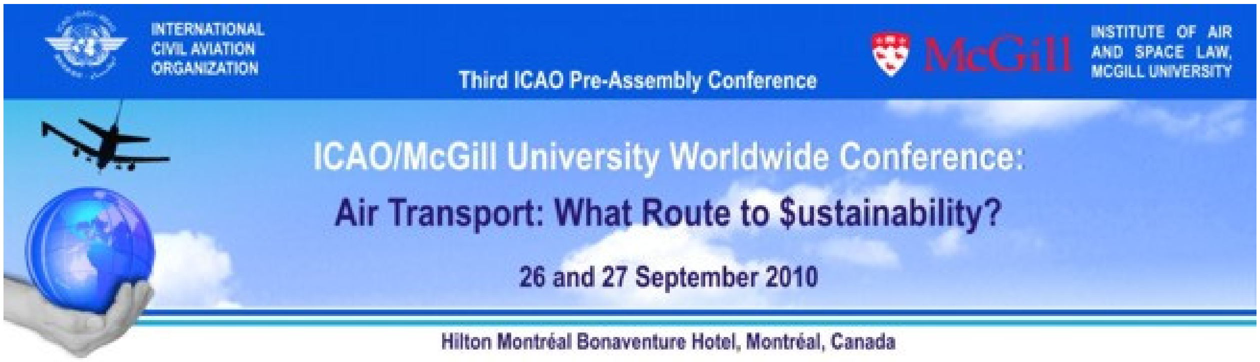

CALIN ROVINESCU, PRESIDENT AND CEO, AIR CANADA

KEYNOTE SPEECH TO ICAO/McGILL WORLDWIDE CONFERENCE
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Bonjour Mesdames et Messieurs. Je suis heureux d'être parmi vous aujourd'hui, en particulier parmi autant d'experts du transport aérien venant des quatre coins du monde. Je saisis cette occasion pour souhaiter à tous les participants de l'Assemblée des discussions des plus fructueuses.

McGill University, this event's co-sponsor is very important to Montreal and to me – I attended this great institution in the 1970's, have occasionally guest lectured in its law and management facilities and my son just graduated from its wonderful law school − so it remains an integral part of my life!

I find it ironic that the airline industry, like Shakespeare's Hamlet, finds itself every several years asking itself 'TO BE OR NOT TO BE' − will it exist or succumb to the multitude of challenges? Therefore, in keeping with the theme of this conference my remarks today will focus on what our industry must do to address that elusive sustainability. It strikes me that the issues Air Canada faces at this time are common to very many airlines throughout the world; for this reason, the route to sustainability is indeed a journey many international airlines must travel together.

When you consider it, it is remarkable that a global $550-billion industry that has existed for a century should still be having conferences with such an existential theme as: "What Route to Sustainability?" After all this time, you would think we would have long ago arrived at that destination.

But as everyone in this room knows, the airline industry is fraught with risk and uncertainty that result in regular downturns and, periodically, outright meltdowns. We are currently exiting the worst of the worst – the disastrous last 2 years − and there is now cautious optimism in the sector. Enough optimism that IATA last week markedly increased its 2010 earning estimates for the industry to $8.9 billion.

But before we spike the ball and declare victory, any joy has to be tempered by the fact an $8.9 billion profit represents a razor-thin margin of less than 2 per cent. Think for a moment how that compares to the margins in the financial services, technology, natural resources or telecom businesses. Two Percent. Moreover, IATA is also projecting the industry, which has yet to regain pre-recession levels in premium traffic, will slow again next year. Finally, these results must be put in the context of the nearly $50 billion in losses accumulated by our industry over the last decade.

The Canadian experience reflects this. Last month, the Conference Board of Canada said while the Canadian industry can expect a turnaround from last year's losses, it will see only a meager pre-tax profit of $192 million. Moreover, as elsewhere, pricing remains soft and our business traffic has yet to return to pre-recession levels.

Before I speak to the half dozen or so drivers of sustainability, let me take a minute to consider whether the airline industry is relevant enough to matter when asking ourselves Hamlet's existential question. Airlines do much more than simply move more than 2 billion people a year or employ millions in good jobs (which in and of itself, is not insignificant!). Air transport exponentially accelerates economic growth by facilitating business. There is a well-documented correlation between air connectivity and economic activity.

