Chapter 8

VENTUREX LIMITED

Background

As early as February 1971, certain executives of both the Canadian National Railway and Air Canada determined that a joint venture agreement should be entered into between the two companies in order to implement a "total travel experience program" which would integrate rail, air, hotel accommodation and ground services for the travelling consumer. A memorandum was entered into by the Chief Executive Officers of both companies on February 15, 1971, to provide for the joint cooperation of the two corporations. To this end a joint *ad hoc* committee was established. Studies were then conducted by the two corporations resulting in a suggestion that a corporation be established as a subsidiary or affiliate of the two named corporations to engage in the business of chartering, tour wholesaling, ground reception services and the financing of the total travel package.

From Air Canada's point of view, around August 1, 1972, a Diversification Plan was established for the years 1973 through 1977 incorporating "the total travel experience" concept. It appears that Drummond (then Director of Diversification) and Vaughan (then Vice-President, Assistant to the President and Secretary) were the chief motivating forces behind the organization of a company to implement this Diversification Plan, or at least a part of the said Plan.

During the fall of 1972, the Marketing Branch of Air Canada knew that the CTC regulations with respect to affinity charters (the type of charter most commonly used for group travel) would be replaced by regulations establishing Advance Booking Charters (ABC). In order to prepare for the new regulations, and quite apart from Drummond's work on diversification, the Marketing Branch in November 1972 proposed to Vaughan establishing a corporation to act as the charterer for the new ABC charters. In these discussions, the proposal was broadened to include the use of the proposed corporation for the implementation of the integrated services. The general plan was at the same time the subject of discussions between Vaughan and his staff and McMillan and Duncan of the C.N.R.

The original desire of the Marketing Department was to establish a "paper company" for use in the ABC operations. However, the Chairman of Air Canada wanted a totally independent company and suggested

in December, 1972, that the corporation should not be merely a paper company. On the recommendation of Menard, he designated the Air Canada personnel to be members of the first Board of the company and agreed to the appointment of Raymond H. Lindsay as the General Manager on the understanding that the activities of the company would be supervised by Vaughan as part of his normal responsibilities as the person in charge of Air Canada's diversification activities.

Organization of Venturex Limited

On or about December 1, 1972, a company was incorporated through the offices of the Canadian National Railway, at the request of Air Canada, under the name of Chartair Canada Services Ltd., a wholly owned subsidiary of Canadian National Realties Limited ("Realties") which is a wholly owned subsidiary of the CNR. The name was changed on January 10, 1973 by supplementary letters patent to Econair Canada Holidays Ltd., and was later changed to Venturex Limited on or about January 16, 1974.

Generally speaking, the objects of the corporation were to carry on the business of a tour operator and charterer. The directors of the corporation at the date of the incorporation were all employees of Air Canada. In the organizational meetings of the Board of the company, in December 1972-January, 1973, Menard was elected President; Vaughan was appointed Secretary; Michel Fournier Assistant Secretary; John Sheehan Treasurer, and Raymond Lindsay General Manager. The directors of the company were Menard, Ballotta and Parisi (Marketing Branch), Drummond (Vaughan's staff), d'Amours, (Vice-President Sales and Services) and Callen (Vice-President Central Region).

An agreement was entered into between Air Canada and the CNR on January 15, 1973, in which is recited the desire of Air Canada to have the CNR incorporate Venturex and cause "Realties" to subscribe for the outstanding capital shares of the corporation and to effect loans to the corporation from time to time to a maximum of $100,000 which monies would in turn be provided by Air Canada to the CNR. The agreement further provides for the indemnification of the CNR by Air Canada against any loss or expense by reason of the CNR incorporating the company and for the transfer of the shares of Venturex to Air Canada, or its nominees, if the airline should thereafter obtain the corporate power or authority to purchase the shares. In fact, a loan of $9,000 was extended, secured by a demand promissory note. The loan is still outstanding.

The best enumeration of the objectives of the corporation is contained in the signed minutes of the Board meeting of Econair held on January 17, 1973. It was stated that the prime objective of the corporation was to distribute Air Canada's summer 1973 charter capacity under the new Advance Booking Charter (ABC) regulations, which, of course, required Air Canada to allocate to the corporation its total charter capacity for the year 1973 between Europe and Canada.

At the same meeting the Board considered and approved a pricing program for the sale of its charter seats. It was established that the corporation, in order to cover its start-up costs, etc., would have to charge and receive a mark-up of 30% in excess of the carrier's rental figure. However, such a 30% mark-up would price the Econair charters out of the competitive market. To remain competitive, a mark-up of only 15% was possible. In an effort to alleviate the losses which this low mark-up would obviously produce for the company, it was proposed that Venturex and Air Canada enter into certain General Sales Agency and Technical Service agreements. Such a proposal was endorsed by the Econair Board and was authorized ultimately by the Air Canada Board as at January 30, 1973. In fact, the Technical Service Agreement and General Sales Agency Agreement were never executed, presumably because such agreements were found to be contrary to the CTC regulations discussed in more detail below. In the end, substantial losses arose in the Venturex accounts during the years 1973 and 1974. The accounting treatment and the funding of these losses will be returned to shortly.

There are no real employees of Venturex in the generally accepted sense of that term. All personnel working for Venturex are paid by Air Canada and in the same manner as ordinary Air Canada employees. They are all in the Air Canada Pension Plan. The company occupies space in Air Canada's Administrative offices at Place Ville Marie. All furniture and equipment is supplied by Air Canada and apart from the name of the company at the entrance to its premises, the premises are not distinguishable from the surrounding offices occupied by Air Canada.

Business of Venturex

(a) *Advance Booking Charter Business (ABC Business)*

The Charter business of Venturex, for which it was initially incorporated, relates to "Advance Booking Charters", which concept was established by the Air Transport Committee of the Canadian Transport Commission when it amended the Air Carrier Regulations under the Aeronautics Act. Generally, a company or person desiring to charter an aircraft does so under a contract with the airline. The person so chartering the aircraft then distributes the seats to the travelling public, either directly or through travel agents, unless the charter arrangements are for an association or club, in which case, as the general public is not involved, the services of a travel agent are normally not necessary. As will be seen in the definition section of the Regulations, cited below, "charterer" means an organization such as Venturex, which leases an aircraft under charter contract from an airline; the airline is referred to as the 'air carrier'.

Under these Regulations the air carrier may not operate a charter service itself. The travelling public is required to reserve a seat on an ABC not less than 90 days in advance of the departure date and 10% of the overall cost must be paid by the passenger at that time, while payment in full must be

effected at least 30 days prior to the date of departure. The ABC type charters are available only between North America and Europe.

The ABC Regulations were introduced to replace the Affinity Charter Regulations under which an organization or association chartered an aircraft to transport its "membership" (and no one else) to predetermined destinations within territories in which the airline was authorized to operate scheduled services under bilateral or other international agreements.

The principal CTC Regulations relating to ABC's are as follows:

"DIVISION F

ADVANCE BOOKING CHARTERS

43.1 In this Division,

'advance booking charter' or 'ABC' means a round-trip international charter originating and terminating in Canada and operated by one or two licensed air carriers under a contract with a charterer, or contracts with charterers, where

(a) one charterer or all the charterers contract for the full capacity of the aircraft, and

(b) each charterer contracts for at least forty seats for hire to the public at a price per seat that is not less than the pro rata of the charter cost thereof to the charterer;

'air carrier' means a person holding a licence and authority from the Committee to provide ABC air services;

'charterer' means a person who has entered into an ABC contract pursuant to this Division;

. . .

'passenger' means a person who

(a) is eligible under this Division to be carried pursuant to an ABC, and

(b) at least thirty days prior to the departure date of the outgoing portion of the ABC has paid to the charterer the full price per seat advertised by the charterer for that ABC.

. . .

Seating Requirements

43.12 No air carrier shall operate an ABC unless the full capacity of the aircraft is chartered and each charterer has contracted for at least forty seats on that aircraft.

. . .

Air Carriers Performing Outgoing Portion of ABC's

43.15 (1) Every air carrier that is to perform the outgoing portion of an ABC shall, upon executing the contract for that ABC,

(a) notify the Committee in writing of the proposed operation;

(b) provide the Committee with an executed copy of the contract including an undertaking by the air carrier and the charterer to comply with this Division;

. . .

(d) provide the Committee with a statement by each charterer, verified by his statutory declaration or, where the charterer is a company, by the statutory declaration of a duly authorized officer of the company setting out

(i) the name, address, nationality and nature of business of the charterer,

(ii) where the charterer is a company, the name, address and nationality of each director of the company,

(iii) a summary of the charterer's business experience relating to transportation activities including, where applicable, particulars of his membership in travel organizations, and

(iv) evidence of the financial responsibility of the charterer, consisting of

(A) audited statements including the auditor's report, and a balance sheet prepared as of a date not more than three months prior to the date of the receipt by the Committee pursuant to paragraph (b) of the executed copy of the contract,

(B) a letter from the charterer's bank stating the charterer's line of credit and the extent thereof,

(C) a description of the arrangements made by the charterer to ensure the protection of moneys paid to him in respect of ABC's during the period in which those moneys remain in his possession, and

(D) such other information as the Committee may from time to time require; and

(e) in addition to complying with paragraph (d), satisfy the Committee as to

(i) the financial responsibility of the charterer,

(ii) the business experience of the charterer relating to the transportation activities,

(iii) the adequacy of the arrangements referred to in clause (d)(iv)(C), and

(iv) the ability of the charterer to successfully fulfil the contract.

. . .

Payment of Benefits and Advertisements of ABC's Prohibited

43.31 No air carrier shall

(a) pay or offer to pay any commission, gratuity or other benefit to any person in respect of any ABC; or

(b) advertise or cause to be advertised any ABC.

. . .

44. (10) No air carrier, or any officer or agent thereof, shall offer, grant, give, solicit, accept or receive any rebate, concession or discrimination in respect of the transportation of any traffic by the air carrier whereby such traffic is, by any device whatever, transported at a toll that differs from that named in the tariffs then in force or under terms or conditions

of carriage other than those set out in such tariffs, unless with the prior approval of the Committee.

. . .

45. (1) All tolls and terms or conditions of carriage established by an air carrier shall be just and reasonable and shall always, under substantially similar circumstances and conditions, with respect to all traffic of the same description, be charged equally to all persons at the same rate.

(2) No air carrier shall in respect of tolls

(a) make any unjust discrimination against any person or other air carrier;

(b) make or give any undue or unreasonable preference or advantage to or in favour of any person or other air carrier in any respect whatever; or

(c) subject any person or other air carrier or any description of traffic to any undue or unreasonable prejudice or disadvantage in any respect whatever."

In addition to these ABC Regulations, it is relevant to point out that IATA Regulations deal with ABC's and are binding on Air Canada as a member of that voluntary association. However, as discussed earlier, IATA Regulations are not considered to be within the scope of this Inquiry.

According to the evidence, Venturex charters the aircraft from Air Canada. The charter agreement and Air Canada's tariff of charges must, in each instance, be filed with the CTC. Venturex markets to the general public through travel agents, aircraft seats so chartered. Where sales are insufficient to fill the aircraft to a level pre-determined by the Venturex staff and alternative charters cannot be substituted, passengers are transferred to regularly scheduled Air Canada flights whose departure and return times approximate those of the cancelled ABC service.

It is not uncommon in the industry for an air carrier's subsidiary to be employed to provide ABC service to the travelling public, since the Regulations prohibit any air carrier from itself operating a charter. It was the understanding at Air Canada, when Venturex was incorporated, that the Regulations would not permit a direct subsidiary to be used for this ABC business, but that the use of a sister company, that is a CNR subsidiary, would qualify.

Another feature of the ABC charter is that when Air Canada enters into a charter agreement with Venturex, the charter price must be the one set out in the tariff filed with the CTC. Once the tariff is filed, Air Canada cannot grant charters of available aircraft at a charter price lower than the one set out in the tariff. The evidence at the Inquiry suggested that once an application for charter of an Air Canada aircraft was made, its success did not depend upon price, which was set by the tariff, but upon availability of the appropriate type of aircraft at the time required by the charterer.

The evidence is that the charter fee which Venturex was required to pay to Air Canada made it impossible for Venturex to pay its expenses arising in its charter business and still market its chartered seats on a competitive basis. The substantial losses which accrued in the accounts of Venturex in 1973 and

1974 gave rise to considerable accounting problems in Air Canada because these losses could not be readily transferred to Air Canada without offending the air carrier Regulations.

The strictures imposed on airlines by the ABC Regulations, which impede what might be regarded as ordinary efficient business practices, are as follows:

1. The Airline is precluded from acting as a sales agent for seats on the aircraft chartered under ABC Regulations. Air Canada agreed in a letter to the CTC, dated November 15, 1973, not to so act on behalf of Venturex.

2. The Regulations do not expressly prohibit the use by the airline of a wholly owned subsidiary as an ABC charterer, but the Regulatory authority, in its correspondence with Air Canada, seems to have taken the position that such a practice would be prohibited. There is some confusion in the correspondence passing between the airline and the authority as to whether it is the subsidiary practice which is prohibited, or the assignment to a charterer of so much of the capacity of the airline that the latter ceases to be a common carrier. In any event, the evidence indicates that wholly owned subsidiaries are known in the ABC business elsewhere in Canada.

3. The prohibition against a carrier paying a commission or other benefit to the charterer precludes the transfer by usual accounting procedures of the losses of the subsidiary to the accounts of its parent.

In the result, Venturex during the years 1973 and 1974 ran up substantial losses in the course of its ABC business as follows:

(a) 1973—$552,000 (including $374,000 passenger inconvenience cost);

(b) 1974—$730,000 (including $257,000 passenger inconvenience cost).

"Passenger Inconvenience cost" may be defined as the cost to the charterer of transferring a charter passenger to a regularly scheduled flight, and is the difference between the ABC passenger fare and the fare for the scheduled flight.

Various devices were considered and partially invoked to transfer these losses from the accounts of Venturex to the accounts of Air Canada (these will be discussed later in this Chapter). This transfer is necessary in order to establish the true financial position of Air Canada in its operations for the purpose of reporting to the shareholders and Government and for the accuracy of its published accounts. The accounts of Venturex per se could not be consolidated into the Air Canada accounts because Venturex is not a subsidiary of Air Canada; hence the device of inter-corporate charges and transfers.

The financial condition of the ABC business, when viewed as a total business carried on by both Venturex and Air Canada, is not by any means

clear. The Chairman testified that the Venturex ABC business amounted to $4,000,000 to Air Canada in 1974, out of a total charter revenue figure of $23.9 million. The ABC losses of Venturex for 1974 were about $730,000. There is nothing in the record to indicate that, notwithstanding the charter fee charged by Air Canada to Venturex, a profit resulted on the Air Canada side of the transaction, but we assume such to be the case. More importantly, there is no evidence to indicate that the consolidated position of the Air Canada group on Venturex ABC business was profitable. This is a further by-product of the dichotomy arising from the creation of independent accounting in Venturex without any prospective plan to transfer losses to the air carrier year by year, and arising out of the artificial atmosphere created by the CTC regulations in which Air Canada must operate.

The accounting proposed for Venturex is discussed below along with the accounting treatment accorded the ABC business in Air Canada.

(b) *Canaplan*

Air Canada was desirous of establishing certain ground reception services and preparatory thereto conducted a market analysis in 1972 and early 1973. Lindsay stated in his testimony to the Commission that, in the latter part of 1973, the Marketing Branch of Air Canada determined that the earlier survey was inadequate and, in lieu of conducting a further survey utilizing Air Canada personnel, asked Venturex to test the market program for Air Canada. According to Lindsay, this survey was done by the operation of a ground reception service. A verbal agreement was entered into in September 1973 between Lindsay and Menard on behalf of Venturex and Air Canada respectively. There was also a reciprocal arrangement entered into between CN France, a CNR subsidiary operating a ground reception service in Europe, and Venturex, which was to perform services of a like nature in Canada.

Lindsay further testified that at the time these preliminary arrangements were reached, no price for this 'survey' by Venturex was settled with Air Canada. Only in the latter part of 1973 was it agreed that the cost of the market test would approximate $150,000.

For reasons never made entirely clear to or understood by the Commission, Lindsay, as General Manager of Venturex took great pains, in his testimony, to establish, as best he could, that the fee for market testing or for surveying the ground reception business payable by Air Canada was not a device for infusing money into Venturex but was an independent enterprise intended to be carried on by Venturex in its own way on a profitable basis.

Lindsay had said as much on July 17, 1974, in a letter to the then Controller of Air Canada, which stated in part:

> ". . . Air Canada had the choice of keeping in house this test; in which case it would have been funded in Mr. Menard's Marketing budget. Instead, Mr. Menard chose to provide the funding to Venturex on the understanding that Venturex would test the concept for a fee of $150,000. This is most certainly a reasonable fee and I believe it has been properly provided for out of Mr. Menard's budget."

In a memorandum from Mr. Kelly, Controller of Venturex, written in June 1974, the cost of the survey or market test fees to Air Canada was estimated to be $143,200.

In any event, the survey appears to have commenced during 1973 and has been carried on continuously since that time. Some interim reports on the operations of the ground reception service were shown to the Commission staff, which reports Lindsay testified were given to Menard together with verbal reports. But no final written report on the results of the market test was ever produced.

In order to market the ground reception service Venturex decided to acquire Touram Group Services Inc. which had experience in this field. Lindsay testified that Venturex in fact was required to acquire the Touram company in order to obtain the services of its principal staff members. The actual conduct of negotiations, preparation of agreements and closing of the transaction was carried out from a legal viewpoint by a member of the Law Department of the CNR. This acquisition was approved by the Board of Directors of Venturex on July 2, 1974 subject to the condition that "... the acquisition of Touram would not expose Venturex beyond $50,000, said amount including the consideration, past liabilities, and future claims arising from law suits or otherwise". When the transaction was closed on September 20, 1974 certain calculations or adjustments, the evidence indicates, were based on an effective closing date of March 1, 1974 which was the beginning of the then current fiscal period of Touram. However, the actual monies changing hands on closing and the liabilities assumed on that date can be summarized as follows:

Cost of shares:		$ 50.00
Advances:		
Settlement of Bellon Debt	$ 5,000	
Other	48,164	
		53,164.00
Total:		$53,214.00

Of the $48,164 "Other" advances, approximately $36,000 was employed to discharge the accumulated liabilities of Touram as at March 1, 1974. The remaining $12,000 of advances represents funds to cover Touram's operating costs for the period March 1, 1974, to September 20, 1974.

If the liabilities or losses incurred by Touram between March 1, 1974 and the closing date of September 20, 1974 amounting to $12,000 approximately, were deducted, then at least from one point of view the acquisition cost was approximately $41,000. It should be noted that as a condition of closing, Touram entered into a service contract with Venturex.

