴

Government regulation of the economic activity of the airside corporation is not necessary. By separating the airport's airside and groundside functions, and basing airside ownership on slots the airside corporation will eliminate Pearson Airport's monopoly or market power.⁴⁶⁵ In a competitive market slot owners will not be able to exact monopoly prices from the public.

An airside corporation has the healthy constraints of being accountable to a number of stakeholders, not the least being the shareholder (the slot owners). Former British Prime Minister Margaret Thatcher wrote in *The Downing Street Years* that "State ownership effectively removes - or at least radically reduces - the threat of bankruptcy which is a discipline on privately owned firms."⁴⁶⁶

⁴⁶³ David Carr, "Perspectives On Public Policy: Commercializing Government Operations" (Address to the Insight Information and Globe & Mail Conference in Ottawa, November 30, 1995) [unpublished] at 9-10.

⁴⁶⁴ Mervin Daub, *Regulation of Private Enterprise vs. Direct Control of Crown Corporations: A comparison of Gas and Electricity in Ontario* (Kingston: Queen's University, October 5, 1992) at 10.

⁴⁶⁵ Benefitting Consumers and the Economy through Airport Privatization, *supra*, note 40 at 32.

⁴⁶⁶ Margaret Thatcher, *The Downing Street Years* (London: Harper Collins, 1993) at 77.

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International law

The Convention on International Civil Aviation ("Chicago Convention") was signed on December 7, 1944.⁴⁶⁷ The Chicago Convention has been signed, ratified and is legally binding on well over one hundred states.⁴⁶⁸ Article 15 provides that "every airport in a contracting State shall ... be open under uniform conditions to the aircraft of all the other contracting States."⁴⁶⁹ In addition, any charges that are imposed at the airport cannot be different for foreign carriers than those imposed on national carriers.⁴⁷⁰

Bilateral air services agreements may also impose limits on an airports charging authority. For example Article 10 of the 1977 bilateral between the United States and the United Kingdom provided these States were to use their best efforts to ensure that charges imposed at airports are "just and reasonable."⁴⁷¹ Private airports, however, are not constrained by bilateral air services agreements.

⁴⁶⁷ ICAO Doc. 7300/6 (1980), *Annals of Air and Space Law*, Volume XVIII-II (Montreal: Institute of Air and Space Law, 1993) at 3.

⁴⁶⁸ ICAO Doc. 7300/6 (1980), *Annals of Air and Space Law*, Volume XVIII-II (Montreal: Institute of Air and Space Law, 1993) at 76-79.

⁴⁶⁹ ICAO Doc. 7300/6 (1980), *Annals of Air and Space Law*, Volume XVIII-II (Montreal: Institute of Air and Space Law, 1993) at 13-14.

⁴⁷⁰ Doganis, *supra*, note 2 at 78.

⁴⁷¹ Doganis, *supra*, note 2 at 80.

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At U.S. slot controlled airports American airlines have complained about discriminatory treatment of foreign carriers.⁴⁷² In 1993, the FAA attempted to take slots away from US carriers and give them to foreign carriers in order to comply with bilateral agreements.⁴⁷³ The U.S. Congress stepped in to stop the FAA.⁴⁷⁴ United Airlines advocates "national treatment" for all carriers at slot controlled airports regardless of nationality.⁴⁷⁵

It has been argued that slot trading systems violate Article 15 of the Chicago Convention requiring non-discriminatory treatment of foreign carriers.⁴⁷⁶ The trading of slots, especially in bilateral air transport agreements involves an exercise of discretion by governments. Clearly, such practice constitutes a violation of Article 15 of the Chicago Convention.

The selling of slots is not discriminatory *per se*. Each particular scheme invented to sell slots must be analyzed to determine whether it is discriminatory. An airside corporation eliminates discriminatory treatment of foreign airlines. Foreign carriers would have to buy slots in the same manner as U.S. Carriers regardless of bilateral arrangements. Therefore, the creation of

⁴⁷² Feldman, *supra*, note 400 at 74.

⁴⁷³ Feldman, *supra*, note 400 at 74.

⁴⁷⁴ Feldman, *supra*, note 400 at 74.

⁴⁷⁵ Feldman, *supra*, note 400 at 74.

⁴⁷⁶ According to Doganis, *supra*, note 1 at 106 and 108: "Finally, trading of slots for International services clearly contravenes the Chicago Convention (ICAO 1980) which requires airports to be available to all on an equal basis. ... Unless International law is modified it seems difficult to envisage the widespread adoption of slot trading at major congested airports outside the United States."

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an airside corporation will not violate Article 15 of the Chicago Convention.⁴⁷⁷ All domestic and foreign airline companies will be able to bid for slots.⁴⁷⁸ __

⁴⁷⁷ Why it Makes Sense to Privatisise Airside Business, *supra*, note 63 at 41.

⁴⁷⁸ Why it Makes Sense to Privatisise Airside Business, *supra*, note 63 at 41.

Conclusions

Government ownership of airports is inefficient and has led to large financial deficits in Canada. Terminals I and II at Pearson Airport are in desperate need of redevelopment. The federal government is not willing or able to finance such redevelopment due to budgetary pressures.

The Pearson Airport Agreements between the federal government and the Pearson Development Corporation ("PDC") to redevelop and operate Terminals I and II at Pearson Airport pursuant to a long term lease would have benefitted the government through the receipt of the proceeds from the sale of the airports while being relieved of the burden of financing airport expansion. The PDC planned to invest \$750 million in redeveloping Terminals I and II.

The decision of Prime Minister Chretien to cancel the Pearson Airport Agreements, based on the advice in the Nixon report was contrary to the public interest. While much of the rest of the industrialized world is headed to full privatization the Canadian Government plans to "commercialize" airports which involves leasing them to airport authorities. The federal government has agreed to transfer Pearson Airport to the Greater Toronto Airport Authority ("GTAA"). This agreement amounts to a transfer of Pearson Airport from one part of the

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public sector to another. It amounts to the transfer of Pearson Airport from a national tax base to a local tax base. It is plagued by many of the inefficiencies that characterize government operated airports.

The transfer of Pearson Airport to the Greater Toronto Airport Authority ("GTAA") under the National Airports Policy will raise a number of legal issues . The creation by provincial statute of the GTAA is not an infringement upon federal jurisdiction over aeronautics. In addition, the operation of Pearson Airport by the GTAA is not an infringement upon federal jurisdiction over aeronautics.

The federal government should sell Pearson Airport to the private sector. It should not regulate decision making authority of the private owners as a private unregulated monopoly or oligopoly is preferable to a private regulated monopoly or oligopoly or to government ownership. Dynamic changes in the transportation industry are highly likely to undermine the existence of a monopoly or oligopoly and there is at least some chance that these will be allowed to have their effect.

The establishment of an airside corporation is recommended in order to effectively eliminate Pearson Airports market power. Separating the airport's airside and groundside functions, and basing airside ownership on slots will eliminate Pearson Airport's market power. Terminals I, II and III will be sold separately and will become the responsibility of several airport companies who will compete for airlines and passengers. Runways, taxiways and the apron would be owned and operated by a corporation made up of investors and third party brokers.

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Pearson Airport is one of the top twenty airports in the world. Pearson is an Atlantic gateway to North America. It competes with numerous American airports for transfer traffic. To maintain their place as a premier Airport Pearson must adopt a commercialized operating structure and aggressively market their facilities Internationally. The Canadian government must come to understand the economic advantages that only full privatization of Pearson Airport can provide for Southern Ontario and Canada.

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