According to a recent Canadian study, in 2009, the air transport industry directly generated $6.5 billion of Canada's GDP. The total GDP impact of the industry is estimated at $12 billion and once the aggregate economic impact (direct, secondary and catalytic) is taken into account, the impact exceeds $35 billion in GDP.

Air Canada's own contribution is estimated at slightly more than 50% of the total contribution of the Canadian industry, including that of foreign airlines operating into Canada. A study done a few years back for IATA estimated the global economic impact of aviation at $3.6 trillion or 7.5 per cent of the world's GDP.

These are significant amounts, particularly in a world still struggling to escape a recession. A world that is desperate for economic growth. For that reason, it is incumbent on governments to recognize a strong societal interest in having a robust and sustainable airline industry. And this is the first driver on the route to sustainability – proper behaviour of governments.

It is incumbent on governments, especially in driving stimulus programs to ensure the correct policies are in place to support this industry and its GDP impact. And by supportive environment I do not mean protectionism, re-regulation or subsidies. Instead, I am referring to having the appropriate regulatory environment, proper non-punitive fees, taxes and charges, an appropriate regime for safety and security, realistic consumer protection rules and a correct approach to environmental policy.

To me the place to start is at the conceptual level. Governments must stop viewing the industry as a cash cow. Everywhere, we see levies and taxes placed on airlines and their customers. Often, I think in the mistaken view air travel should attract "sin taxes" like tobacco, alcohol or other frivolous perquisites for the rich; rather than be seen as a key driver of business and growth.

We all remember the proposal in 2005 when the EU intended to put a tax on aviation fuel to fund anti-poverty and debt relief programs in the third world. A laudable goal for sure but one cannot help but wonder whether an industry with such razor thin margins is the right candidate for this form of benevolence.

While this proposal was eventually set aside, the philosophy remains alive. And more recent proposed levies are now disguised as green initiatives. Consider the thinly-veiled German effort to balance the state budget with its proposed $1.3 billion tax on travellers or the earlier Dutch effort to raise almost $400 million from a similar tax. In the latter case, the Dutch government relented when it realized such a tax cost the Dutch $1.55 billion in lost business, including sending travellers outside the country to catch their flights.

The Canadian experience is little different – in fact I would argue is frankly worse - we face a wide range of taxes and fees that extract millions from our industry that are not reinvested. For example, although Canada privatized its airports in 1992, the Consolidated Revenue Fund continues to collect nearly $300 million annually in rent for these facilities. This is something no other developed country does and it makes Air Canada and Canada less competitive. Indeed, as in the Netherlands, we increasingly see Canadians driving across the border to places such as Plattsburg, to Buffalo or to Seattle because flights there are cheaper without these taxes.

Between airport rent, airport infrastructure, navigation fees and charges, the Air Traveller's Security charge, fuel excise taxes and other direct and indirect taxes, it costs our company nearly $1 billion more annually than if we operated in the U.S., with the same volume of business. This $1 billion could be reinvested to develop new routes or acquire new aircraft or at the very least assist in badly needed infrastructure linking airports to main cities.

The second driver of industry sustainability is the area of trade policy where our industry is subject to an outdated regulatory framework that dates back to the middle of the last century. In many places governments stubbornly cling to outmoded, protectionist policies over navigation that stifle the growth of air travel and connectivity. This refusal to modernize spills over into other areas too, and although I am pleased to see momentum building for NexGen in the U.S. and the Single European Sky ATM Research (or SESAR) project in Europe, there remain countries who refuse to update their approach to air traffic control, forcing carriers to fly roundabout, uneconomic and environmentally-damaging routings. This is one area where Canada has shown leadership- since assuming control of the Air Navigation System in 1996, NavCanada has adopted an aggressive strategy to modernize and enhance the delivery of air traffic services across the country and in international airspace assigned to Canadian control. It remains a leader in this sector.

On the bilateral policy front, I fully agree with liberalization where and to the extent there is reciprocal demand. Air Canada is fully supportive of fair and balanced Open Skies with all countries where there is reciprocal demand.

We have welcomed liberalization agreements with the United States and most recently with the European Union, two of the most competitive markets in the world where there is real two-way demand with Canada. We are not, however, supportive of turning over our hard-earned network and flow traffic to state subsidized carriers of countries where there is no such reciprocal demand.