The Air Canada Finance Branch analysis at July 22, 1974 suggested that the net benefit to Venturex of the Touram acquisition over the period 1974 through 1976 would be $8,000 at best and might even increase the losses in

Venturex. On the other hand, the preliminary assessment of the Touram operation by the Venturex staff was that Touram would result in increased profitability of Venturex over the same period of time of about $84,000. Although both estimates showed a profit from the outset, the statement *in toto* with respect to the Touram company indicated a net loss for the period March 1, 1974 to December 31, 1974 of $23,739.

The Touram transaction and the operations of the Canaplan Division provide another route by which the adequacy or otherwise of the financial controls within the Air Canada family may be examined.

On September 20, 1974 Venturex sent a first invoice to Air Canada "for service rendered October 1, 1973 to September 30, 1974 in conducting a market test on demand and profitability of ground reception services $108,750".

On December 1, 1974 a second invoice was submitted for the period October 1, 1974 to December 31, 1974 for $36,250, making a total of $145,000, part of which was of course, billed in advance.

In response to those invoices, the Accounting Division of the Finance Branch in Winnipeg asked Garratt, the Controller of the Marketing Branch, to provide an AFE. Garratt in turn sought a waiver of this requirement from Sheehan, Controller of Air Canada, who, by letter dated December 16, 1974, insisted that an AFE be raised. The AFE was issued December 18, 1974 and was signed by Pratte and Menard. The AFE, on its face, contained the following: "based on Air Canada produced study of 1973 that the demand and profitability of a ground reception survey was undertested in the market place, Venturex Limited was chosen to carry out the market test on behalf of Air Canada".

It should be borne in mind that, by the time Sheehan had received the request to waive an AFE, and certainly by the time the AFE was processed through Marketing up to the Chairman and transmitted to Winnipeg, the McGregor AFE's had come to light and had been subjected to some examination in Finance. While the signing of this AFE by the Chairman initially precluded the examination of the AFE for comments by the Finance Branch under the then existing AFE Regulations, nonetheless, this AFE came in for financial analysis and comment, as seen in Chapter 6, along with the McGregor AFE's. Presumably this route in clearing expenditures for the purpose of balancing accounts with Venturex, took on an added significance in the Venturex accounting because of the sensitivity of Venturex to the CTC Regulations regarding the receipt of benefits of any kind from an airline by a charter organization.

On the other hand, the matter might be regarded as highly significant from another viewpoint. The acquisition of Touram and the opening of a Canaplan venture represented an acquisition combined with a new undertaking by Air Canada. The procedure prevailing in Air Canada at the time in question for acquisitions was not followed in the case of Touram. Indeed, we have the unusual situation where the acquisition was made outside the Air Canada Act, and not through a section 18 subsidiary, but by the intervention of a CNR subsidiary. Indeed, the transaction was negotiated, according to the evidence, by an attorney of the CNR Law Department. Neither the agree-

ment, written or oral, to acquire shares of Touram, nor the Canaplan project as a new venture was placed before either the Executive Committee or the Board of Directors of Air Canada. The Chairman of the Board in his testimony stated that he did not know of the Touram acquisition until after this Inquiry commenced its hearings and that the share acquisition was a violation of the acquisition rules in effect in Air Canada at the time.

Here again the Commission has not been directed to any legal study or opinion that the Canaplan business could not have been engaged in by Air Canada directly and within section 13 of the Air Canada Act; nor has any study or opinion been placed before the Commission indicating that a section 18 subsidiary was then available to undertake this business. Both of these courses would, of course, require approval of the two aspects to this venture by the Board of Directors of Air Canada, whereas the use of Venturex, as we have seen, precluded any such approval and seems to have required only the approval of the Board of Directors of Venturex obtained on May 12, 1974. As mentioned earlier, even that approval was obtained on rather sketchy documentation placed before it by the management of Venturex.

The evidence does not disclose any contract of purchase, any closing procedures, or any solicitor's report on the completion of the transaction revealing the precautions taken to ascertain the ramifications of the acquisition of the Touram charter.

Accounting Solutions to Venturex Limited Deficit

As we have seen, Venturex incurred losses by reason of the ABC business in the years 1973 and 1974, and in the year 1974 incurred expenses or losses, depending upon which view one takes of the transaction, in the course of establishing the Canaplan business, including the acquisition of Touram. By the end of 1974 the cumulative deficit in Venturex was approximately $1,200,000.

In the manner detailed above, $145,000 had been transferred by intercompany account adjustment pursuant to the AFE issued in that amount and referrable to the Canaplan business. There still remained a very substantial deficit.

The Advisory Committee of the Board of Air Canada on subsidiary and associated companies, reviewed this entire problem on March 5, 1975 and six alternative methods of liquidating the deficit of Venturex were considered. These solutions range from a service agreement by which Air Canada would pay Venturex "a technical assistance or administrative fee with respect to Venturex's ABC business in the years 1973 and 1974", to the liquidation of Venturex in a voluntary winding-up. The Committee considered the most appropriate procedure to be an agreement under which Air Canada would provide financial arrangements to Venturex "to cover Venturex start-up expenses and cost of creating such product images as 'Econair' and 'Canaplan' "; and that "Air Canada and Venturex enter into a service agreement under the terms of which Venturex will charge Air Canada for certain administrative services relating to its ABC business". The Committee considered

that by these agreements the 1974 financial statements of Venturex would reflect the following adjustments:

Administrative & Technical Services	$ 584,000
Financial Assistance (start-up, promotion, market test expenses, etc.)	550,000
	$1,134,000

It is interesting to note that in the material before the Committee and the Board of Directors thereafter on these matters, no mention is made of the $145,000 payment having been made by Air Canada to Venturex for "market test expenses", which became the subject of a further reimbursement along the lines of this recommended procedure.

In any event, the Board of Directors at its meeting on March 25, 1975 gave approval to this proposal and the following is the relevant excerpt from the Minutes:

> "Approval was given to the recommendations of the Advisory Committee on Subsidiary and Associated Companies:
>
> That Air Canada remain in the charter business and employ Venturex Ltd. as its sole merchandising arm for ABC charters;
>
> That steps be taken to improve the financial accounts of Venturex Ltd. and that methods be adopted to insure that the ABC operations of Venturex Ltd. become viable;
>
> That more specifically, Air Canada and Venturex enter into a Service Agreement under the terms of which Venturex will charge Air Canada for certain administrative services related to its ABC business;
>
> That Air Canada provide financial assistance to Venturex to cover Venturex's start-up expenses, the cost of creating such product images as 'Econair' and 'Canaplan', and such other incidental revenue as may be appropriate considering the function of Venturex and the relationship between the two companies; and
>
> That Air Canada and Venturex consider ways and means of adjusting the 'Econair' charter and retail prices so as to provide Venturex with a more appropriate trading margin.
>
> It was noted that the aforementioned recommendations had been discussed with the Auditors of Air Canada and Venturex Ltd. and that the following specific adjustments would be reflected in the 1974 Financial Statements of Venturex:
>
> | | |
> |---|---|
> | Administrative and Technical Services | $ 584,000 |
> | Financial Assistance (start-up, promotion, market test expenses, etc.) | 550,000 |
> | | $1,134,000 |

> Also it was noted that there was a need for the boards of subsidiaries and associated companies to act independently of the parent and this was difficult when officers of the parent served as directors of the subsidiary and associated companies; that this was one of the problems the Advisory Committee intended to address beginning with its next meeting; and that initial recommendations on the organization, management, and control of subsidiary and associated companies had been presented at the last meeting."

Thereafter, financial statements for Venturex Limited and its wholly owned subsidiary were prepared on April 11, 1975 wherein Venturex, instead of showing a loss of some $500,000 for that year, showed a profit of $434,168, leaving on the balance sheet a deficit of only $87,542 instead of a deficit which had otherwise been shown in earlier draft statements of about $1,200,000. This result had been achieved in these draft statements by using the figures from the calculations put to the Board, as shown in the above excerpt from the Minutes, of $550,000 and $584,000 respectively, by charging the former to a reduction of expenses and including the latter as an extraordinary item relating to "service and departmental activities charged to, and start-up costs recovered from an affiliated company". Thus, in effect, $1,134,000 of expenses was transferred from Venturex to Air Canada. These financial statements had not, by the date of these hearings, been certified by the auditors and had not been approved by the Board of Directors of Venturex.

The accounting accorded these procedures for the elimination of the deficit of Venturex in the 1974 financial statements of Air Canada is on a somewhat different basis. The Air Canada accounts reflect a ticket expense in the year 1974 in the amount of $1,134,000 which was applied against the inter-company account with Venturex and which would require the taking into revenue by Venturex of a like amount.

In the 1974 financial statements, as published by the company pursuant to the Air Canada Act, the auditors in their report on these accounts make no reference to the $1,134,000 transaction or adjustment of the accounts between Air Canada and Venturex Limited. The evidence is that the "general and administrative operating expense" has been increased in such net amount as to bring about the above result.

General Accounting and Financial Controls in Venturex

In a memorandum dated June 20, 1973, prepared by Mr. J. W. R. Drummond, as a Director of Econair, but whose responsibilities at that time were under the President of Air Canada, some very illuminating comments were made: "Econair was conceived in haste, born in adversity and raised in uncertainty. Even its name is singularly uninspiring, it now has many aspects of an unwanted child". The author goes on to point out that the company was incorporated as a subsidiary of the CNR "upon the advice of legal counsel". Even by the date of this memorandum in June 1973, the executives

of Venturex were able to comment "the business undertaken by Econair so far is unlikely to result in profits . . . the loss for this fiscal year is estimated to be of the order of $450,000".

In the reorganization of the company recommended in the memorandum, an Executive Committee was proposed which would include one member of Air Canada's Executive Committee. The proposal was also made that the company be accountable for financial results and that it include in its financial planning provisions for the "disposition of the ticket losses suffered by Econair in its ABC business". This recommendation arose out of a comment that the accounting function is performed for the company by Air Canada, "but to date no understanding has developed between the two companies with respect to the reporting of financial results". The memorandum concludes its comments about the possible uses of the Venturex vehicle: "clearly there have been conflicting views in all quarters concerning the role of Econair". The memorandum then proposes that the company diversify its efforts by entering the ground reception service business with the hope of generating some profits for the Air Canada group.

The disquietude of the management of Air Canada concerning the uncertain status of the affiliate Venturex and its accounting and financial controls is illustrated by a memorandum directed by Sheehan, Controller of the airline, to Fournier, the Secretary of the airline, on June 17, 1974 which states:

> "We believe the policies for control over subsidiaries should contain the following:
>
> A. For such subsidiaries which are 100% owned by Air Canada, whether directly or indirectly:
>
> (1) Officers and employees should have the same obligations, responsibilities and accountabilities as they would have had at a similar level of responsibility in Air Canada, i.e. they should act as if the particular company was really an extension of a Branch of Air Canada and under no circumstances should an individual have more authority than he would have in a similar position in Air Canada.
>
> (2) The By-laws of the subsidiary should basically be patterned after those of Air Canada.
>
> (3) The financial control packages, whether they be control over cash flows, procedures relating to people, accounting services, tax obligations, etc. should be subject to the approved disciplines established by the Finance Branch. In the case where this is not possible, such as Airtransit, we recommend that Finance Branch have the same degree of responsibility as if it were in fact performing these functions.
>
> (4) Financial reports to the Board of Directors of Air Canada should be made at least every quarter. Financial reports should ideally be received by Air Canada each month but at least quarterly and the salary results should be presented to the Board of Directors of Air Canada at least each quarter.

(5) Budgets should be prepared annually and be presented in a manner expected by the Finance Branch prior to the beginning of each fiscal year.

B. For those subsidiaries which are not 100% owned by Air Canada or for those companies in which Air Canada has a major investment:

(1) Air Canada should have strong Finance Branch representation on the Board of Directors.

(2) Where possible, the Finance Branch should see that internal controls over cash flows, ownership assets, etc. are acceptable to Air Canada."

In the course of the Inquiry, Cochrane, Vice-President Finance, stated that items (1) and (3) had been implemented, item (4) would be implemented in the second and third quarters of 1975 and item (5) would be implemented in 1975. There was no evidence that items (1) or (2) had been implemented. The Commission was not furnished with any evidence in response to a letter directed to Air Canada on July 15 as to how the above-quoted letter from Sheehan had in fact been implemented in Venturex. This is not set out in criticism of the Finance Branch of Air Canada or the Secretary of the corporation, but simply an illustration of the difficulty which management hierarchy of Air Canada encountered in attempting to find the proper place in the scene for Venturex as regards financial, accounting and policy control, both prospective and retrospective.

It is perhaps illuminating that Lindsay, unlike other officers in the Air Canada headquarters at his level, does not assemble a reading file to be passed to any supervisor or superior and no one has ever asked for one. In Chapter 6 we deal at some length with the reading file of J. J. Smith and the supervision it affords his superiors.

Conclusions—Venturex

The role of a subsidiary within the Air Canada group is at best ill-defined and at worst has hardly ever been the subject of conscious attention. At some points in the testimony, Air Canada witnesses strongly asserted that Venturex is but a division of the company. At other points in the testimony, it is equally strongly asserted that Venturex is an independent body whose virtue and effectiveness varies directly with its remoteness from Air Canada. Spokesmen for this latter school of thought contended that the immunity of Venturex from the AFE regulations, the Air Canada By-law controls and the requirement of the Air Canada Board of Directors' approval for acquisitions, new ventures, etc., was not only justifiable but necessary. The Commission does not agree and neither did the Chairman in his testimony.

When Venturex was originally conceived, it is clear from the evidence of the Chairman and others, that it was to be used for the ABC business and hence subject to CTC scrutiny. The addition of other business ventures to the Venturex undertaking has complicated the accounting of Venturex with respect to these other undertakings. Whatever other conclusions we may

draw with respect to the ground reception business, which will be the subject of comment below, it is clear that the accounting solution adopted with respect to the losses incurred thereby, were designed to circumvent the CTC Regulations which prevent the conferring of a benefit on a charterer by an airline.

I. *Relationship with Air Canada*

The constitution and role of the Board of Directors of a subsidiary comes up for examination in the context of Venturex. If Venturex is to be cast as an independent corporation for the purpose of qualifying as a charterer for CTC purposes, then the Board of Venturex must operate independently of the Air Canada Board and the company must be regarded as an independent entity, *de facto* as well as *de jure*. Nowhere in the CTC Regulations is such independence required; indeed the Regulations do not prohibit a direct subsidiary being used by an air carrier as a charterer for ABC work and the evidence discloses that some air carriers have so utilized wholly owned subsidiaries. Indeed, if the doctrine of independence were applied vigorously, the subsidiary would sooner or later be in conflict with the airline's pattern in such areas as finance, accounting, personnel, facilities, etc.

The Venturex concept, in our view, was not well thought out after the initial phase when its need for the purpose of charter business was discerned. There is at least serious doubt that a CNR subsidiary is required for the charter business or for the Canaplan business. There does not appear to have been any serious effort to ascertain whether or not a Section 18 subsidiary of the Air Canada Act could have been incorporated. This method might have avoided problems of consolidation, control, acquisition of other companies, for example Touram, and the many uncertainties which have arisen by reason of the sister company relationship between Air Canada and Venturex. The disadvantage from the point of view of Air Canada management is, of course, the delay which Section 18 entails because of the need of an Order in Council for the incorporation of such a subsidiary, as well, of course, as the fact that the executive branch of government would have to be apprised of the nature of the new undertaking. On the other hand, Parliament may well have intended that the airline would be required to obtain subsidiaries by petition to the executive branch of government except in the limited situation authorized by Section 13(1)(e) of the Air Canada Act relating to the purchase of shares of airlines. This observation carries us to the edge of this Commission's mandate, restricted as it is, to the issues flowing from financial controls. The observation is made nonetheless to underline the difficulties of both the airline and the executive branch of the government in labouring in the 1970's with a statute of the 1930's.

II. *Venturex Board of Directors*

The Board of Directors being composed as it is of employees of Air Canada (except for one CNR employee) is, in the ordinary sense of the

term, a management controlled organization. The Venturex Board cannot, by definition, bring an independent mind to proposals from management. Furthermore, the detection by the Board of managerial impropriety is simply a case of alerting the wrong-doer of his wrong-doing. Additionally, the directors suffer from a conflict between their duties as Air Canada employees and Venturex directors if the company, in fact, is required to operate as a fully independent self-contained corporation.

Finally, whichever role Venturex plays, either as a division or an independent organization, there is an inadequacy of information placed before the Board of Venturex by management when decisions of far reaching importance are placed before it. This problem manifests itself in the record before this Commission both in the case of the Touram-Canaplan business and in the case of the Barbados transaction.

Again, admitting the present structure and *modus operandi* of Venturex as a legal and practical necessity (which the Commission does not admit), the efficacy of the present Board structure is open to very serious question. The Board has not met for about a year. The General Manager apparently reports to the President of the company, although there exists no record of written reports or minutes of meetings between these officers. If the Board is indeed a useful part of the company function, then that function is not now performed. The company's business discipline and control systems must be impaired by the failure of the Board to meet over such a long period of time.

III. *Lines of Communication with Air Canada*

Underlying the uncertainty surrounding the relationship between Venturex and Air Canada, and the Board of Directors of Venturex and Air Canada, is the question of the channel of communications of reports from Venturex to Air Canada.

First, there are no monthly or quarterly written reports on the operations of Venturex made to the Board of Air Canada. Secondly, the question as to whom reports should be made has not been refined to the point of operational efficiency. In the first year of its existence the General Manager of Venturex reported to the Secretary of the company, Vaughan, who was not a director. During the second year of its existence the General Manager appears to have had this channel of reporting as well as a responsibility to the President of Venturex, Menard. In the third year this problem may have been partly solved by the departure of Menard and the succession of Vaughan to the presidency of Venturex. This, however, leaves open the question as to whether the subsidiary should be reporting to the President of the airline, who is not an operating branch-head, or whether the General Manager of Venturex should be reporting to one of the staff branches of the airline, for example Marketing. This in turn raises a question as to whether the subsidiary is in fact tantamount to another branch of the airline, or is a hybrid of some staff and some operating branches of Air Canada. All of this goes to the

question of financial control of Venturex and its business operations by means of direct corporate control, corporate procedure, financial and audit supervision by the Finance Branch, and reporting supervision to the appropriate staff and operating agencies of Air Canada.

IV. (A) *Authority of the General Manager*

The Board of Directors of Venturex, by a resolution passed pursuant to Section 28 of By-law 1, authorized the General Manager to sign contracts on behalf of the company, subject to the qualification that where the contracts are with persons other than Air Canada, the Secretary or Assistant Secretary, or Treasurer or Assistant Treasurer of the company are required to sign as well. Only where the consideration is in excess of $150,000 does the resolution require the contract or document to be approved by the Board of Directors of Venturex. It is clear that Lindsay as General Manager of Venturex has a signing authority about the same as that of the Chairman of the Board of Air Canada. This is of particular importance when one remembers that Venturex does not have the Air Canada AFE system. The effect of this resolution is that Lindsay and Fournier may, without reference to any other authority, obligate the company to any liability not greater than $150,000. No amount of financial controls which are retrospective in operation will protect the company's assets from an error in judgment or impropriety by authorized signing authorities operating within the limit of their authorization.

The defence or explanation urged by Air Canada, at least at one stage of the hearing, was that this area of limited control was not significant because Air Canada provided all the funds required by Venturex and by simply withholding funds and allowing Venturex to become insolvent, the obligation was in fact reduced to zero. This position is neither practical nor moral and certainly is no basis for a financial control system of a corporation, particularly one which is state owned. Indeed, this proposition was completely disowned by the Chairman in his testimony before the Commission.

One cannot leave this conclusion in this area of the affiliate's operations without observing that there appears to be no formal analytical procedure within Venturex's operations leading to the exercise by the General Manager of his discretion to the level of $150,000. However capable and well-trained an incumbent may be, senior executive authority in the realm of business is traditionally outlined either in by-laws, policy studies or executive edict, such as Manual 300 in Air Canada, and is not left to individual discretion and capability.

(B) *Authority of the Board of Directors*

Related to the foregoing point is the fact that the Venturex Board of Directors can enter into any project of any magnitude that it wishes without any intervention by the management of Air Canada. The individual employees of Air Canada, who almost entirely make up the Board of Venturex, are thus

able to incur far greater obligations in their incidental role as Directors of Venturex than they can in their primary role as senior officers of Air Canada. Again, it is no answer to say that retrospective control systems will protect the assets of Air Canada, nor that Air Canada is adequately protected by reason of the fact that it supplies all the funds to Venturex and may simply withhold same. More fundamental is the fact that the highest guiding authority of the Air Canada family is its Board of Directors, but, with its present structure, Venturex removes this area of the Air Canada group operations from the policy, guidance and security of the Air Canada Board.

The Board of Venturex is comprised primarily of senior officers of Air Canada and does not include any representatives from the Board of Directors of Air Canada. Air Canada did not attempt to restrict the activities of the Board of Venturex in any way, at least until November 1974 when the committee relating to subsidiaries and affiliates was formed, despite the evidence that indicates that the substance of the relationship between Air Canada and Venturex is that of principal and agent.

V. (A) *Accounting for Losses in ABC Business*

The two proposals for the alleviation of the deficit in Venturex Limited (although it is not sure which proposal has been implemented because the accounting records of the two companies are not congruent) necessarily involve a serious question with reference to the applicable Air Carrier Regulations under the Aeronautics Act and the IATA Regulations, the latter of which are not directly within the province of the Commission. The Air Canada proposal to compensate Venturex by an offset in the form of a ticketing charge of $35 per seat filled by Venturex on an Air Canada aircraft would appear to be a "benefit" passing between an air carrier and a charterer contrary to Section 43.31 of the Regulations. The "service charge" proposed is in principle the same.

On the other hand, the practice adopted by Air Canada and Venturex of aborting an ABC when sales through Venturex do not attain a pre-determined level, would appear to represent two violations. First, the practice of Air Canada as a carrier releasing a charterer from a charter and all the attendant obligations arising therefrom would appear to be another form of benefit particularly because there was no evidence that the airline offered this benefit universally to charterers. Indeed, such a practice would render the need for a charter contract nugatory other than as a formalistic compliance with the CTC Regulations which require a written charter contract. Secondly, and more importantly, the carriage by the air carrier of an ABC passenger on a scheduled run at ABC fares, which the evidence indicates are substantially lower than a scheduled fare, is a violation of Sections 44(10), 45(1) and (2) of the CTC Regulations (as quoted above).

The airline took the position that Air Canada as an air carrier received the full fare for each such transferred passenger by charging the difference

between the ABC fare and the applicable excursion fare to Venturex Limited. It necessarily follows that it is the airline's position that the air carrier is then free to write off, waive, or otherwise cancel out the resulting inter-company charge by failing to recover it from the charterer, without violating the aforementioned Regulation.That may well turn out to be the case in some forum other than this Commission, but, for the purposes of this Commission, it must be concluded that the lack of subsidiary controls, which will be the subject of further comment elsewhere in this Report, manifests itself among other places at the point where Venturex, for reasons not entirely clear to the Commission, finds itself with an enormous deficit (but of no significance to the overall airline family) which it can only liquidate at the peril of violating the law. In short, there seems to have been no prospective application by the legal and accounting staff to the solution of the foreseeable problem before it arose. Perhaps the best illustration of this remoteness of control is that in 1975 we find the airline Board itself debating whether or not there is time even to correct the situation prospectively for the current fiscal year.

This subject should not be left without stating in the clearest possible terms that the strange regulatory approach to the charter issue was not in any way of Air Canada's making. It is this Alice in Wonderland framework of rules that has caused Air Canada to search frantically for matching Alice in Wonderland accounting. The only criticism to be offered within the terms of reference of this Commission is that the financial, accounting and legal problems here encountered were foreseeable, and indeed were articulated in a July 1973 memorandum set out earlier in this Chapter, but appropriate coordinated anticipatory staff work was not undertaken by the Finance Branch, the President's group, including Venturex staff, the Law Branch and the external auditors.

(B) *Origin of ABC Losses*

A great deal of the time in the Commission's hearing was taken in discussing why the charter fee charged by Air Canada to Venturex was so high as to throw Venturex into a loss. This must be considered in the light of the knowledge that while Venturex paid about $4 million in charter fees to Air Canada in 1974 other charterers contributed to Air Canada's ABC revenue in the sum of $5.9 million. Obviously these tour operators were carrying on business at a profit. If Air Canada were to reduce the charter fee to Venturex, then the same reduction would have to be made available to the other tour operators under CTC Regulations which would simply mean a reduction in cash revenues for the Air Canada group. If there were no other variables this would be sufficient to maintain the charter fees at the prevailing level.

Lindsay, however, advanced a further reason for wishing to maintain the high charter fee. By keeping profit margins in ABC to a minimum it discouraged other persons from entering the business and applying to Air

Canada for charters. The control of its business and clientele by Air Canada is, in Lindsay's view, greater if the ABC charters are operated by Venturex, and sold by it through travel agents, than if outside charterers became significant in any market serviced by Air Canada. There is, in his view, a vulnerability in Air Canada to the risk that the charterer might transfer his aircraft leasing to other airlines and leave Air Canada to redevelop the territory in question.

Air Canada's justification for the formation of a CNR subsidiary has been that it was necessary to establish a non-subsidiary (which we have dealt with above) and to ensure that it remained in a suitable financial position. Section 34.15(1)(d)(iv)(a) of the Air Canada Regulations requires that the charterer of an aircraft for ABC purposes be financially sound, which term is not defined. In fact, it should be noted that in 1974 Venturex obtained its licence, or charterer status from the CTC when it had a deficit of half a million dollars.

VI. (A) *Purpose of $145,000 AFE, December 18, 1974*

It is apparent, when all the evidence is considered, that this item relates to a contra payment by Air Canada to Venturex to reimburse Venturex for the cost of acquisition of Touram and for the start-up losses incurred by Venturex in inaugurating, at the behest of Air Canada, a ground reception service under the name Canaplan. The evidence does not suggest the conclusion that the amount of this AFE was reduced below $150,000 to avoid the approval of the Board of Directors of Air Canada. In fact, it is clear that as early as June 1974 the management of Venturex believed the losses in Canaplan, including the acquisition costs of Touram, would not exceed $143,000. It is not entirely incorrect to characterize the payment as was in fact done in the AFE, but in the ordinary run of commerce one would not consider Air Canada was acquiring a service from Venturex but rather was causing Venturex to get into a new line of business. The language in the AFE was adopted to enable the Marketing Branch to include the sum of $145,000 in a conveniently available "services" budget item and also to avoid putting this relatively small venture through the complex acquisition procedures which were followed in the acquisition of an interest in Allied Bermuda (to be discussed in Chapter 10).

(B) This AFE was signed by Pratte and Menard. Neither before nor after execution was it sent to Finance for its comments. This is contrary to the Chairman's testimony that by reason of his memorandum of January 1974, referred to in Chapter 5, AFE's over $50,000 required comments by the Finance Branch and were to be routed through Finance before coming to the Chairman for signature. This, he explained, was established as a routine in order to save time and to place all AFE's in this category on the same footing. That being so, the Chairman himself should have refrained from signing this AFE without the comments of the Finance Branch. In

fairness it should be observed that this AFE, which related to an inter-company transaction entirely, was only raised at the behest of the Finance Branch in Winnipeg. Nonetheless the AFE procedures require comments of the Finance Branch in Montreal before the AFE could be properly signed and such a review might have had a salutary effect on both the Marketing Branch and Venturex.

The object lesson associated with this deviation from the rule is that the Chairman has testified he had no awareness of Touram or its acquisition by Venturex on behalf of Air Canada until this Inquiry started. Neither this undertaking nor the acquisition of Touram were approved by senior management of Air Canada, or discussed by the Executive Committee of Air Canada, and certainly were not approved by the Board of Directors of Air Canada.

VII. *Venturex Accounting—Generally*

With respect to disbursements in the ordinary course of business, (and without reference to losses incurred in respect of which disbursements may be made) the control in Venturex is as strong or stronger than that of Air Canada.

All the expenses of Venturex are paid through the regular Air Canada disbursement system and charged to a receivable account in the books of Air Canada. The revenues of Venturex are credited to this account. Periodically Air Canada supplies the controller of Venturex with a listing reflecting all the transactions in their account with Venturex. The controller uses this transaction listing to identify the various revenues and expenses which are then recorded by journal entry in the accounts of Venturex Limited. Air Canada only pays invoices of Venturex that are submitted through, and bear the approval of, the controller of Venturex. Invoices received by the various managers of Venturex operations are approved by these managers and forwarded to the controller. In the event that the controller is not familiar with the nature of a given expense, he will ask for approval by the General Manager, Lindsay.

VIII. *Summation*

The whole concept of Venturex has been poorly thought out and serves to weaken the Air Canada control environment.

Venturex was set up to allow Air Canada to do something indirectly that it could not do directly; that is operate ABC charters. This has led to the following incompatible situations:

(a) Air Canada has set charter prices designed at least in part to discourage independent ABC operators (other than tour operators for established groups) from chartering Air Canada aircraft. These high prices have contributed to the operating losses of Venturex.

(b) CTC Regulations preclude Air Canada from conferring benefits on a tour operator. As a result, Air Canada is precluded from making

contributions to the surplus of Venturex to wipe out operating losses or to transfer them into Air Canada where they rightly belong.

(c) Venturex operated on the belief that it was required to show financial solvency in order to be registered as a tour operator with the CTC.

The result of the above situations was that for the year 1973, Air Canada provided an allowance for doubtful accounts against its net receivable from Venturex and thus reflected as bad debt expenses the net operating result of the ABC charter business. Subsequently, it was recognized that while this method of accounting served to reflect the net results of the operations within the accounts of Air Canada, it did little to solve the problem of Venturex vis-à-vis the CTC. Accordingly, in 1974 Air Canada reversed its previous bad debt treatment and set up by journal entry a ticketing expense approximating Venturex's losses in the charter business in the two years 1973 and 1974. The amount of the charge was credited as an offset to Air Canada's receivable from Venturex.

The ticketing charge is an obvious fabrication, forced upon Air Canada by the operation of the CTC Regulations, and in fact, invoices prepared by Venturex covering this ticketing charge have been rejected by the Finance Branch of Air Canada to date. It is interesting to note that the confusion in this area is further heightened by the fact that Air Canada's Board has approved the accounting treatment within Venturex of these proposed charges on behalf of Air Canada although it is unclear what is meant by their approval of the accounting treatment of the transactions within Venturex.

The convenient misdescription in the AFE with reference to the Canaplan transaction (that is in the explanation in the AFE for $145,000) is made only because this business was placed in the ABC vehicle, Venturex. If this were carried out in Air Canada or by another subsidiary, the intercompany accounting would not require such intellectual gymnastics. The second and less satisfactory rationale for the issuance of this AFE appears to have been to give the transaction the appearance of a contract for services when in reality it was for the purpose of reimbursing Venturex for Canaplan losses and for a share acquisition, however justified that acquisition may have been. This practice of fabricating transactions in order to obscure the true nature of the principal agent relationship of Air Canada and Venturex, and the true nature of the underlying transaction, can only serve to weaken the control environment.

IX. *Fiscal Reports*

By reason of the fact that Venturex Limited is in law only a subsidiary of Canadian National Railways and is not an operating subsidiary of that group, the auditors of the CNR do not consolidate the Venturex accounts when reporting to Parliament. The same auditors did not consolidate the accounts of Venturex into Air Canada's accounts because it is not a subsidiary. The result of this conduct is that Venturex Limited's accounts do not

reach Parliament in any form, and certainly not in an understandable form as a report of an identified legal entity, although the net operating result is reflected in the accounts of Air Canada as part of general and administration expenses. On the other hand, if Section 18 of the Air Canada Act were invoked and the charter subsidiary incorporated pursuant thereto, then the accounts of that subsidiary would be consolidated into the accounts of Air Canada when delivered pursuant to the statute to the Minister of Transport, and thence to Parliament. It may well be that no direct harm can, in the fiscal years with which we are concerned, be traced to this anomalous practice, but on the other hand the amount of the Venturex losses in 1973 and 1974 is a very significant sum relative to the loss of Air Canada reported in the year ending December 31, 1974, namely $9,225,000. In any event, it is further evidence of the need for a cohesive and sound relationship between the airline and all the other legal entities which are carrying on part of its undertaking or related undertakings so that fiscal reports are complete and communicate information to persons not only employed in the Finance and Audit Branches of the airline itself but to the Minister and to Parliament, the representatives of the ultimate owners. There is no doubt that the final fiscal responsibility for Air Canada resides in Parliament when all other resources fail and therefore Parliament is entitled to the fullest and clearest financial reporting.

Chapter 9

CONFLICTS OF INTEREST

Purchase of a Villa in Sunset Crest Development by Mr. Yves Menard

Since he joined Air Canada in 1970, Mr. Menard had been Vice-President Marketing. He had been a Director of Venturex since January 15, 1973 and was President of that Company from January 15, 1973 to January 24, 1974. He was Mr. Lezama's superior when Mr. Lezama, on Menard's instructions, conducted negotiations with Sunset Crest Rentals Limited in March 1973 which led up to the leasing by Air Canada from Sunset Crest Rentals Limited of 25 villas for 17 weeks during the 1973/74 winter season under the terms of a lease executed July 26, 1973. It was Menard who instructed Lindsay in March of 1973 to negotiate with Sunset Crest Rentals Limited for the leasing by Venturex of 103 condominium units. An agreement in principle was reached in April 1973 which was approved of by the Board of Directors of Venturex on May 10, 1973 with the actual lease documents signed September 4, 1973. Both of these matters are dealt with at some length in Chapter 7 of this Report.

It had been Menard's habit, prior to 1973, to take winter vacations in Barbados, particularly following the purchase in 1969 by his brother-in-law, Mr. Jean-Marc Audet, of a villa in the Sunset Crest development. As a result of this purchase and of his many visits to the development, Menard became acquainted with Alfred Laforet, a part owner of Sunset Crest Limited, the Barbadian Company which was managing the development and the sole owner of Sunset Crest Rentals Limited which was responsible for leasing villas and condominiums while the owners of these units were not in residence.

Laforet and Menard had a series of discussions dating back to September of 1972, and perhaps prior to that date, relating to the possible leasing by Air Canada of accommodation in the development. As a result of these discussions, and through negotiations conducted not only by Mr. Lezama and Mr. Lindsay, but also by Mr. J. J. Smith, Air Canada, by December 1974, was leasing from Sunset Crest Rentals Limited 104 condominium units, 25 villas and 72 apartments.

In May of 1973 after the Venturex Board of Directors had approved of the leasing of 103 condominiums, but before either those lease documents or the lease of the 25 villas was executed, Menard went to Barbados and entered

into negotiations with Sunset Crest Limited for the purchase of a villa. Mr. Laforet was not involved in these negotiations; all were conducted with Mrs. Thora Hassell, then Sales Manager for Sunset Crest Limited. The contract was signed about May 19, 1973, in Barbados by the vendor, and by Mr. Menard in Montreal on June 11, 1973.

There were then in the course of construction some four villas, which were being built on speculation by Sunset Crest Limited. Menard chose the three bedroom villa being constructed on lot 188 because of its close proximity to a park and to the villa owned by his brother-in-law, Mr. Audet, on lot 182. The terms of purchase agreed upon between Mr. Menard and Sunset Crest Limited were precisely the same terms on which any other buyer could have acquired this villa, both as to price and terms. The total purchase price for the completed villa was $82,281, Eastern Caribbean dollars (about $41,000 Canadian), with a down payment payable on signing of the purchase agreement of $8,228, a cash payment required on completion of $10,053 and a first mortgage back to the vendor of $64,000 calling for monthly mortgage payments of $776.54 and bearing interest at 8% per annum. If the buyer wished to pay any larger amount of cash, he was entitled to receive a discount of 16% of any reduction in the mortgage below $64,000. (All amounts are expressed in Eastern Caribbean dollars.)

A series of documents were prepared on standard Sunset Crest Limited printed forms in relation to Mr. Menard's purchase. These were:

(a) An agreement with Sunset Crest Limited dated May 19, 1973 providing for the purchase of the land on which the villa was being constructed. The purchase price of the land was $26,404, payable $6,000 on signing of the agreement and $20,404 payable when Menard was handed a properly executed and stamped Deed of Assurance for the lot. This agreement required Mr. Menard to pay $1,500 for membership in the Sunset Crest Club on the Development, half on signing the agreement and the balance on completion of the purchase;

(b) A contract with Sunset Crest Limited dated May 21, 1973 in connection with construction of the villa. The construction cost was $54,377 payable $1,478 on execution of the agreement; $10,053 on the day when possession of the house was handed over to Menard; and $42,846 within 15 days from the date a certificate was issued by the Chief Town Planner that the dwelling house had been constructed in accordance with all planning requirements and regulations;

(c) A mortgage agreement with Sunset Crest Limited dated May 21, 1973 under the terms of which Sunset Crest Limited agreed to make $64,000 available to Menard on the security of a first mortgage containing the terms and conditions previously described in this chapter;

(d) Specifications dated May 28, 1973 to be followed in completing construction of the villa. The specifications agreed upon by Menard involved certain additions and improvements to the standard villa specifications. These added $5,390 to the standard cost of the lot and villa.

The three agreements described in (a), (b) and (c) above were all signed on behalf of Sunset Crest Limited in Barbados. The specifications referred to in (d) above are unsigned. All documents were taken back to Montreal by Menard and signed by him in his secretary's presence. The signed copies were mailed to Barbados, presumably on or about June 11, 1973, on which date Menard arranged with the Bank of Montreal for the purchase of $8,228 Eastern Caribbean dollars and their transfer to Barclay's Bank in Barbados for the account of Sunset Crest Limited. This amount was the down payment required under the terms of the purchase arrangements.