Whenever, I talk about our views on liberalization, the issue of the UAE carriers and their powerful lobby and media campaign aimed at various Canadian government officials, local communities and airports arises. It is the same issue that comes up in many countries around the world where UAE airlines are aggressively pressing to expand in order to support their over-built airports and other infrastructure back home. It is well known in our industry that these state-owned and subsidized carriers are pushing hard to capture and divert as much global flow as possible to Dubai and elsewhere in the region even if the point to point market between the two countries is very thin.

Few Canadians actually travel to Dubai as a destination and fewer still residents of Dubai travel to Canada.

Simply put, it would be yet another defeat for Canada to adopt an unbalanced trade agreement with the UAE and allow for the ‘‘dumping” of seats into the Canadian market to siphon off profitable flying. The impact would be severe and would have the effect of restricting the growth of direct services from Canada, to many other international points - especially for thinner markets like Calgary, Montréal and Ottawa.

A second key driver of long term industry sustainability is therefore fair and balanced trade agreements on aviation, especially where state owned or sovereign-fund controlled entities are involved.

The third driver for sustainability will derive from some form of consolidation in our industry, whether through M&A activities or true revenue or profit sharing joint ventures. Several major mergers have been completed or are in various stages of completion - Delta/Northwest, British Airways/Iberia, Tam/Lan Chile. And this morning Southwest/Air Tran was announced. Another merger of special interest to us involves our Star partners Continental and United and we've been watching developments in each of these cases closely. Generally, we believe the outcome will be positive for these carriers, largely because of the synergies expected from integration and the overcapacity that exists in these markets.

In the past, due to concerns about sovereignty and national security that date back to the Chicago Convention, governments have been slow or simply refused to countenance trans-national mergers for airlines. The result is that companies in our industry have been denied the opportunity -- if that is the way they wish to develop -- of achieving through mergers the size enjoyed by multi-national corporations in other industries.

Air Canada has adapted well to this policy approach and we have grown to be the 15th largest among the world's 1000 or so airlines despite Canada being only the 36th largest country. We have over the years acquired directly or indirectly several Canadian carriers including, of course, Canadian Airlines International which itself acquired PWA and Wardair amongst others. Key to our strategy for sustainable growth has been the partnerships we have formed through the Star Alliance which has allowed us to expand our reach to offer customers a choice of 1,200 airports in 180 countries – more than we could ever hope to serve alone. More recently we have implemented a revenue-sharing alliance with our partners Lufthansa, United Airlines and Continental Airlines on the Atlantic.

We sell seats on the other as if we were de facto one large carrier with a single network. In effect "metal neutrality", so that over time we should become indifferent as to which carrier is flown over the Atlantic as long as it is one of the four. This has achieved many of the benefits and efficiencies of consolidation while still maintaining each individual carrier's autonomy and governance. And I believe this form of commercial consolidation or true joint venture will be the way of the future for us. Until, at least foreign ownership rules in certain countries, including Canada, are relaxed.

In some quarters, however, governments and labour groups have voiced reservations and sometimes opposed such partnerships, but I think it would be very damaging to the industry were we to regress on this issue. As globalization of air travel has taken hold, these alliances will, in effect, provide more consumer choice to more destinations, with participating carriers taking appropriate financial and commercial risk. Not only would consumers lose choice, but these arrangements give us most, if not all, the advantages of size and cost synergies without the labour, regulatory and other complications of mergers.

The fourth element of sustainability relates to keeping costs under control or in effect succeeding at transforming the costs of legacy carriers. Higher structural and labour costs including work rules at legacy carriers impede growth and make it difficult to compete with low cost and other carriers not saddled with these constraints. Some carriers have taken an innovative approach such as Qantas with their launch of Jetstar, their low-cost, no-frills subsidiary which competes effectively in both the domestic and international markets. ANA has recently announced its intention to invest in or create a LCC vehicle. In our case, we have implemented a comprehensive Cost Transformation Program aimed at achieving $500 million in annual cost and revenue improvements by the end of 2011 - and we are right on track.

Two other policy areas that are closely intertwined are safety and security. One thing all of us in our industry can be justifiably proud is the industry's safety record. It is undeniable proof that we mean it when we say the safety of our customers and employees is our top concern.

The key however, is not to become complacent. Safety has to be a process of continual improvement and that is the essence of our new Safety Management System we have developed in Canada and have started to implement this year. SMS requires that we work collaboratively with our regulator and while we are both still in the learning process there is no doubt all parties are committed to achieving the end goal of enhancing our safety record.