On July 25, 1973 Menard retained as his solicitor Mr. Cyril Brooks of Yearwood and Boyce in Bridgetown, Barbados. Mr. Brooks had acted as Mr. Audet's solicitor in connection with Mr. Audet's purchase in 1969.

In September 1973, Mr. Menard again visited Barbados and during his stay on the Island, purchased furniture for the villa which was then nearing completion. He was given a standard printed form of agreement dated September 12, 1973 with Sunset Crest Rentals Limited which provided that, commencing December 1, 1973, Sunset Crest Rentals Limited was to use its best efforts to secure suitable tenants for the villa when it was not occupied by the owner and which specified that Sunset Crest Rentals Limited would provide certain management, bookkeeping, housekeeping and maintenance services in relation to the villa. Menard on his part, as consideration for these services, was to pay Sunset Crest Rentals Limited a management fee calculated as a percentage of the gross rents received from villa rentals. Menard later signed this agreement in Montreal and returned the executed copies to Barbados. During the visit, Menard opened an account with a branch of the Canadian Imperial Bank of Commerce located in one of the two shopping centres on the Sunset Crest Development.

The certificate of the Chief Town Planner required as a condition of closing the purchase, was issued on October 17, 1973. On October 24, 1973, the solicitors for Sunset Crest Limited forwarded to Mr. Menard's solicitors in Barbados a form of conveyance for his execution. This conveyance was delivered to Menard for execution by his solicitors in December of 1973, when Menard travelled to Barbados to take possession of the then completed villa. He did not then sign the conveyance, but paid Sunset Crest Limited the $10,033 due under the terms of his purchase arrangements at the time possession was taken (the documents actually called for a payment at that time of $10,053), and $5,350 in respect of the extras involved in his villa specifications (the actual cost of these extras was $5,390). As a result of these payments, Menard still owed to Sunset Crest Limited the amount of $64,060, which the parties intended would be paid when the $64,000 mortgage advance was made to Menard by Sunset Crest Limited.

Menard executed the conveyance in Montreal and returned it to his solicitors with a letter of January 21, 1974 in which he stated in part as follows:

> "I am enclosing herewith signed copy of the conveyance documents which you had given us to read.
> I have not heard anything from Sunset Crest or their lawyers concerning the mortgage documents, conditions, etc. I would appreciate it if you could look after this for me."

The Deed of Conveyance was not properly executed by Menard according to the requirements of Barbadian real estate law and hence it was not turned over by Menard's solicitors to the solicitors for Sunset Crest Limited. Neither was it returned to Menard by his solicitors for proper execution. Meanwhile, Menard had taken possession in mid December 1973 and spent the Christmas holidays in the villa.

On February 14, 1974 the Barbados Shipping & Trading Co. Limited bought out Mr. Laforet's interest in Sunset Crest Limited. The funds which Sunset Crest Limited had been using to make mortgage advances to villa purchasers had always been obtained through the Barbados Shipping & Trading Co. Limited by way of borrowings from Barclay's Bank. At about this time the rate of interest payable on such borrowings ranged between 10% and 11% per annum and there was no eagerness on the part of either Sunset Crest Limited or the Barbados Shipping & Trading Co. Limited to borrow at these interest rates in order to lend out, in turn, to villa buyers on mortgages bearing an interest rate of 8% per annum. Consequently no pressure was applied on Menard to conclude his purchase since such would have required a mortgage advance of $64,000 under the above circumstances. Menard, on his part, did nothing to urge completion of the transaction but stated in his evidence that he was accumulating the monies required to meet the monthly mortgage payments which, he was assuming, would have to be brought to a current position when closing actually took place. He acted in this respect in the same way as the purchasers of villas on lots 179 and 192. According to the records of Sunset Crest Limited, which we examined, those purchasers owed Sunset Crest Limited the same balance of their purchase prices on February 14, 1975 as they owed on January 31, 1974. In those records opposite the liability of Mr. Menard is the handwritten note "MTGE agreed for $64,000 per pipeline dist. but no funds available". A similar note appears opposite the indebtedness of the buyer of lot 208 which reads "Mortgage agreed but no funds available".

After Mr. Menard's villa ownership was disclosed in newspaper articles in the Montreal Gazette on March 1, 1975, which appeared in Barbadian newspapers during the first week of March 1975, Menard received from his solicitors a letter dated March 18, 1975, which contains the following sentence:

> "As a result of the recent publicity given this matter in the Canadian and Barbadian newspapers, it has now been realized by ourselves, the solicitors for Sunset Crest Limited and the solicitors for Barbados Shipping & Trading Co. Limited that this matter had not been completed."

The letter sets out the amounts which Menard would have to pay to complete the purchase by the end of March, 1975 as follows:

"Short payment on the total cost as per paragraph 1	$ 60.00
Arrears of principal to March 1975	5,500.21
Interest on $64,060 for 15 months @ 8%	6,406.00
Amount due to complete matter	$11,966.21"

Menard replied by letter of April 1, 1975 confirming that he was in a position to pay this amount and stating that he would be in Barbados from April 18 through April 28 to settle the matter. It was, in fact, completed on April 24, 1975.

When Menard was not in Barbados, Sunset Crest Rentals Limited in fact on occasions rented his villa to vacationers. It was not one of the 25 villas leased to Air Canada either in the winter of 1974 or the winter of 1975.

One of the services which Sunset Crest Rentals Limited undertook to provide to villa owners in the service agreement executed between villa owners and Sunset Crest Limited (in Mr. Menard's case, the agreement of September 12, 1973) was the preparation and filing of income tax returns with the Department of Inland Revenue, Barbados, in respect of rental income received from the rental of the villas and expenses incurred in connection therewith. The return for Mr. Menard which was filed by Sunset Crest Rentals Limited for the 1974 calendar year shows that Menard received rental income during that year in the aggregate amount of $8,480 Eastern Caribbean dollars. That return also shows that after all expenses for items such as taxes, repairs, telephone, electricity, commissions, maid service, garden maintenance and provision for the mortgage interest which was accruing on the unpaid balance of the villa purchase price, Menard suffered a net loss for the villa in 1974 in the amount of $1,763.88.

Menard made no attempt to hide the fact that he had purchased a villa in the Sunset Crest Development from anyone in Air Canada. Indeed, the evidence is quite to the contrary. Most officers in Air Canada, certainly at the senior level, were told of his purchase, some as early as June of 1973 and others at varying times in the period prior to April 30, 1974 when the Air Canada Board of Directors approved of the renewal of the condominium and villa leases and the lease of the 72 apartments. On occasion, when neither Menard nor members of his family were occupying the villa, he offered it to his friends. One occupant was Mr. Pratte, the Chairman of the Board of Air Canada who, accompanied by his two sons, spent ten days to two weeks in the villa in the early part of January 1974.

Menard testified at the Inquiry in relation to his villa ownership, as did Mr. Laforet and Mr. Lynch, the Deputy Chairman of the Barbados Shipping & Trading Co. Limited. We are satisfied from their evidence that Menard received no special concessions whatsoever in relation to his purchase. He paid the same price as any other purchaser would have paid; he received the same mortgage terms as would have been available to any other purchaser; and he was charged the going rate for the extras which he ordered. He was not

pressured to conclude the purchase but neither were the purchasers of other villas who found themselves in the same position. His property has never been leased to Air Canada or to any vacationer utilizing Air Canada's Sun Living Program. In fact, the vendor was in breach under the mortgage agreement when the mortgage money was not advanced on the completion of the building so as to permit the purchaser, Mr. Menard, to close the land purchase and the construction agreements. Menard's lawyers did not advise him of his rights in this respect. These lawyers, it should be observed, exhibited little efficiency or desire in the closing of the purchase transaction. In fact, no attempt was made to complete the transaction in accordance with the terms of the several agreements. The easy-going pace of this transaction was said to be the normal custom on the Island.

Some witnesses who testified at the Inquiry were critical of Menard's actions in failing to apply pressure on Sunset Crest Limited to complete his mortgage financing and permit the purchase to be concluded. Others felt that at a minimum he should have applied rental receipts against the balance of his indebtedness owing to Sunset Crest Limited. These criticisms may not be justified. Menard had made all payments required under the terms of his contracts as and when the same became due. While he might have exhibited more anxiety to conclude the matter and been more forceful in insisting upon the mortgage advance, his failure to do so was not unusual in the case of a busy executive otherwise occupied many miles away. Since he did not do so, one could not expect that he would make payments of principal or interest whether out of rental income received or funds available from other sources until the mortgage arrangements were finalized.

None of the witnesses who testified at the Inquiry felt that there was any impropriety in Menard's purchase of the villa as such, despite the fact that the villa was located in a development which was a major element of Air Canada's Sun Living Program in Barbados. So far as these witnesses were concerned, the first thought of possible impropriety arose in their minds only after they were made aware that the purchase had not been finalized, that is, the mortgage was not advanced and that rentals received in the interim had not been applied to reduce the balance owing.

If this whole matter involves any impropriety or insensitivity on Menard's part or places him in a position where he had an actual conflict of interest or the appearance of such a conflict, surely that impropriety, insensitivity or actual or potential conflict of interest is the result of his entering into the purchase agreements in May of 1973 and not the result of the events subsequent to that date in relation to the conclusion of the transaction, all of which, we find, have been adequately explained. It is puzzling that no one in Air Canada who was aware of Menard's villa ownership recognized this as a potential conflict of interest situation. Not having recognized it as such, of course, none of them raised the matter for discussion with Menard. The issue of actual or potential conflict of interest arose for the first time in the minds of the Air Canada senior executive officers, according to the testimony of Messrs. Pratte, Fournier, Vaughan and Taylor, during the last

week of February 1975 when information was received that the Montreal Gazette was planning to publish an article on the subject.

Because Government-owned corporations are much more in the public eye than commercial corporations and operate, as some witnesses testified, "in a fish bowl atmosphere", there may be an even higher standard of conduct required of their employees, against which the propriety or impropriety of their actions must be tested, than in the case of independently owned business enterprises. It is imperative, of course, that employees do not become involved in any situation which places them in a position of actual conflict of interest. It is equally important, however, that they avoid any appearance of a conflict of interest where no actual conflict of interest exists. While all of this applies to any employee, the standard of compliance must be higher in the case of senior management where the exposure to conflicting interest is greater. The corporate policy and guidelines on business conduct adopted by the Board of Directors of Air Canada on May 27, 1975 recognizes this in its policy statement which reads in part as follows:

> "persons. . .in positions of responsibility in Air Canada are expected to arrange their private affairs in a manner that will prevent conflicts of interest from arising or from appearing to arise. They should not place themselves in a position where they are under obligation to any person who might benefit from special consideration or favour on their part or seek in any way to gain special treatment from them. Equally, employees should not have a pecuniary or other interest that could conflict or appear to conflict in any manner with the discharge of their duties and responsibilities."

With a single exception, the question of actual conflict of interest arising out of Menard's villa purchase was not raised by any senior Air Canada executive until the last week of February 1975; the question of an appearance of conflict of interest because of such purchase appears never to have occurred to any such executive during the same period.

Mr. Vaughan disclosed to the Commission that, at some unspecified time in 1974, he brought up with Menard the ownership of his house in Barbados and inquired as to whether "it was clean", that is, whether Mr. Menard received a reduced price or any special arrangement. Upon being assured by Mr. Menard that it was "clean", he did not pursue the matter further. Menard had no recollection of this discussion with Vaughan.

As noted earlier, the Chairman of Air Canada stayed in Menard's villa in January 1974. At that point in time, Mr. Pratte testified that he was unaware of the precise nature of the contractual relationship between Air Canada and Sunset Crest Limited. He stated that, insofar as he was concerned, Air Canada was promoting the Sunset Crest properties as part of its Sun Living program pursuant to which accommodations were blocked in certain resorts in the Caribbean. Under this type of arrangement, the airline pays a holding fee to the resort owner to hold space subject to a right of cancellation. According to his evidence, Pratte became aware of Air Canada's commitment to Sunset Crest only a few weeks prior to the

April 30, 1974 Board meeting. He stated to the Commission that no conflict of interest issue arose in his mind even at that time since he had no reason to believe that Menard had purchased his house otherwise than for cash. This in itself, of course, would not have placed Menard in a position where he could properly purchase a house from a company from which his officials were at the same time renting a considerable amount of property.

During the weekend of February 22, 1975, information was received by Mr. Claude Taylor, Vice-President, Public Affairs of Air Canada that the Montreal Gazette was planning to publish a story alleging a conflict of interest between the airline and one of its vice-presidents in respect of the latter's ownership of a villa in Barbados. Although the name of the Vice-President was not disclosed, Mr. Taylor immediately concluded that it could only be Menard. Taylor testified that he attempted unsuccessfully to reach the Chairman and convey this information to him during the weekend. However, Taylor did reach Cochrane, Vice-President, Finance on Sunday, February 23 and they agreed to alert Mr. Phillip Aspinall, the partner in charge of the Air Canada audit at the firm of Coopers & Lybrand. Mr. Aspinall was asked by Cochrane to begin an investigation of Menard's title to his Barbados villa forthwith. It is interesting to note that this was done without awaiting the Chairman's approval even though the person involved was the equivalent of a Group Vice-President and senior to either Taylor or Cochrane. This efficient and speedy reaction is in contrast to the manner of investigation in the McGregor matter as described in Chapter 6 above, even after the villa investigation was instituted.

On Monday, February 24, immediately after the daily operations' meeting, Taylor communicated to Mr. Pratte the information conveyed to him during the weekend concerning Menard's house in Barbados and reported that the external auditors were inquiring into the situation. According to Taylor's evidence, which is corroborated by Menard, the latter attended this meeting in the Chairman's office and disclosed that the mortgage on his Barbados house had never been processed and that no mortgage payment had ever been made, but that this was not unusual in Barbados and there was nothing improper with the transaction. Pratte's evidence on this crucial point is that Menard assured him during that Monday morning meeting there was nothing improper about the purchase of his villa and offered to show him his title deeds but at no time disclosed that the mortgage had not been processed and no mortgage payments made. According to Pratte's testimony this pertinent information only reached him two days later via Taylor while Pratte was in Winnipeg.

The regular Board meeting of the Air Canada directors was held on Tuesday, February 25. No mention was made by the Chairman to the directors of the Menard matter. During that afternoon, the two reporters who were working on the Menard story sought and obtained a meeting with Mr. Menard in the latter's office. This meeting was attended by Mr. Kendal Windeyer and Mr. William Fox of the Montreal Gazette as well as Mr. Grey who worked in Mr. Taylor's office. The reporters who had previously been in Barbados confronted Menard with the information they had gathered concerning his title to

the villa and he replied to their questions honestly and thoroughly. Menard even offered to show the reporters his title deeds, which were at home, but they agreed rather to meet again in his office the following morning to peruse the documents.

Pratte recalls being informed at the end of Tuesday that Menard's meeting with the reporters had gone off very well and that it was unlikely that the article would be published.

As previously scheduled, Pratte left for Winnipeg early Wednesday morning, February 26. When he arrived in the airport in Winnipeg, he had an urgent message to contact Taylor in Ottawa. According to his evidence before the Commission, he then learned for the first time that the mortgage on Menard's Barbados villa had never been processed and that this information had been disclosed to the two reporters by Menard at their second meeting in Montreal that morning.

Pratte stated that for him the matter had then become a serious one and he forthwith cancelled his plans to travel to Vancouver later on that day and returned to Montreal. While in Winnipeg, Pratte received a telephone call from the Honourable Jean Marchand in the course of which the Minister, according to Pratte's evidence, expressed the view that "Menard had to go". From Winnipeg, the Chairman telephoned Cochrane in Montreal and asked him to arrange a meeting the following day with Mr. Aspinall. Pratte also spoke to Menard from Winnipeg and told him that he now considered the matter a very serious one. Menard offered to resign but was told by the Chairman to await the report from the external auditors before taking any final decision.

When Pratte arrived in Montreal on Wednesday evening he had a lengthy meeting at his home with Mr. Chartrand, Vice-President Personnel and Organization Development, to discuss the implications of a resignation by Menard in relation to airline personnel.

As soon as he arrived in his office on Thursday morning February 27, Pratte had a meeting with Mr. Aspinall. The latter reported to the Chairman on the result of his investigation to date including a long meeting the previous day with Menard in the course of which he had been handed the title deeds and other pertinent documents. Pratte considered the memorandum submitted by Aspinall as well as the relevant documents concerning the Menard villa. Armed with this information, he consulted with Mr. Vaughan who was then vacationing in Barbados (he did not stay in the Menard villa or in the Sunset Crest property), as well as with all other members of the Executive Committee. He telephoned all the directors to obtain their advice and counsel; he had lunch on Thursday with one of the directors, Mr. Pierre DesMarais who happened to be a personal friend of Mr. Menard. He also sought the advice of trusted friends and associates not connected with Air Canada. Pratte told the Commission that he agonized over this decision which he said " . . . was one of the most difficult . . . " he had ever taken. It is curious that despite the obvious legal considerations, the Air Canada Law Department was not consulted or directed to participate in this investigation.

Late on Thursday, Pratte reached Menard at home and asked him to come back to the office for a meeting. During the two-hour meeting which followed, Pratte reviewed with Menard the only two alternatives: to resign or not to resign. They agreed that the only practical decision open to Menard in the circumstances was to resign. At the conclusion of that Thursday evening meeting, to all intents and purposes, Menard had resigned from Air Canada. Although, according to Pratte and Menard, it was not a factor which influenced their decision, it should be pointed out that Pratte had then been told by Mr. Marchand, then the Minister of Transport, that he would not have Ottawa's support if he decided to stand by his Vice-President, Marketing.

Mr. Pratte was asked to explain why he felt that Mr. Menard had no alternative but to resign. The Chairman told the Commission that, in his view, Mr. Menard had made a mistake by contracting to purchase his home in Barbados from the same concern with which Venturex was negotiating concurrently. He further was of the opinion that Menard had erred in not pressing his vendor to process the mortgage during more than 20 months. By allowing himself to remain in that position during such a long period of time, he created a "continuing conflict of interest situation".

The regular weekly Friday meeting of Air Canada's Executive Committee scheduled for February 28 was cancelled. However, the members of the Committee did hold an unminuted meeting attended by Mr. Menard. While opinions continued to be sought and views continued to be expressed, Menard communicated to his colleagues his decision to resign. Because of continuing doubts expressed by one director about the advisability of accepting Menard's resignation, the Chairman convened an informal meeting of those directors who could be in Montreal for 4:00 p.m. that afternoon. Five directors attended the meeting chaired by Mr. Pratte and the decision was taken not to press for the recall of Menard's resignation. Mr. Menard addressed his letter of resignation to Mr. Pratte on February 28 and Pratte accepted the resignation formally in a letter dated March 1.

The Montreal Gazette in a front page article published on Saturday, March 1, 1975, announced Menard's resignation and linked it to his ownership of the Barbados villa; the article reflected some of the explanations provided by Menard to the reporters earlier that week. Pratte stated that he and his colleagues had known since Wednesday of that week that the article would be published. This evidence was contradicted by Mr. Windeyer who testified that the resignation of Menard on Friday had triggered the publication of the article, and that until that event, the article had not been scheduled for publication but was still under consideration.

It is unfortunate that the Barbados villa by itself cost Mr. Menard his position as Vice-President—Marketing of Air Canada. He was an innocent, if insensitive, victim of circumstances. He did not recognize the impropriety of purchasing a villa in the Sunset Crest Development because of the appearance of conflict of interest which this purchase created. He apparently did not recognize the higher standards of conduct against which the actions of

executives in Government owned corporations have to be tested. However, in these respects he was not different from any other senior executive in Air Canada who was aware of his villa ownership. If he was culpable, they were equally so.

Air Canada's lease commitments for Sunset Crest Development properties were in excess of $500,000 for the 1974 calendar year, in excess of $1,000,000 for the 1975 calendar year and had the leases been renewed in accordance with their terms, would have been more than $1,000,000 for the 1976 calendar year. Having regard to the magnitude of these obligations, it could be expected that some responsible senior executive, or indeed director, of Air Canada would have suggested to Menard certainly no later than April 30, 1974, on which date renewal of the Sunset Crest leases was approved of by the Board of Directors, the advisability of selling his villa in order that any appearance of conflict of interest during the lease term would be totally eliminated. No such suggestion was ever made to Menard and the failure to do so, makes those executives or directors who should have done so, equally responsible with Menard for the consequence of his continued ownership.

From the beginning of the villa transaction, personnel in the Head Office of Air Canada were aware of the Menard villa. From January 1974 onwards many such persons stayed in or visited the villa which is, of course, physically situated within the Sunset Crest development. The facts of the conflict of position were there to be seen. For those persons who also were engaged in the Sunset Crest leasing negotiations or renewal negotiations, the sensitivity of the position of Mr. Menard as Vice-President, Marketing, must have been both real and obvious.

In January 1974, a Director of Air Canada enquired of the Chairman, under circumstances detailed in Chapter 7, about Air Canada's interest in accommodation in Barbados. On being satisfied by Menard's statement that Air Canada had not acquired any property in Barbados, the Chairman pursued the matter no further. He testified that he assumed the Sunset Crest promotion was just another part of the "blocked accommodation" of the Sun Living program. As mentioned earlier, the blocking of accommodation on any scale involves the payment of stand-by or holding fees by the airline to the owner of the accommodation, in this case the developers of the Sunset Crest project. The conflict in the Vice-President's position is the same in principle in either case, the difference being only one of degree.

All of this contact with the Menard villa and his role in the Barbados negotiations did not cause any executive reaction in the airline. The turning point, we are told, came when it was learned that Menard had not paid cash for the villa. It is difficult to understand why this new and serious aspect was not answered by the auditor's investigation and later by the investigation of Mr. P. Lamontagne, a solicitor retained to investigate the purchase of the villa by Menard, who prepared a report thereon dated the 7th of April, 1975. These investigations demonstrated quite clearly that Menard paid the same price and in the same manner as other purchasers of like villas in the same development from the same vendor. If the only element of a business

conflict was the method of payment, with which premise the Commission does not agree, the resignation need not have been accepted on the basis of the explanation revealed by the documentation which Menard volunteered and which later was proved out as accurate.

Additionally, there was a complete waiver or surrender of any right of complaint by the employer. The employer's right to react to the failure by Menard to comply with the customary rules of conduct of executive employees in areas where the employer's interests are put at risk or apparent risk, seems to have dissolved in the acceptance by the governing echelons of the company over the period from January 1974 to February 1975 of Menard's ownership of a villa in the Sunset Crest development. A commonly understood fact in 1973 and 1974, suddenly in 1975 took on such added significance that the employee had to go. In fairness to Menard, we must view such a severe consequence on the limited issue of conflict of interest, critically.

But two matters are of much greater concern to the Commission:

(a) The crash of realization of Menard's apparently serious involvement in Barbados did not evoke any executive response or reaction from the airline's outside auditor to Menard's concurrent involvement in the McGregor matter. This is discussed more fully in Chapter 6.

(b) There was a high level of awareness by April 30, 1974 in the Chairman, the members of the Executive Committee and others in senior management positions, of the involvement of Menard in a Barbados villa, but no discussion of the possibility of a conflict of interest was entered into at the meeting of the Board of Directors on April 30, 1974, at which the renewal of the Barbados leases were approved. All this is the more remarkable because of the fact that neither the Marketing Branch nor the President's group responsible for Venturex had brought the matter forward for Board approval before the leases were signed in the first instance in 1973.

The Menard villa, in itself an act of impropriety, was of greater importance as a signal of further problems below the surface, but no one in the airline headquarters bothered to look at or, perhaps in some cases, to report upon them to their colleagues.

Mr. Menard's association with Herdt & Charton Limitée

Yves Menard testified before the Commission that during the whole time that he was employed by Air Canada, he had had the use of an automobile provided to him by Herdt & Charton Limitée, his employers for five years prior to May 1970 when he joined Air Canada. Herdt & Charton act as agents in Quebec for the sale of wine, toileteries, fine foods and the like from France and other countries.

Upon being questioned on his relationship with Herdt & Charton after May 1970 when he joined Air Canada, Menard testified that he served as "counsel" to that firm throughout the term of his employment with Air Canada. He acknowledged that on two occasions he introduced Mr. Jean

Charton, the President of the firm, to Mr. John McGill and Mr. Bryce Buchanan, successively Directors of In-Flight Operations for Air Canada, who were responsible for the purchase of wines for the airline. According to his testimony, when he introduced Mr. Charton, he declared to McGill and subsequently to Buchanan that he was a director of Charton's firm; erroneously, Menard believed this to be the case; in fact, he was not.

Menard stated that he did nothing further in order to promote the interests of Herdt & Charton Limitée with Air Canada. However, following one of these meetings, Herdt & Charton Limitée bid on and were awarded a contract for the supply of a certain brand of wine to Air Canada. There is no reason to believe that there was anything irregular or improper about the awarding of this contract to Herdt & Charton Limitée or that Menard personally benefitted from it.

In February 1972, Lelarge Inc., an importer of fine food became a subsidiary of Herdt & Charton. Yves Menard accepted the invitation of Mr. Charton to become a director of this company without asking for the approval of Mr. Pratte. It should be pointed out that Menard did not participate in the profits of Lelarge Inc. but merely owned a qualifying share to accommodate his friend, Mr. Charton.

According to the Chairman's evidence, Mr. Pratte did not know that Menard was a director of this firm until so apprised by Commission counsel. Pratte further testified that all executives of Air Canada, including Menard, upon joining the airline were asked to disclose their directorships. The Chairman then determined which ones could be retained and which ones were judged for various reasons to be incompatible with Air Canada employment. Pratte instructed his employees to submit to him any invitation to join a board as a director.

Menard's continued relationship with the firm Herdt & Charton Limitée following his employment with Air Canada undoubtedly would have offended the corporate policy and guidelines on business conduct which were adopted by the Board of Directors on May 27, 1975. Those guidelines specifically preclude any person in a position of responsibility in Air Canada from serving as a director of a commercial entity that has a significant present or prospective business relationship with Air Canada if such service could either place on that person demands inconsistent with his duties, call into question his capacity to perform those duties in an objective manner, or be so time-consuming as to cause job performance to suffer. Those guidelines were, of course, not in effect during the period of Menard's association with Herdt & Charton Limitée, but he should have recognized the possibility of actual or apparent conflict of interest and terminated that association. There is no indication of any awareness by senior executives of Menard's activities concerning Herdt & Charton Limitée and no laxity or opacity on their part in not being so aware.

Chapter 10

ACTIVITIES OF SUBSIDIARY & AFFILIATED COMPANIES

A. *Diversification*

For a number of years the management of Air Canada have recognized a need to diversify the airline's activities in order to compete in today's marketplace. Accordingly, a diversification strategy was adopted and programmes set up to implement this strategy. The policy behind the strategy was stated concisely in a report prepared jointly by Corporate Development Services and Finance for a Meeting of the Board of Directors on April 30, 1974, which report is entitled "Concerning Diversification Strategy and Subsidiary and Associated Companies' Activities";

> "Diversification is not being undertaken simply for its own sake, or for the mere desire to invest in more profitable businesses. The socio-economic environment in which a modern airline must operate is changing in a manner which could not have been foreseen by the authors of the *Air Canada Act*. It is for this reason that one must consider the diversification activities outlined below in the light of the real need for change, rather than in the context of the constraints that have and may still apply and which must gradually be circumvented or removed."

It appears that management have recognized the limitations of the corporate powers of Air Canada, and are therefore faced with a dilemma as to how to implement the diversification programme. The powers of a company such as Air Canada, incorporated by special act, are *prima facie* those which are conferred by the Act itself. Such powers are supplemented by powers conferred by provisions in the general company legislation, the *Canada Corporations Act*. In the case of Air Canada, the *Air Canada Act*, R.S.C. 1970, Chapter A-11, sets out in detail in section 13 the powers of the corporation. The text of this section is attached as Appendix "a" to this Chapter. Section 163 of the *Canada Corporations Act*, R.S.C. 1970, Chapter C-32, confers certain additional powers on the corporation, and is for convenience attached as Appendix "b" to this Chapter.

In order to meet the dilemma, the company has enlisted the assistance of certain subsidiary and associated companies to carry on activities which contribute to the attainment of the goal of diversification. According to the evidence presented at the hearings, these companies are as follows:

I. *Wholly-Owned Subsidiaries incorporated under s. 18 of the Air Canada Act*

Airtransit Canada

This company, Airtransit Canada, was incorporated as a wholly-owned subsidiary of Air Canada and is engaged in the establishment, operation and development of a STOL air transport system between Montreal and Ottawa.

II. *Companies in which Air Canada holds shares directly*

Air Jamaica (1968) Limited (presumably under s. 13(1)(c) of the Act)

Air Jamaica (1968) Limited is a private company operating under the Companies Act (1965) of Jamaica. It operates international air transportation services from a base of operations situated in Kingston International Airport and serves other islands of the Caribbean and a number of points in the United States and Canada. The shareholders presently are the Government of Jamaica, through its selected nominee, as to 66% of the authorized ordinary share capital, and Air Canada as to 34% of the authorized share capital.

III. *CN Subsidiaries established by CN at request of Air Canada*

(i) *Canadian National Realties Limited*

Canadian National Realties Limited is a wholly-owned subsidiary of Canadian National Railway Company and possesses wide corporate powers to engage in a number of different fields. Because of its wide corporate powers, the company is being used as a depository for shares of subsidiary and associated companies taken down on behalf of Air Canada's diversification programme, such as, shares of Venturex Limited and Allied Innkeepers (Bermuda) Limited.

(ii) *Allied Innkeepers (Bermuda) Limited*

This company owns and operates eight properties in the Eastern Caribbean. Seven are operated as Holiday Inns and the eighth is expected to be upgraded to equivalent status. Air Canada, through its nominee, Canadian National Realties Limited, holds one-third of the equity shareholdings in Allied Bermuda. The other two-thirds are held by Commonwealth Holiday Inns of Canada Limited, as to one-third, and Commonwealth Development Corporation, as to the remaining one-third.

This investment is reported in the 1972 report of the Board of Directors to the Minister of Transport and to Parliament as follows:

> "In recognition of the requirement to become more closely involved with the hotel industry, negotiations were concluded with Allied Innkeepers (Bermuda) Limited, and Com-

monwealth Holiday Inns of Canada Limited (CHIC), in order to obtain a supply of quality hotel space in the Caribbean. Allied Innkeepers was established to hold the pooled hotel interests of CHIC and the Commonwealth Development Corporation, a consolidation which has more than 1,000 rooms in eight properties on six islands. Canadian National Realties Limited, as representative of Air Canada's shareholder, Canadian National Railway Company, holds one-third of the shares. The hotels are managed under contract by CHIC, a Canadian controlled company, and the arrangements and marketing agreements pursuant thereto link Air Canada with the world famous name of Holiday Inns."

It is perhaps of more than passing significance that in reporting this same transaction to the Board of Directors of Air Canada, management described the status of CN Realties as follows:

> "Canadian National Realties Limited, a nominee of Air Canada, acquired one-third of the common shares of Allied Bermuda."

Allied Innkeepers apparently suffered substantial losses in the succeeding years and Air Canada has written off the $240,000 which it invested in the enterprise through CN Realties. This matter is discussed further in Chapter 13.

Management when reporting on this transaction in April 1974 and again in April 1975 did not mention that the airline's investment had been written off.

(iii) *Airline Maintenance Buildings Limited*

Airline Maintenance Buildings Limited is a private company incorporated in the Province of Ontario. It was established originally for the purpose of building and leasing on Crown property located at Toronto International Airport facilities required by Air Canada for the handling of air cargo in the performance of ancillary services. The company was purchased on September 26, 1972, at which time all of the outstanding shares were transferred to Air Canada's nominee, Canadian National Realties Limited.

(iv) *CANAC Consultants Limited/Ltée.*

This company presently operates as a wholly-owned subsidiary of Canadian National Realties Limited and is engaged in the performance of consulting and management services relating to transportation by rail, truck, water and air. By a proposed memorandum of agreement between Canadian National Realties Limited, Canadian National Railway Company and Air Canada, such agreement to extend from January 1, 1974, until the 31st of December, 1975, continuing from year to year thereafter unless sooner amended or terminated upon 60 days' notice, it is intended that Air Canada

would become a shareholder in CANAC Consultants Limited/Ltée as soon as it is empowered to do so following an amendment to the *Air Canada Act*.

(v) *CANAC Distribution Limited/Ltée.*

This company is also operated as a wholly-owned subsidiary of Canadian National Realties Limited. Its principal business is to undertake the planning and management of movement of goods between points of original shipment and ultimate destinations for industrial shippers, particularly those having, or wishing to have, formal physical distribution systems in which containerization and intermodal services play an important role. A proposed memorandum of agreement is in existence similar in effect to that discussed above with respect to CANAC Consultants Limited.

(vi) *MATAC Cargo Limited/Ltée.*

This company has leased land at Mirabel International Airport and is in the process of constructing thereon buildings for the handling of air cargo and the performance of other services. At the present time its operations are confined to this airport. This company is set up as a joint venture with Marathon Aviation Terminals. It was incorporated as a private company under the *Canada Corporations Act* by letters patent issued November 7, 1973. The shareholders are Marathon Aviation Terminals Limited as to 50% and Canadian National Realties Limited as to the remaining 50%.

(vii) *Venturex Limited/Ltée.*

As discussed more fully in Chapter 8 above, the company is a wholly-owned subsidiary of Canadian National Realties Limited. By an agreement dated January 15, 1973, between Air Canada and Canadian National Railway, Air Canada at its option may take over the shares held by Canadian National Realties Limited; as well by this agreement Air Canada is to indemnify and save harmless Canadian National Railway for losses, claims, etc. arising out of the operations of Venturex.

B. *Corporate Powers of Air Canada*

Although the above companies are in law distinct entities, it is clear that their activities are carried on on behalf of Air Canada, in many cases through an intermediary, namely Canadian National Realties Limited. The problem of the relationship between Air Canada and the above companies has been highlighted during our inquiry through our investigation of the activities of Venturex Limited. For regulatory purposes, the company is treated as a separate entity; for accounting and financial control purposes it is considered at times to be a division of Air Canada and at other times to be an affiliated company.

Regardless of the characterization of the relationship, two things are clear: (1) the management of Air Canada is aware that certain activities involved in its diversification programme are beyond its corporate powers; (2) the above corporate relationships were established to permit Air Canada to carry on indirectly that which it cannot do directly. The question then becomes whether Air Canada is acting *ultra vires,* and therefore unlawfully.

The inherent powers of Canadian companies differ in certain respects in consequence of differing methods of incorporation. There are three methods of incorporation.

(i) by letter patent;

(ii) by the filing of a memorandum of association

(iii) by special Act.

Under the first method the corporation thereby created is customarily described as a common law company and under the latter two methods as a statutory company.

(i) *Letters Patent Companies*

The doctrine of *ultra vires* is not applicable to companies incorporated by letters patent. Such a company has the capacity of a natural person to acquire powers and rights. If by the terms of the charter it is prohibited from doing so, a violation of this prohibition is an act not beyond its capacity, and is therefore not *ultra vires* although such a violation may well give ground for proceedings by way of *scire facias* for the forfeiture of the charter. (*Bonanza Creek Gold Mining Company Limited* v. *The King,* [1916] 1 A.C. 566, at p. 584).

(ii) *Registration Companies*

The leading case with respect to powers of companies incorporated by memorandum of association, so-called registration companies, is *Ashbury Railway Carriage and Iron Company Limited* v. *Riche,* [1875] L.R. 7 H.L. 653, where Lord Selborne said at page 693:

> "A statutory corporation, created by act of Parliament for a particular purpose is limited, as to all its powers by the purposes of its incorporation as defined in that act. The present and all other companies incorporated by virtue of the Companies Act of 1862 appear to me to be statutory corporations within this principle. The memorandum of association is under that Act their fundamental, and (except in certain specified particulars) their unalterable law; and they are incorporated only for the objects and purposes expressed in that memorandum."

This bald statement of the rule is subject to the principle that actions incidental to or consequential upon those things that are authorized ought not to be

viewed as *ultra vires*. The following statement of Fletcher Moulton, L.J., in *Attorney General* v. *Mersey Railway,* [1907] 1 Ch. 81 (C.A.), at page 99, clearly establishes the rule:

> "It is authoritatively laid down by Lord Halsbury in the case of *London County Council v. Attorney General,* by reference to the decisions of the House of Lords in the two cases of *Ashbury Railway Carriage and Iron Company v. Riche,* and *Attorney General v. Great Eastern Railway Company.* They established that in the case of a company created by statute for a special purpose, that which is not permitted by the statute is impliedly prohibited, but that, in applying this principle, whatever may be regarded as incidental to or consequential upon those things which the Legislature has authorised ought not, unless expressly prohibited, to be held by judicial construction to be *ultra vires.*"

Of course, the objects and powers must not include anything in contravention of the Acts or the general law.

(iii) *Special Act Corporations*

The powers of companies, such as Air Canada, incorporated by a special Act of the Parliament, are subject to the doctrine of *Ashbury* v. *Riche,* and not to that of the *Bonanza Creek* case: that is these corporations are subject to the doctrine of *ultra vires*. The powers of such a corporation are limited and circumscribed by the statutes which regulate it, and extend no further than are expressly stated therein, or are necessarily and properly required for carrying into effect the purposes of its incorporation, or may be fairly regarded as incidental to, or consequential upon, those things which the Legislature has authorized. What the statute does not expressly or impliedly authorize is to be taken to be prohibited. (Halsbury's *Laws of England,* 4th ed. Vol. IX, paragraph 1333). A passage from Halsbury illustrates the application of the principles by a series of authorities relating to railway companies. Such a company could not guarantee the profits of a steam packet company which would operate in connection with it, or properly promote a bill for other than strictly railway purposes, nor could it work coal mines otherwise than for its own use, or carry on an omnibus business, or subscribe to the funds of a public institute having no connection with the company. On the other hand, it was not *ultra vires* the railway company, which was authorized to keep vessels for the purposes of a ferry, to use them for excursion trips to the sea; or for a company to make charges for the use of its weight machines, or to lease part of the land acquired by it in pursuance of its statutory powers; or for a railway, with which a dock company had been amalgamated, to supply water to the docks from a source acquired for railway purposes.