Air Canada has long been an early-adopter in terms of safety systems and technology as we pioneered the use of the black box recorder. We were also among the first airlines to successfully undergo the IATA Operational Safety Audit. And while safety oversight properly remains the regulator's responsibility, IOSA is an effective tool that helps governments to achieve the goal of enhanced safety.

However, I must say that as a member of IATA, and as the ultimate accountable executive at Air Canada, I agree with the view that there is opportunity to enhance safety by encouraging better coordination among the world's assorted safety authorities. Various programs such as ICAO's Universal Safety Oversight Audit Program and the FAA's Safety Team are complementary yet operate too much in isolation.
Agencies need to work better in such areas as information sharing to become more effective and efficient. Moreover, the unfortunately slow and seemingly uncoordinated European government response to the closure of European airspace last spring following the Icelandic volcanic eruption underscores that as an industry we need to get our agencies and governments to work faster, better and in a coordinated fashion. In effect, to recognize that we operate in a complex 24-7 global environment with a very high fixed cost structure. While Europe was shut down for a week, the industry lost $1.7 billion as we continued to pay for airplanes, for facilities, for staff, etc.

Similarly with security, the industry record is very strong but it is always possible to fine tune processes in order that we can be more certain of stopping threats without inhibiting the flow of traffic.

This is an important issue, not only because we are talking about security in the skies but this is also in my view the 5th element for the sustainability of the industry. People want to feel secure when they travel. And they want a hassle-free experience. We can, and must, give them both. No question, we can do a better job at identifying higher risks earlier.

The Nexus program, the joint Customs and Immigration program for trusted travelers implemented by the Canada and U.S. is a good example of the kind of smart, efficient security we need. This is also why Air Canada is highly supportive of IATA's engagement with ICAO to develop a protocol for industry-government cooperation on security issues. The aim is to ensure we adopt a standardized well-thought out approach rather than the ad hoc, disparate measures that all too often characterize security responses, especially in the face of unfolding threats such as the Christmas bomber last year.

Coordination is also essential if we are to successfully implement cross-border collection of passenger information. This calls for cooperation and standardization of requirements. Coupled with this must be intelligent airport screening, which if not done properly can result in bottlenecks, lineups, passenger anxiety and ultimately ineffectiveness.

In Canada, the federal government is currently undertaking a review of the Canadian Air Transport Security Authority (CATSA) which we hope will lead to the development of an innovative, cost effective and customer-friendly security system for the benefit of all Canadians.
If the in-transit experience, whether because of security or immigration checks, at our main hubs is a hassle, a burden for our connecting passengers, you can be sure that connections will be made through other hubs, rather than say Toronto or Vancouver and, at the end of the day, connecting passengers are a main driver of sustained activity at these airports

The 6th element for sustainability is the simplest to explain and the hardest to achieve – good customer service. Last year, as we worked through significant challenges threatening Air Canada's very survival, we vowed to win the customer back. And we did just that – as we ended the year 2009 named Skytrax's Best Airline in North America in a survey of 17 million frequent travelers worldwide. So I am well aware of the impact good service can have on our results and therefore on our future sustainability.

In a complicated industry such as ours, with all its moving parts and reliance on so many outside agencies, suppliers and partners, it is inevitable, however, that airlines will sometimes disappoint customers. It is also true that recovery can entail compensation and that in some cases legislation is needed to give this teeth.

But there is a danger when governments, however well-intentioned, impose unrealistic performance metrics or punitive regimes that inflict penalties on carriers out of proportion to the damage done, especially in cases where this is through no fault of the airline itself. In Canada last year, Parliament briefly entertained one such piece of legislation which, among other things, would, for example, have penalized airlines $350,000 if a 777 was delayed on a tarmac for three hours regardless of the cause, including weather.

The legislation was a draconian version of consumer protection laws enacted by the EU and the U.S. However, the danger of such regulations is that they often do not account for the operational complexities of our business and have the perverse effect of diminishing rather than improving customer service. For example, in the U.S., current regulations make it tempting to cancel rather than delay flights, although our experience is that most customers would much prefer to travel late than not at all. And no one will soon forget how European carriers were forced to pay millions in penalties and hotel bills when the Icelandic volcano, an unquestionable Act of God, exposed the flawed, open-ended nature of the EU rules. So sustainability must also mean treat your customer correctly but not through knee-jerk regulatory measures, some of which also purport to have extra-territorial effect.