In Canada, the test as to whether acts are incidental or consequential within the meaning of the rule in *Attorney General* v. *Mersey Railway* (supra) was set out by Duff, J., in *Hughes* v. *Northern Electric and Manu-*

facturing Company, [1915] 50 S.C.R. 626 at 654. The two points to be considered in every such question are, first, is the power to enter into the transaction, if not expressly given, *prima facie* invested in the corporation by implication as being reasonably necessary in the business sense to enable the corporation to carry on its authorized undertakings, and secondly, although it is *prima facie* given by implication, is it the proper inference from all the instruments defining the corporation's objects and powers and prescribing the regulations for the conduct of its business that such a power has been denied.

There is of course a very serious issue in political science, arising in the case of a special act company, which transcends the importance of the legal difficulties flowing from the application of the doctrine of *ultra vires* to a special act company such as the Crown corporation Air Canada.

Parliament created a corporation to undertake the establishment of a national airline for reasons some historically known and, perhaps now, some unknown. Presumably the need for the service and the unavailability of any other agency, government or non-government, were the largest single considerations. The public treasury was the source of the funds which were put into the corporation in the first instance and for many years continued to be the only source for additional capital required to expand and develop the undertaking. Today there are other sources of capital utilized by the management of the corporation in the conduct of its business. Parliament remains however as the final principal to which resort will be had when other sources of capital, including working capital, dry up. Parliament may therefore have intended that the narrow, but clear lines of authority established in the statute, be the limits of corporate action whether or not Parliament was ever made aware of the doctrine of *ultra vires*. If the taxpayer's money is to be put at risk, the taxpayer's representatives may well have deliberately defined and confined the risk.

There may well be a further consideration. The taxpayer, contributing to such a commercial undertaking and speaking through Parliament, may not have wished to be understood as contributing the money to the Crown corporation to employ it as the management of the day may consider appropriate, in the view of that management, without the need for any reference back to the donor of the money for a new mandate. The donor or investor, Parliament, or the now perhaps mythical taxpayer, may not for example wish to have the Crown corporation compete with existing taxpaying enterprises engaged in a business not related to the airline business for which it was established. Also the community may be adequately served, in view of Parliament, by existing enterprises in the area which the Crown corporation may now covet. The responsible minister of the Crown (acting under Section 18) or Parliament may have, given the opportunity to speak, considered the proposed venture too risky for a government enterprise to engage upon.

There are many practical and realistic reasons why one may conclude that the statute is deliberately narrow and precise and subject to the doctrine of *ultra vires*. Section 18 of the *Air Canada Act* enables Air Canada to

establish subsidiaries but only on a petition to the Governor-in-Council. This may also invite a narrower interpretation for the same reasons and preclude any right or authority in the corporation to establish affiliates or subsidiaries in any other manner such as by arrangement with a parent Crown corporation, the CNR. We are not required or indeed authorized to consider and comment upon the propriety of the CNR lending itself to this process.

The activities which Air Canada carries on through its subsidiaries and associated companies include the following:

1) ground reception services (Venturex)
2) ABC charters (Venturex)
3) operation of hotels in the Caribbean (Allied Bermuda—also, through Sunset Crest leases)
4) consulting and management services relating to transportation (CANAC Consultants Ltd.)

Following the two-pronged test of Duff, J., set out above, the Commission does not believe that it is "reasonably necessary" for Air Canada to be involved in the above activities, except perhaps the ABC charter and ground reception services, to enable the Corporation to carry on its authorized undertaking. As well, it cannot be the proper inference from the *Air Canada Act,* which limits the airline to the purchase, lease, holding, use, enjoyment and operation of hotels in Canada, that the power to operate hotels outside of Canada has not been denied. Accordingly, Air Canada is acting *ultra vires* in carrying on these activities. Whether this be desirable or undesirable in the national interest is not within the competence of this Inquiry to say. What can and must be said, however, is that the financial control mechanisms and corporate control channels of the corporation are designed primarily for the mainline operations and purposes of the company, and that almost all the difficulties which the corporation has recently encountered are related to the ancillary or off-shoot enterprises into which the 'diversification' program has carried it.

No opinion was presented to this Inquiry, and indeed it appears from the evidence that no opinion was presented to or requested by Air Canada, as to whether the carrying on of ABC charters was within the company's powers. If this activity is not within the company's powers, it should not be involved through Venturex. If it is within the company's powers, it must be asked why a section 18 subsidiary was not incorporated for that purpose. The evidence of Mr. Vaughan was that Venturex was set up in anticipation of the CTC's ABC regulations, which, it was thought, would provide against a direct subsidiary being so involved in ABC. As the regulations promulgated did not so provide, Mr. Vaughan stated that Venturex was utilized in any case "to be safe". A section 18 subsidiary may be created only upon a declaration by the Governor-in-Council. It may be inferred that Air Canada did not wish to present this proposal to the Governor-in-Council, for whatever reasons it may have had.

This Commission makes no judgment as to the value from a business point of view of the company diversifying its activities. However, the Order-in-Council requires the comment that from a legal standpoint the company should be restrained from acting outside the scope of its charter or its charter should be re-examined in the light of present competitive airline conditions. This comment was expressed many years ago by Lord MacNaghten in *Attorney General* v. *Mersey Railway,* [1907] A.C. 415, at p. 417; his statement echoes forcefully in the present circumstances:

> ". . if they wish to extend their undertaking beyond the limit authorized by their charter, the proper course is to apply to Parliament for further powers. In my opinion a matter of this sort is much better left to Parliament. There, everybody who has a right to be heard will be listened to, and there the interests of the public will be protected."

APPENDIX "a"

BUSINESS AND POWERS OF THE CORPORATION

13. (1) The Corporation is authorized

(*a*) to establish, operate and maintain air lines or regular services of aircraft of all kinds, to carry on the business of transporting mails, passengers and goods by air, and to enter into contracts for the transport of mails, passengers and goods by any means, and either by the Corporation's own aircraft and conveyances or by means of the aircraft and conveyances of others, and to enter into contracts with any person or company for the interchange of traffic and, in connection with any of the objects aforesaid, to carry on the business of warehousing goods, wares and merchandise of every kind and description whatever;

(*b*) to buy, sell, lease, erect, construct and acquire hangars, aerodromes, seaplane bases, landing fields and beacons and to maintain and operate the same;

(*c*) to borrow money for any of the purposes of the Corporation and, without limiting the generality of the foregoing, to borrow money for capital expenditures from time to time from the Canadian National Railway Company;

(*d*) to carry on its business throughout Canada and outside of Canada;

(*e*) to purchase, hold and, subject to this Act, sell and dispose of shares in any company incorporated under section 18 or in any company or corporation incorporated for the operation and maintenance of air lines or services of aircraft of any kind;

(*f*) to lend money to any corporation incorporated under section 18 on such security as the Minister may determine;

(*g*) to deposit money with or lend money to the Canadian National Railway Company at such rate of interest as may be agreed upon between the Corporation and the Canadian National Railway Company;

(*h*) to issue such bonds, notes or other securities of the Corporation as are necessary to carry out the provisions of this Act;

(*i*) to buy, sell, lease and operate motor vehicles of all kinds for the purpose of transporting mails, passengers and goods in connection with the Corporation's air services and the air services of other air carriers and to enter into contracts with any other person respecting the provision of motor vehicle services of all kinds;

(*j*) to purchase, lease, or otherwise acquire or provide, hold, use, enjoy and operate such hotels in Canada as are deemed expedient for the purposes of the Corporation; and

(*k*) to use the words "Air Canada", "Trans-Canada Air Lines", "Lignes aériennes Trans-Canada", or any abbreviation thereof, as a trade name, mark or designation for any purpose connected with the business of the Corporation, and no other person shall hereafter use any such name, mark or designation for any purpose.

(2) The Corporation shall not sell or dispose of any of the outstanding shares of any company incorporated under section 18 except with the approval of Parliament.

(3) Subject to section 37 of the *Canadian National Railways Act,* the Canadian National Railway Company may lend money to the Corporation upon such terms and conditions and at such rate of interest as may be agreed upon between the Corporation and the Canadian National Railway Company. R.S., c. 268, s. 14; 1952-53, c. 50, s. 15; 1964-65, c. 2, s. 3.

General Powers

Powers constructively conferred by charter

163. (1) Every company incorporated under any Special Act shall be a body corporate under the name declared in the Special Act, and may acquire, hold, alienate and convey any real property necessary or requisite for the carrying on of the undertaking of such company, and shall be invested with all the powers, privileges and immunities necessary to carry into effect the intention and objects of this Part and of the Special Act, and which are incident to such corporation, or are expressed or included in the *Interpretation Act*.

Inter-insurance

(2) The powers conferred by this section shall be held to include the power to exchange with any person or company reciprocal contracts of indemnity against loss by fire or otherwise under the plan known as "inter-insurance" R.S., c. 53, s. 151.

Chapter 11

BUDGETARY CONTROL

Budgetary control refers to the whole process of planning, executing and evaluating a program of business activities by the use of a detailed estimate of future transactions, designed to provide a plan for, and control over, future operations and activities. Proper budgetary control encompasses four distinct phases:

(a) The setting of budgets;

(b) The recording of actual transactions;

(c) An investigation into the reasons for variations from the budgets;

(d) The exercise of executive action to correct adverse tendencies and to encourage good ones where possible.

The Setting of Budgets

At Air Canada the planning process starts with the definition of goals, strategies and tactics in a five-year plan. The five-year plan is prepared by the Chairman with his Executive Committee and approved by the Board of Directors. Naturally the goals, strategies and tactics are set out in much greater detail for the first year of the plan than they are for years two through five. With his Executive Committee the Chairman then converts these statements of goals, strategies and tactics into planning guidelines. Planning guidelines include such things as profit objectives, load factors, service levels, utilization levels, etc. as well as certain economic assumptions.

The planning guidelines are then turned over to the planners whose responsibility it is to produce various detailed calculations that are prerequisite to the achieving of the goals contained within the planning guidelines. For example, the planners would calculate the necessary revenue per passenger mile and revenue per ton mile. When the detailed planning calculations have been made the data is turned over to schedulers whose job it is to work out an operating plan; that is they must determine the type and number of aircraft, the frequency of flights, the tariff schedules, etc.

The operating plan is used by the Finance Branch to prepare budgeted income statements, balance sheets, source and application of funds and a

plant and equipment budget. In preparing these financial statements the Finance Branch makes use of a number of known relationships (e.g. ground service personnel required to support a given number of flights) and a number of assumptions which they make (e.g. the price of fuel and the cost of labor). The budgeted financial statements are reviewed by the Chairman and the Executive Committee. If they are found to be satisfactory the Chairman then sets objectives for each of the group Vice-Presidents and staff Vice-Presidents that report to him. The setting of objectives involves defining for each of these group Vice-Presidents or staff Vice-Presidents the responsibilities assigned to him under the operating plan and assigning a certain portion of the dollar budget to him.

The group Vice-President in turn assigns operating plan responsibilities and dollar budgets to each of the Vice-Presidents reporting to him. After an interval of approximately two months the Vice-Presidents will meet with their group Vice-Presidents and negotiate the adequacy of the dollar budget to meet the objectives set out in the operating plan. Some Vice-Presidents use this intervening period to have detailed budgets prepared for each of the budget expense centres in their branch. Others restrict their review of the adequacy of the budget to meetings at the senior executive level within the branch. In either event after the branch Vice-President meets with his group Vice-President an amount is "struck" as the agreed budget for the branch. It is then up to the branch Vice-President to divide his total budget among the various budget expense centres within the branch. This is done in a variety of methods but eventually a detailed budget by expense function is prepared for each expense centre within the branch. These budgets are signed by the budget centre manager, and his immediate superior and forwarded through the branch controller to the Finance Branch.

The Finance Branch uses these reports to prepare a summary for presentation to the Board of Directors and to input the data to the Winnipeg Accounting Centre.

The Recording of Actual Transactions

Each month Air Canada's accounting system produces a statement for each budget expense centre within the airline. There are approximately 700 such centres. The statement shows the actual expenses for the month as compared to the budget for that month as well as the actual expenses for the fiscal year to date together with the budget for the fiscal year to date. Copies of these statements are sent to each budget expense manager, his immediate superior, and the Finance Branch. In addition, various consolidations of budget expense centres are prepared so that each manager has a statement of the total area for which he is responsible. The basic level of responsibility is referred to as level 7, the responsibility for the operation of a total branch is referred to as level 2, a group responsibility is referred to as level 1 and the total corporate responsibility as level 0.

Investigation of Budget Variations and Executive Action

It is the responsibility of each budget expense manager to satisfy himself that the expenses reflected in the month are proper charges of his centre and that all the charges of the centre have been properly reflected. In addition, the immediate supervisor of the budget centre manager should satisfy himself that the operations of the centre are in accordance with the budgeted plan. It is the responsibility of the branch controller to review each of the budget centre expense statements for his branch and obtain explanations for significant variations from budget and information as to any further variations for the balance of the fiscal year. He then prepares a report for review with the branch Vice-President setting out the major variances for the period, the year-to-date and the outlook for the balance of the fiscal year. After review with the branch Vice-President this report is forwarded to the Finance Branch.

The Finance Branch reviews these reports and satisfies itself that the explanation for budget variations and the outlook appear reasonable. The reports are packaged together with a consolidating report in a booklet entitled SEMR (Senior Executives' Monthly Review). The SEMR report forms the basis for discussion at the Executive Committee of the outlook for each branch of the corporation.

Evaluation of the Adequacy of Air Canada Routines

The basis by which the Chairman divides the total corporate budget among his deputies (group Vice-Presidents and staff Vice-Presidents) is not uncommon in the airline industry. Once the operating plan has been decided upon, many of the costs of the airline are in fact fixed. Thus, while textbooks frequently suggest that the only satisfactory budgeting system is one which starts at the basic transaction level or the first level of management in order to obtain a commitment by management to the budget, in fact in the airline industry, it is possible to provide a guide. Air Canada has experimented with the concept of building a budget from the basic transactions in prior years, but has discovered that when all the pieces are added up the total is frequently unacceptable and the process must be started all over again from the bottom.

In this process of allocating a portion of the total corporate budget to individual branches and dividing branch budgets within expense centres the Finance Branch plays a consulting role. They may be consulted by the Chairman as to their views on the reasonability of a given branch budget or conversely they may be consulted by branch executives to consider whether the allocation is compatible with the operating plan. In any event the financial responsibility for allocating the corporate expense budget to particular functions rests with branch personnel. Provided a branch Vice-President agrees to live within the expense budget allocated to his branch there is likely to be very little discussion of the various detailed components of the budget.

Control would be stronger if the Finance Branch was responsible for satisfying itself as to the reasonability of the budget for each centre. In other words, the Finance Branch would be in a much better position to subsequently play an effective controllership role if it had an obligation to comment on the reasonability of the detail of the budget rather than merely responsibility to mechanically summarize the budget and assist with budget decisions on a consulting basis.

It is natural of course that the investigation of budget variations becomes less detailed at the higher levels of the corporate structure. There does however seem to be a lack of an independent review of budget variations. The budget centre manager supplies explanations to the branch controller and the branch controller supplies these to the branch Vice-President and the Finance Branch. If a given budget expense centre is within budget on an overall basis, or is forecasted to be within budget by year-end, it is unlikely that explanations will be requested by the branch controller or Vice-President. In the same fashion if a given branch is within budget the Finance Branch is unlikely to request explanations on any of the detail. Thus for a branch that is within budget on an overall basis the only items that are likely to be raised for discussion at the Executive Committee level would be those that a Vice-President wanted to raise. Many large corporations have a group within the Finance Branch referred to as "profit analysis". It is the responsibility of this group to review the operating statements of branches in considerable detail. The question is therefore raised as to whether Air Canada does sufficient profit analysis and whether the results of what analysis that is done are properly reported up through to the Executive Committee.

In its report on the apparent weaknesses in the disbursement system, Clarkson, Gordon cited "a lack of definition of responsibility of the divisional controller with respect to reporting requirements to the Finance Branch on budget variations". This problem could perhaps be put more strongly that: There should be more independent involvement in the analysis of budget variation rather than relying on the branch or budget expense centres to initiate such analysis.

The Marketing Branch breaks down its total advertising and promotion budget into various planned programs. The system by which they allocate the total budget to planned programs and monitor the month-to-month position to each program is referred to as "PPBS" (Planned Program Budgeting System), as described above in Chapter 5. During the course of the Inquiry a number of matters came to light that would indicate a real need for a more independent review of budgets as they are prepared, and review of variations of actual from budgeted performance. Examples are:

(a) *The McGregor Incident*

The availability of funds for the $100,000 disbursement to McGregor Travel was made possible by cutting back expenditures

within the advertising and promotion function of the Marketing Branch as an offset to the over expenditure in consulting fees. Had it been generally known that a large variance in consulting fees in the month of December, 1974 would have triggered an independent Finance Branch review it seems doubtful that the Marketing Branch would have proceeded with the McGregor transaction without first reviewing the total transaction with the Finance Branch.

(b) *Sunset Crest*

The Sunset Crest program was budgeted for $155,000 for the 1974 fiscal year and this amount was first detailed in a Marketing Branch report in November, 1973. The testimony given in the hearings revealed considerable confusion as to whether this budget related to advertising costs in connection with Sunset Crest or whether it related to the anticipated excess of the lease obligations over the room rentals. In any event as the 1974 fiscal year progressed the budgeted outlook for the cost of the Sunset Crest program was increased and other programs were cut back to accommodate this increase within the total advertising and promotion budget.

Testimony given to the Commission indicates that the Sunset Crest program was never discussed at the Executive Committee level and accordingly the exact nature of the commitment was never made known to the Chairman of the Board until only shortly before Air Canada had to decide on whether to exercise its option for the 1975 year. Presumably Mr. Menard as Vice-President, Marketing concluded that the Sunset Crest program was not of such significance to warrant discussion at the Executive Committee meeting even though it was known within his Department that the operating outlook was growing less favorable with each passing month.

The Finance Branch cannot claim to have not had knowledge of the transaction since they were making regular payments to Sunset Crest and receiving room rentals and the net of these transactions was reflected in a suspense account within the balance sheet caption sundry receivables in the accounts of Air Canada. The Finance Branch undertook the responsibility of analyzing the suspense account and reporting thereon to the marketing branch on a regular basis. The Finance Branch involvement however seems to be one of a mechanical nature (i.e. providing data to the marketing branch). The fact that the Finance Branch did not raise the Sunset Crest program for discussion at the Executive Committee brings into focus again the program of a Finance Branch role. They seem to be only a mechanism for conveying information and take little responsibility for ensuring that all the appropriate information is properly conveyed. Since the Marketing Branch did not report the

Sunset Crest program in its outlook report to the Finance Branch, the Finance Branch did not make any comment in the SEMR Report.

In addition to these specific incidents, evidence came to light that raised doubt as to whether the Executive Committee makes proper use of the SEMR Report. The SEMR Report for the ten months ended October, 1974 indicated that:

(i) Marketing Branch was underspent $784,000 or 5% year to date as against budget.

(ii) For the total year Marketing Branch expected to be underspent only $145,000 or 1% as against budget as a result of overspending forecasted for November and December of $639,000 or 12% over budget.

There is no indication that the Executive Committee ever discussed the possibility of preserving the savings in the Marketing Branch as realized to the end of October. If the expenditures could be postponed from earlier months, consideration should have been given to eliminating such expenditures. There was no discussion of what these postponed costs were. It was the "slack" in this budget that facilitated the McGregor payments. Furthermore, one of the forecasted costs was the recognition of the Sunset Crest operating losses.

Capital Budgeting

The capital budgeting process appears to be an effective control tool. The capital budget as agreed upon by the various branch Vice-Presidents specifies the assets to be purchased and is approved by the Board of Directors. Budget approval however does not eliminate the AFE requirement, and accordingly the project is reviewed thoroughly before commitment. The AFE procedures are documented in further detail in Chapter 5.

Conclusions

1. Finance Branch should be responsible for reviewing the details of the branch budgets.

2. Finance Branch should independently review variances from branch budgets during the year in order to report and interpret variances to the Executive Committee.

Chapter 12

SPECIFIC ACCOUNTING RECOMMENDATIONS

A. *Disbursement System*

Clarkson, Gordon & Co., in their capacity as advisors to the Commission on accounting matters, undertook a review of the disbursement system. This review dealt primarily with the Winnipeg centralized payment system, the Montreal payment system, the Dorval purchasing system, certain local branch purchases and the system of "authorization for expenditure". The review did not include payrolls and did not examine (except in a very summary fashion) the subroutines related to specific disbursement types (e.g. fuel).

As a result of this review Clarkson, Gordon & Co. prepared a description of the disbursement systems and submitted this description to the Commission, a brief summary of which is included in Chapter 5. Air Canada personnel reviewed the exhibit prior to its submission and agreed that the descriptions were generally accurate. Clarkson, Gordon & Co. further supplied the Commission with a letter setting out their opinion as to weaknesses in the disbursement system and Air Canada (through the Vice-President, Finance), submitted a response to these opinions. Both the Clarkson, Gordon letter and Air Canada's response were filed with the Commission as Exhibits 212 and 216.

Although Finance Branch review all disbursements, there is no clear definition of its responsibility to ensure that Air Canada has received value since the prime responsibility for the propriety of a given disbursement is that of branch personnel. The major exception to this concept, that is the area where Finance Branch responsibility is clearly defined, is for disbursements in excess of $50,000 of a type which require an "authorization for expenditure". In this case the system does require the prior review by Finance Branch personnel before the commitment for the expenditure is made.

Thus, the main control of the Finance Branch central payment function is to ensure that proper approvals have been obtained at the branch level. Under the existing system invoices can be submitted individually to the Finance Branch in Winnipeg for payment from each of the approximately 700 budget centres within the corporation. However, no central file is maintained in the payment centre of names and signatures of persons authorized to approve invoices and their approval levels.

The wide distribution of authority to commit Air Canada to disbursements obviously increases the chances of unauthorized disbursements occurring. It therefore makes sense to control to the greatest extent possible the use of all forms, by the creation of a system of master files, in the disbursement process, and by institution of some sort of final review by a senior official of larger disbursements.

Clarkson, Gordon & Co. dealt with these issues in the first five points raised in its memorandum on the disbursements system. As the publication of these matters would seriously jeopardize the effectiveness of the existing control system, the five points and our comments thereon are included in the Confidential Supplement to this report.

In testimony given to the Commission, Clarkson, Gordon stated that while weaknesses in the control system over disbursements do exist, generally the control system is as adequate as that of other corporations of a like size and complexity. It was also stated that the Authority for Expenditure System, properly executed by individuals in the Company, represents an excellent control tool.

The weakness that presently exists with the AFE System stems from the fact that Air Canada has no prohibition against splitting of a particular AFE. This results in the ability of an individual within the Company to defeat certain defined levels of authority or to manipulate the timing of certain expenditures to fall within his annual budget of expenses. These weaknesses were evidenced in the McGregor disbursement as well as the "Market Facts" research fee, discussed below. While the present procedure manual—Manual 300—infers that splitting should not occur, there is no specific reference to its prohibition. The Commission understands that the predecessor to Manual 300 contained a definite AFE splitting prohibition but that this prohibition was omitted when consolidating the present procedural manual.

However, it is Clarkson, Gordon's opinion that those problem transactions encountered during the course of their investigation resulted more from management attempts to circumvent controls than from weaknesses in the control system itself. It is again evident that the Finance Branch must develop at a minimum, a meaningful procedure to independently check that Company authorization and approval policies have been adhered to.

In addition to their procedural review of the disbursement system, Clarkson, Gordon & Co. did undertake a limited review of actual disbursements over the past few years. The basis of selection was disbursements having at least one or more of the following characteristics; initiated by an AFE, disbursement made by way of a manually prepared cheque (versus a a computer prepared cheque), and disbursements initiated by the Marketing Branch. The findings of Clarkson, Gordon & Co. on specific disbursements were submitted to the Commission in Exhibit 213. Findings of interest are as follows:

1. An amount of $20,000 was disbursed to a retiring Vice-President on the basis of a memorandum from the President to the Vice-President, Finance. The payment purported to be compensation for

moving expenses and was selected for investigation on the basis that the amount appeared unreasonable. Mr. Cochrane stated that he received verbal approval from the Chairman that the $20,000 was part of an authorized severance package. On the basis that the amount was part of a total severance package and not a normal business transaction, an AFE should have been prepared. Furthermore, since the terms of employment of senior officers of the company are determined by the Board of Directors, severance arrangements should also have been approved by them.

This transaction is indicative of the passive role of the Finance Branch. It did not query the Chairman as to whether a higher approval would be appropriate, nor did it question the propriety of describing as a moving expense, what appears to be a lump sum payment for loss of office.

2. This matter relates to a former practice of the airline of making solicitation payments to travel agents, which practice grew out of the industry environment in which the airline was operating. As mentioned in Chapter 5 above, there is no indication that such practices are continuing today. As well there is no evidence that the McGregor transaction represents an example of a systematic practice to provide kickbacks to travel agents.

   As the publication of further details of this extinct practice could only do harm to the airline vis-à-vis its competitors, without any benefit to the Canadian public, our further comments on this matter are provided in the Confidential Supplement to this report.

3. Another example of a "split" AFE was uncovered. Three cheques totalling $55,000 were paid to a company named Market Facts under the authorization of three AFE's. The Market Facts study was a *bona fide* research job but the costs ran out of control as a result of a lack of monitoring by Air Canada personnel. Rather than admit the error an attempt was made to cover up the problem by obtaining separate AFE's for the overrun cost. The matter came to light within the Marketing Branch, but there is no indication that the procedural violations were reported to the Finance Branch. This situation is indicative of the lack of involvement of the Finance Branch in the policing of adherence to prescribed policy. In this situation when senior personnel of the Marketing Branch become aware of procedural violations they issue instructions to correct the problem within the Branch but do not bother to report the violations to the Finance Branch.

4. Clarkson, Gordon & Co. questioned an AFE covering disbursements to Venturex totalling $145,000. The details of this disbursement are covered in Chapter 8. The payment however does represent another example of disbursements made upon the authorization of senior officials without the consideration by the Finance Branch as to whether any real value has been received.

B. *Role of the Finance Division*

Throughout the Inquiry, the Commissioner and his accounting advisers reviewed the quality of controls and procedures within the framework of the company's overall organizational structure. Those comments and criticisms discussed above, which were given in testimony by Clarkson, Gordon & Co. based upon a review of the disbursements' controls existing within the present organizational structure, are also applicable if the company were to change the overall responsibility of Finance as is recommended herein.

The Role of the Finance Division

As explained in more detail in Chapter 5 above, the Finance Division has interpreted its controllership role as a passive one primarily concerned with accounting and reporting of results from the operating divisions. Its function as controller, or policeman, over the operating branches has been limited. This is so notwithstanding its job description set out in Chapter 5.

There is a controller in each operating division who has functional responsibility to Finance, but whose primary obligation is to the management of the division which has the principal responsibility for his evaluation, remuneration and promotion. His primary loyalty obviously lies to his operating division and not to Finance.

Finance has only a consulting role in the creation of the budget and is not directly involved in interpreting budget variances. The budget is a result of interplay between the divisions and the chairman, and the variances during the year are reviewed by the divisions themselves without any independent interpretation. Only those variations and changes in budget strategy which are considered by the division to be of interest to the executive committee are reported there.

The role of the Finance Branch with respect to disbursements has been to process items for payment and accounting after approval by the branches. It has had a limited role in providing independent review of disbursements.

A Need for Stronger Involvement by Finance

The passive role of the Finance Branch in an organization which emphasizes the independent role of the operating branches is used successfully by many large companies and by some other airlines. We believe, however, that the fundamental role of the Finance Division should be changed to provide a much stronger controllership role in Air Canada. The reasons for this are the following:

1. The competitive environment in the airline industry is such that operating divisions (particularly Marketing) appear to require some independent control over their actions.

2. The public interest requires that the Finance Branch have a more through knowledge of the operating plans and any variances from them than it has had in the past, in order, for example, that it may adequately deal with government inquiries into the affairs of Air Canada.
3. There is, at least at the present time, poor communication among senior executives which would be improved by the active involvement of Finance Division within the operating divisions' budget planning, review and disbursement processes.

It is therefore recommended that:

1. Finance should be the final approval on all expenditures and its responsibility should be to ensure that Air Canada receives value for money spent.
2. The functional role of Controllers in branches and regions should either be discontinued or fully articulated in regulations.

Chapter 13

GENERAL COMMENTS ON MATTERS INVESTIGATED

The record compiled in the extensive hearings is lengthy and complex. Before analyzing all the events and transactions and before setting out conclusions, critical and otherwise, in extensive detail, four comments should be made in order to bring a balanced approach to the answers to the many questions raised in this Inquiry and by the convening Order in Council.

(a) The transactions reviewed, the reactions by the Executive staffs to events related thereto, and the work of the same staff in establishing structures and procedures to properly guide the business machine of Air Canada, have all concerned the Inquiry with an examination of the work of a large body of trained and experienced personnel who have shown a dedication to their tasks. Nowhere have we encountered dishonest treatment of the airline's assets, or any disposition to do other than serve the best interests of the corporation. It should be said at the outset of these conclusive comments that there is no sign in the lengthy documentary and investigative record of any effort by these senior personnel to profit in any way at the expense of the corporation or to subvert the airline's interest to their own.

(b) There is an inevitable tendency on the part of any investigation, sooner or later, to forget that all is clear in hindsight. Once the extent of the risk in any individual instance becomes known it is most difficult to back up to the beginning of the transaction and re-evaluate the executive's action, not in the light of all circumstances as known, and not according to the standards which would have applied had the conclusion of the matter been known at the outset. The McGregor transaction is an instance where it is difficult to refrain, as one should, from expecting a Finance Branch reaction in November 1974 commensurate with the state of the Branch's knowledge in March-April 1975. It is also fair to say that a retrospective microscopic review of the affairs of any large business would turn up a number of slow, inadequate or erroneous executive responses, incomplete fiscal procedures, missed storm signals and extensive misjudgments, both of the market and of the business' own capabilities.

(c) The actions of executive personnel of an airline, both with respect to designing and composing control structures and in responding to information exposed by these devices and procedures, must to some extent be

weighed according to the industrial milieu in which a world airline operates. Competitive practices have been engaged in by all major airlines which in some other industries would be discouraged or prohibited. While the industry through IATA has made strenuous efforts to purge itself, nevertheless we saw many references to IATA fines assessed against some of the world's leading airlines for making kickback payments (excessive or clandestine commission payments) to travel agents for the purposes of inducing them to favour the offending airline by steering routine or special business. These schemes are of course designed to increase the business volume of the airline. The payments are made by a variety of subterfuges calculated to deceive the IATA investigators. In many cases the books were cooked. This creates a dangerous atmosphere in a business organization. The need comes to justify the means; not only can the 'right' thing be done the wrong way, it becomes profitable to do so. We saw one such instance where a large non-Canadian airline deliberately set out to buy the goodwill of the travel agency industry by payments prohibited by IATA, the airline voluntary trade regulation and enforcement agency; the company immediately thereafter reduced its devastating losses and moved into profit. Presumably the fine and penance were nothing compared to the financial ruin which continued losses had threatened. We also saw that state owned airlines and agencies of foreign governments countenanced like expedients.

Air Canada, prior to 1973, was fined for such practices by IATA though apparently on a scale smaller than most large operators. By July 1973 the world airlines had realized that all such rewards and 'bribes' to the travel agency and charter industry were counter-productive and simply reduced the revenues of the airline industry. Air Canada, in common with the other IATA members, agreed to put an end to such practices and the Chairman's directive of July 1973 resulted.

By that time disciplines and standards had no doubt been eroded to some extent by the very presence of such disguised and clandestine payments in airlines' books. Air Canada was no more immune to the effects than any other operator. This background will not justify but might explain in part the individual willingness of some senior staff, particularly in the Marketing Branch, to interpret the Vice-President's directive in the way they obviously did and to implement the directive so interpreted in the face of the clearest regulations. One must remember that these improper commissions had been paid out contrary to the announced policies of the airlines and often disguised both in budget and ledger. The McGregor payments were similarly handled; and so far as can be ascertained all this was done in the best interests of the airline as the Marketing Branch saw it. The other branches concerned had either been spectators or less involved actors in the earlier improper practices and their reactions were perhaps to some extent conditioned by that experience. Perhaps everyone involved thought it was more of the same kind of travel agency dealings and that it was known to or implicitly understood by the Chairman and all the Executive Committee.

In any case, not dissimilar actions had been taken by Air Canada in early 1973 and in the years prior. As has been said already, this business atmosphere can explain but cannot exonerate the many failures to act and react on the part of the senior staff later catalogued in this chapter.

(d) Finally and most importantly, one should at this stage of an Inquiry consider the general corporate picture from which the areas scrutinized by this investigation have been extracted. The present management team results from a build-up starting in December 1968 with Mr. Pratte's appointment. The troubles revealed in this chapter have to find their scale alongside management's general record in recent years. In 1968 Air Canada's capital assets amounted to $288 million, by 1974 the figure had reached $1.1 billion. 6.4 million passengers were carried in 1968, 10.3 million in 1974. In the same period operating revenues had climbed from $387 million to $848 million annually. In the six years from 1969 to 1974 inclusive (the years when this team controlled the enterprise), four years of profit and two years of loss were experienced. The employees in the airline increased from 12,700 in 1968 to 21,167 by the end of 1974. The airline in this span moved from a fleet made up of about 50% propeller driven and 50% jet powered aircraft to an all jet powered fleet. During this period Air Canada consolidated its position as a power in the worldwide airline business serving North America; Europe as far east as Moscow; Bermuda and the Caribbean to the northern coast of South America.

1. *Terms of Reference*

Essentially this Inquiry, according to its recitals, came about due to some apparent indications of "inadequate financial administration". The Commission was therefore directed essentially to "the system of financial controls, accounting procedures and other matters related to fiscal management and control . . . ".

For reasons set out in Chapter 2 this direction has been interpreted as including not only the direct financial control accomplished through accounting procedures and disbursements regulation but managerial controls designed to ensure the incurring of corporate obligations only by specified levels of authority and in prescribed manners. This interpretation seems to the Commission not only logical but necessary to accomplish a worthwhile review of fiscal management from top to bottom. Accordingly, as mentioned in Chapter 12, we have concerned ourselves only very briefly with revenue accounting but heavily with disbursement accounting.

When this Inquiry was launched, it soon became apparent that some selective standards were necessary. Otherwise, within the limits of reasonable time and reasonable expense, the Inquiry would not be completed. Accordingly, the Inquiry directed its main efforts towards the cash disbursement controls and management and corporate controls relating to the undertaking

of corporate obligations. Both controls of course involve prospective as well as retrospective control.

As well, a technique was adopted, with the cooperation of Air Canada counsel, of reviewing all available documentation in certain areas or transactions where such documentation could be readily isolated, and preparing a report on the factual aspects of the area or transaction in question. Counsel for the Commission and Air Canada thus worked out a common factual basis for certain major transactions, and obviated the need for lengthy examination of witnesses in public hearing. This saved a great deal of hearing time. One example is Chapter 7, where the basic facts were established by this technique, and only a limited examination of witnesses was therefore necessary.

2. *General Observations*

The examination of matters recited in the constituting Order in Council, and like matters encountered in the records of the corporation, revealed four principal transactions which required detailed review. These were:

(a) McGregor Transaction—Chapter 6

(b) Barbados Leases—Chapter 7

(c) Venturex Limited—Chapter 8

(d) Conflicts of Interest—Menard villa, etc.—Chapter 9

These transactions were found to be illustrative of certain common problems. The first common denominator to become evident was that all were centred in the Marketing Branch at the Head Office of Air Canada in Montreal. The second common denominator to all these transactions and events is that the overriding characteristic leading to the difficulties in question was not dishonesty, greed or cupidity but opacity or cavalier disregard of the ordinary rules of business. The third common denominator was a desire to disguise or to masquerade the nature of the transaction or of some document involved in the transaction. In the result, the investigation was led into an endless chase for a wrongful intent or an improper motive, none of which were ever discovered.

The Marketing Branch will come in for special attention in this paragraph and a word on its personnel and role at the outset is required. When, in 1970, Mr. Menard joined the airline as Vice President Marketing, he reported to the President of the airline, then Mr. John Baldwin. This continued until December, 1973 when Mr. Baldwin retired. Thereafter Menard reported directly to the Chairman of the Board, the Chief Executive of the Corporation, Mr. Pratte, and not to the President, Mr. Vaughan.

By early 1973, Marketing began to extend its influence and activities into the area of diversification of corporate activities. The broad guidelines of a diversification policy were adopted by the Board of Directors of Air Canada in June 1972 and envisaged moving into the businesses of lodging, tour whole-

saling, retail passenger channels of distribution, and cargo channels of distribution. The policy was no doubt designedly broad and in some aspects ambiguous. It is not clear whether the new areas of endeavour were to be taken up by acquisition or expansion of existing corporate organization and resources.