The last element of sustainability I want to mention today is in the area of the environment. As an industry we have stepped up to the plate in terms of doing our share to curb greenhouse gases and operate in an environmentally responsible way.

Air Canada has already made meaningful progress in improving its environmental performance. With respect to Greenhouse Gas Emission targets, we met our IATA commitment to cut emissions 26 per cent from 1999 levels by 2012 in 2004, or eight years early. We similarly met our National Airlines Council of Canada target of a 24 per cent reduction by 2012 -- five years early.

Reaching these goals was not easy but we did it through a variety of initiatives, both big and small. We renewed our fleet to get more fuel efficient aircraft, we lightened our aircraft by investing in new products such as Kevlar cargo containers to replace heavier aluminum ones, we cut fuel burn through reduced flying speeds, new landing procedures and more direct routings, and on the ground we switched to more efficient vehicles.

Today, we are involved in experimenting with leading edge technologies that will yield the emissions reductions of the future. We are working with partners to test a new steam process for de-icing aircraft to curb the use of glycol and we are also cooperating with a group of other carriers in the development and application of sustainable alternative fuels. In addition, we have ordered 37 Boeing 787 Dreamliners, which we anticipate will set the standard for fuel efficiency for the next generation of aircraft; they are expected to be true game-changes for us with respect to range, cost and fuel consumption. Other manufacturers are also making great strides, including Canada's own Bombardier whose C-series is promising to set new standards for narrow bodies in terms of efficiency.

Having reached the initial goals, we committed to new ones by endorsing IATA's targets that include attaining an average improvement in fuel efficiency of 1.5 per cent per year from 2009 to 2020. We also want to achieve carbon neutral growth by capping CO2 emissions after 2020. Finally, we have pledged to reduce CO2 emissions by 50 per cent from 2005 levels by the year 2050. This very ambitious target is almost not believable when mentioned to business people in other industries.

Yet, despite such progress, more regulation is on the horizon. The European emissions scheme gets the most publicity, but there are also proposals for parallel regimens in such places as Australia, the U.S. and Japan. Our concern is the industry could be confronted by a mix of uncoordinated, overlapping cumbersome and costly controls.

We have participated in various efforts to define appropriate market-based measures for the industry. The basic goal is to reduce carbon emissions based on set targets while holding airlines who fail to meet targets financially accountable.

One such measure currently on the table is carbon trading or emissions trading. Simply put, all airline companies would be given a CO2 emissions allowance based on current targets. If a company's emissions exceed its allowance, it can either find ways to cut emissions, for example by improving efficiency, (buying more efficient aircraft etc.) or by buying additional allowances from companies who are below their quota. Essentially, the buyer would be paying to emit more, and the seller would be paid for emitting less.

Air Canada supports such measures if they are implemented on a global scale. Though we are currently complying with the EU Emissions Trading Scheme, we are less in favour of a regional approach of this kind. Apart from unnecessary complexity, it could result in varying degrees of competitive distortion, as airlines might divert traffic to peripheral hubs where the scheme is not in effect. To avoid such an imbalance, Air Canada is advocating for a global approach to emissions control that is fair and balanced, for all.

Despite the size and global reach of our industry, despite its often mission-critical service, despite its hundreds-of-billions of dollars in annual revenue and despite its critical importance to the modern world and to all emerging economics, our sector is fragile. It is easily buffeted by economic reversals, geo-political developments, fuel prices, security threats and natural events such as hurricanes, earthquakes or volcanoes; all of which are largely out of the control of any given airline or for that matter any given country no matter how powerful.

Good management teams will get their houses in order quickly coming out of this recession and will tackle each of the 7 elements of sustainability that I have discussed. But the one variable that plays a role in each of the 7 elements is frankly fully within the control of individual governments - and that is regulation. As I have tried to explain today, regulation that is costly, onerous, unbalanced or does not fully account for the complexities and fragilities of the airline industry will have detrimental effects, not only on airlines, but also on the entire economy, which is so dependent on the connectivity and stimulus our industry provides. It is the route to stagnation.

Air carriers have the potential to be one of the leading drivers, globally coming out of this recession and can yield multi-fold benefits in terms of economic return, passenger safety, national security and a healthier environment. The key, I believe, is to let them flourish without creeping re-regulation in this supposedly de-regulated environment and allow them to chart their own route to sustainability, as in so many other industries.

Thank you.

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