The then Vice President Marketing, Menard, seems to have misconstrued the role of the Marketing Branch in this program. No one in any other office or branch seems to have taken issue with his initiatives and actions based on this misconstruction, and the boundary lines of corporate authority between the President and his staff, which included the Director of Corporate Development, and the Marketing staff began to blur. The sharing of the time of J. J. Smith, Director of Corporate Development on the President's staff, between the Vice President Marketing and the President of the airline, Mr. Vaughan, did not help either function discern its proper region of operations within the corporate camp. The purpose of the sharing of Smith's time between these two Branches was never explained. The Marketing Branch did not receive any formal powers of acquisition and development. The President's area was not delineated in By-law, Board Minute or recorded policy, but did include the Directorate of Corporate Development.

About the same time, that is, early 1973, Marketing also began to assert an operational role, as distinct from its staff role, as a Branch in the corporate Head Office. Led by Menard, both as Vice President Marketing and as President of Venturex, Air Canada was catapulted into the business of operating tourist accommodation in the Caribbean, not as a blocked accommodation service to its passengers, but as a principal. Marketing, in this endeavour, had neither the corporate authority for the undertaking nor the staff and experience to carry it off. The other operating ventures of the Branch fared no better.

3. *Principal Transactions*

It is against this background that we turn to the four major areas or transactions mentioned above.

(a) *McGregor Transaction*

The specific conclusions with reference to the McGregor transaction are outlined in Chapter 6. An investigation of the McGregor affair operates like an x-ray of the Air Canada financial authority and control systems. The purpose or purposes of the McGregor matter we are no longer concerned with at this point; the fact that $100,000 could get out of the company accounts in these circumstances is our concern.

To begin with, we find absolutely no evidence of any improper pecuniary gain to any Air Canada employee. We find absolutely no evidence of collusion or conspiracy between any employee of McGregor and any employee of Air Canada to obtain funds from Air Canada in any wrongful manner or

sense. Misguided or over-enthusiastic as the officers of Air Canada might have been, neither illegality nor tortious or criminal conduct is anywhere indicated.

The McGregor payments manifest several defects in the structures of control of Air Canada.

(i) The Vice President Marketing adopted a grand indifference towards the details of his Branch operations and towards his own duty to adhere to the rules of the company or indeed to the basic principles of management. We are asked to believe that he did not know the contents of the three agreements of November 28, 1974 until April 16, 1975 when he saw copies of them on a T.V. news screen. At best he was negligent and reckless in signing important documents obligating his employer to pay substantial sums of money; at worst he set out deliberately to pay the money to McGregor in defiance of all applicable rules of Air Canada because it suited his personal grand design of Air Canada's business destiny to do so, and then feigned ignorance of the details of the transaction. Whichever is the case we need not determine in order to condemn this former senior officer for his part in this long and bizarre affair.

(ii) The senior staff of Marketing directly concerned with the transaction cannot be excused for their part in bringing about this improper disbursement, but their plight can be understood. It is unfortunately a case of sympathy without exoneration.

Parisi probably played the major role in designing the plan. Garratt, who, as Branch Controller, should have known better than anyone else, had ample forewarning of the nature of the plan to be able to contemplate the gravity of the breach of regulations involved, and then proceeded to play a leading role in attempting to bury the matter from view even after the Finance Branch investigations began. He had a clear duty to explain to Menard, his Vice President, before the fact, the magnitude of the breach and its consequences, as well as the seriousness of acquiring an option without a contract and, more importantly, without turning the project over to Mr. Vaughan's department. His second line of action was to report the whole strange interlude to the Vice President Finance, his functional superior. He did neither.

Smith continually straddled the line between Marketing and the President's staff and in the McGregor matter did not act decisively as a representative of either staff. He did not have the opportunity, or indeed the corporate authority or stature, to block the deal. He could, however, have blown the whistle by seeking formal approval of the option aspect from his superior Mr. Vaughan.

Compare then the actions of the Marketing staff to those of Mr. Bagg, in the Purchasing and Facilities Branch, who recognized, on the basis of the AFE's alone, the likelihood of a deliberate avoidance of the control system; and compare the response of Whitrod of the Finance Branch, who, in his investigative report recommended all the actions which, if taken,

would, in January or early February at the latest, have bared the whole affair to the Vice President Finance and probably thereby to the Chairman of the Board of the airline.

(iii) The role of the Finance Branch in the McGregor matter is more difficult to assess definitively. To begin with it must be said that the Finance Branch cannot avoid its responsibility by merely demonstrating (if that could be done) that the Chief Executive Officer had a general knowledge of the impending transaction. Nor can the Finance duty be discharged by the Vice President Finance directing the Vice President Marketing to clear the program with the Chief Executive Officer before proceeding with its execution.

The next ground advanced for removing some or all of the contributory responsibility from the shoulders of the Finance Branch was the failure of the functional responsibility of the Marketing Controller at the time when the disbursement plan was formulating in Marketing like a young thunder cloud visible for the Marketing executives to behold.

None or all of these explanations divest the Finance Branch of its overriding responsibility for matters financial where the establishment and enforcement of reasonable controls would have saved the corporate treasury harmless; but that is only one side of the story. A concerted effort in Marketing to avoid the Finance Branch scrunity of a transaction will always succeed in the first instance. Two questions therefore arise. Did the Vice President Finance receive sufficient warning signals of this irregular plan and its impending improper execution? Secondly, did the Finance Branch respond quickly and correctly after discovery of the event? As to the first question, the Vice President Finance testified that he did not receive copies of the explanatory memos of Smith. He did not hear of the AFE-raising problem from Parisi through Seath; and finally when told of the plan to acquire an interest in a travel agency in general terms by Menard, the Vice-President Finance said that he told him to clear it with the Chairman. Seath took the same position in these events, except, as is pointed out later, he clearly received a great deal more information about the project. Kendall and others incidentally involved did not have the exposure to the preparations for the payment out to be expected to forewarn their superiors.

In order for Cochrane to escape all responsibility with reference to the McGregor transaction, he must pass the following three tests:

(a) The evidence must demonstrate that he had no prior knowledge of the transaction;

(b) If he had prior knowledge, it only ran to the questions put by Garratt which Cochrane referred to Seath and about which he had heard no more;

(c) When he received the memogram or the AFE or the verbal report from Anderson, Brooks or Sheehan:

(i) he reasonably failed to associate the explanations of Menard on November 22 and the questions of Garratt on or about

November 25 with the revelation of the three AFE's about two or three weeks later;

(ii) and (even if all the foregoing tests are passed) he then instituted and supervised a *bona fide* expeditious and reasonably thorough investigation.

Dealing first with (a), Cochrane cannot disclaim all knowledge, for as a minimum he knew the following: Menard had described the transaction to Cochrane at least in general terms and, according to Cochrane, claimed Chairman approval. So far this relates only to the option alternative. Secondly, Garratt called Cochrane some time between November 22 and 25 to find out how the monies could be made available and Cochrane admits directing him to Seath. At least Cochrane is aware from these two contacts that some kind of a transaction between Air Canada and McGregor Travel was in the works, if not imminent.

As to (b) if we assume Seath never referred the matter back to Cochrane when in his very presence Parisi and Garratt over a two day period changed the deal from 'option' to 'services', then Cochrane does not receive any additional or later input on the McGregor transaction. Seath supports Cochrane; Parisi does not.

A crucial document is the memorandum to file (undated) by Smith in which he stated that he sent on November 25 to Messrs. Garratt and Seath and on November 26 to Cochrane, copies of the memos of November 15 and 20, the latter having attached thereto the McGregor financial statements. These memos fully describe the impending transaction in both its aspects, that is 'services' and 'option'. Smith's evidence is that he directed his secretary to deliver these documents by hand to the above persons and that she confirmed doing so. Seath and Garratt acknowledged receipt; Cochrane denies receipt. This memo to file is peculiar in that there is no explanation as to why Smith bothered to write it and it bears no date. However, we know from other similar instances that Smith is an avid memo writer and that he was in the habit of putting such memos on file after events or discussions had taken place. Smith explains the transmission of these documents to Cochrane on the ground that Smith was then moving into the Finance Branch and wished Cochrane to know of the ongoing transactions in which he was involved. This seems to be a *non sequitur* when one realizes that Smith at the time was on Mr. Vaughan's staff but he sent no memos or copies of memos concerning the McGregor transaction to Vaughan, nor does the evidence reveal that he ever reported orally on the matter. However, he may have assumed that Vaughan was reading Smith's monthly reading file.

If Cochrane escaped the tests of paragraphs (a), (b) and (c) above, then we must consider a memo from Smith to Cochrane dated November 27, 1974 two days before the payment to McGregor and about the time that the undated memorandum mentioned above was probably written. The memorandum of November 27 lists Smith's "ongoing projects". On page 2 under that heading it is said "No. 5 advice to Mr. Menard on: (a) alliance with

McGregor Travel. Action agreed with Mr. Seath". It is possible Smith, Garratt and Parisi by their visits and memos sought to web in either Cochrane or Seath, or both, so as to pass off their oral approval as the Finance Branch comments required by Chapter 8 of Manual 300 on AFE procedures.

As to (c)(i), a short two or three weeks after the above events (of which Cochrane admits knowledge) he is again confronted with a transaction described in AFE's and agreements, on which appears McGregor's name and a member of the Marketing Branch as the Air Canada originator. Even with this reminder Cochrane testified that he did not associate the Menard and Garratt conversations (and maybe also the Seath conversation and the enclosures mentioned in Smith's memo mentioned above) with the transactions described in the AFE's and the contracts. This is very difficult to believe because on the evidence the frequency of Marketing transactions involving AFE's is not great. The reference of the matter by Cochrane to Seath was only a short period before the AFE's arrived at Cochrane's desk and the same Branch was involved. However, in fairness it should be noted that Pratte in his testimony found this failure of association by Cochrane to be understandable.

As to (c)(ii), Cochrane clearly instituted the investigation and whether he directed it actively or not, he is responsible. Between the first half of December and March 17, the investigators saw only Anderson of Finance and Garratt, the Controller of Marketing. In this period of time the investigators did not:

(a) Ask for files of Smith, Parisi, Garratt, Menard, etc.

(b) Interview the originator of the AFE, Parisi.

(c) Interview the authorizer of the AFE, Menard, or arrange for that to be done by Cochrane.

(d) Interview Cochrane once they learned, on January 30, by reason of Garratt's conversation with Cobb, about Cochrane's knowledge of the transaction prior to its closing.

It is imperative to note that on January 13, Kruger, after at least one meeting with Cochrane, virtually directs that no investigation of AFE splitting be considered. On February 11 Cobb announced that because of "unique circumstances" there would be no further investigation. On February 18 Cobb adds to the February 11 memo only by referring to an "off the record conversation" with Garratt and then asks, or inferentially directs, that the AFE's be closed out. Cobb then deflects the investigation into an exercise for the amendment of Manual 300 re AFE splitting. By this time it appears that the investigation was shut down and the transaction well buried.

Unpredictably the Menard resignation flurry blows up in the week of February 23. During this week neither Cochrane nor Taylor, both of whom had read Cobb's memo of February 11, mentioned the fact of the investigation of Menard to the Chairman or the Executive Committee who were deliberating along with some members of the Board of Directors as to

whether or not to ask for or to accept Menard's resignation. Presumably Cochrane and/or Taylor recognized the danger of withholding this information from their colleagues on the Executive Committee and from the Chairman any longer; or perhaps they, or Cochrane alone, realized that the Chairman may have forgotten about Menard's dealings with McGregor. Cochrane in any case communicated the matter to the Chairman on March 7 by purporting to remind the Chairman of a conversation which Cochrane said he believed Menard had held with the Chairman in the week of November 20. Cochrane says, and Pratte denies, that Pratte remembered the conversation and that it was a stock transaction involving McGregor.

It is important in analyzing this history to determine the state of Cochrane's knowledge immediately before the monies were paid out.

Certain conclusions must be drawn from the foregoing:

1. It seems impossible to completely exonerate the Vice President of Finance. If he passes tests (a) and (b) above he most certainly is responsible for the ineptitude, if not the designed failure, of the investigation.

2. We do not believe that the Vice-President Finance did not, or could not be reasonably expected to, connect up his conversations with Menard and Seath on a fairly precise marketing problem to some bizarre AFE's drawn to the attention of his Branch by another Branch, Purchasing and Facilities, and not longer than three weeks at the very outside after the conversations with Menard and Seath.

3. Seath likewise cannot escape responsibility. He did not report back to his superior Cochrane the astounding behaviour of the Marketing Branch personnel, including the Director of Merchandising Parisi, when, in Seath's office, in the course of discussing the McGregor option transaction with Seath, they changed the form and appearance of the transaction to one involving 'services'. These Marketing personnel thereby changed in Seath's presence the fundamental nature of the transaction without any apparent reference (a) back to the Vice President Marketing for authority, or (b) to the other party to the deal, McGregor Travel. Furthermore so far as Seath was aware there were no funds available in the Marketing Branch budget for this new 'services' proposal.

Finally Seath also became aware in that conversation that three separate services were being contracted for and that the total of the payments was $100,000. The tactics of Parisi in the presence of Seath were transparently those of a person determined to pay out $100,000 in whatever way was necessary to accomplish this goal.

4. The investigation staff did not testify that the Marketing Branch executives had successfully buried the transaction and therefore they must be responsible for their failure from the first part of December to March 17 to discover that the 'services' transaction also included an unwritten gentleman's option and that services of value were apparently not going to be provided under the contract.

There are at least two possible theories to explain this nonsensical transaction, which are as follows:

(a) Menard realized that McGregor Travel was a big supplier of sales to Air Canada but was not financially strong. Menard, in an expansive mood, set out in the style of the modern conglomerate to take Air Canada into the travel agency business by vertical and horizontal integration with travel agents and tour operators. This process stretched out to 18 months, by which time McGregor Travel was in obvious financial troubles. Menard by his repeated expressions of interest in merging with or acquiring an interest in McGregor Travel realized that he had painted himself into a corner. Faced with the threatened financial collapse of McGregor Travel, Menard suddenly agreed to proceed with the vague plan of integration. To do so he simply instructed his staff, plus Lindsay, to find how much was needed by McGregor Travel and how to make the payment. An option was apparently discarded because it required the approval of Vaughan's Branch and because there was no budget for it in Marketing. Therefore they stumbled on to the "services" idea, found the funds in the Marketing Branch Merchandising budget, and then split the AFE's, at least to avoid delay in the Finance Branch, and at best to avoid detection. It was all done in Marketing and by Marketing staff with only accidental leaks by McGregor to McGill, by Garratt to Cochrane, and by Parisi to Seath. After the event the cover-up was effected by investigating AFE policies, by delaying discussion with Sheehan, by avoiding Marketing Branch files, by not going to anyone but Anderson and Garratt for three months from mid-December to mid-March, by not "finding" any reference to an unwritten gentleman's option until March 17, long after the closing out of the AFE's, and the closing down of the investigation had been directed. The reason the investigation had to be revived and the Chairman involved was Menard's unexpected resignation during the Barbados crisis.

(b) Alternatively McGregor Travel had given worthwhile services either in sales volume or in connection with the Quebec travel agency legislation and was being paid for such services.

There may be other explanations. There is almost nothing to support explanation (b) and the evidence neither entirely supports nor destroys explanation (a) which we advance as the best product of our efforts to unravel the mysterious comings and goings of the many personnel involved in this transaction.

In summary therefore, the Vice President Finance was exposed intermittently to the unfolding McGregor transaction and at least saw documentary reference thereof in the Smith memorandum of November 27, just one day before the AFE's and the contracts were drawn and two days before the cheques were issued and delivered.

5. Seath's connection with this transaction commenced November 22, 1974 when Cochrane told him that Menard had mentioned some kind of deal between Air Canada and McGregor Travel and that Garratt, the Controller of Marketing, would be contacting Seath. Presumably this matter was routed

to Seath because it was a capital acquisition requiring funds. The question immediately arising is why Cochrane, Seath and Menard did not individually refer the matter to the President Mr. Vaughan or his Director of Corporate Development, Smith, for processing. In any case no one did. On November 26, 27 and 28 Seath met with Garratt, the Controller of Marketing, Parisi, the Director of Merchandising in Marketing, Lindsay, the volunteer from Venturex, who is somehow involved as a quasi-member of Marketing, and with Kendall of Seath's section. During these many contacts Seath read memos describing the transaction in detail and was consulted by Garratt for assistance in financing and in the preparation of AFE's. During the same period, Seath was told by Dobson, a director of and chief investor in McGregor Travel, that the company needed money "to stay alive". In the course of these talks Seath advised the representatives of Marketing that the program with McGregor could not be in the form of a loan as it was beyond Air Canada's powers, and if in the form of an option, Board approval would have to be sought through the President Vaughan. Seath also pointed out to them that as an investment it did not offer any return to Air Canada and that he feared the implications under the IATA Regulations. As a result, Seath understood that the "option" plan was dead and that the deal would go forward on the basis of "personal services". Garratt, at this time, stated to Seath that there was some urgency in getting the $100,000 over to McGregor Travel and, either because of this fact or because of what he had told the Marketing executives, Seath concluded that under these circumstances no option acquisition was being undertaken.

Smith's memos of November 15 and 20, which Seath had read, described the 'services' program in detail. At this point Seath and Kendall informed Garratt that the "services" transaction would require an AFE and Kendall added that Menard's signing authority was $50,000 when in fact it was $100,000. It is of interest to note that Kendall advised Garratt in this meeting that it was not proper to charge these kinds of services to advertising promotion. While his views seemed to have had very little effect they do reveal an awareness in Marketing, and in Seath as well, that this transaction was in fact a masquerade. What followed was the formulation of the paperwork to transform the option plan into a contract for consulting services which would be charged to the Marketing budget and authorized by three AFE's all below the presumed level of authorization of Vice President Menard. Garratt, and probably Seath, knew that Menard's authority went to $100,000 but they were also aware that Finance Branch comments were required for all AFE's over $50,000. Presumably neither wanted either the delay entailed or the risk of adverse comments. In the end Seath was fully aware of the 'services' basis for the deal and that there would be three cheques, not one.

Seath says, in justification for his failure to intervene or to withdraw from the program, that he understood there would be invoices from McGregor or his company, that Marketing could justify the value of the services, and

that he did not understand there would be three contracts. As mentioned above, Smith later reported on November 27 to Cochrane (in the course of reporting on his work generally) with reference to the McGregor transaction, that "action agreed with Mr. Seath". As an explanation of his memo Smith testified as follows:

> "Q. What did you mean on November 27 when you wrote to Mr. Cochrane that insofar as the alliance with McGregor Travel was concerned that the action was agreed with Mr. Seath.
>
> A. Mr. Seath had become aware that some money would have to be issued.
>
> Q. Had he been made aware by you, Mr. Smith.
>
> A. Not primarily by me but I had contributed to his understanding by sending him the memo of November the 20th and I had understood him to say that he thought the money could be issued so that hence the phrase 'agreed with Mr. Seath'."

There is no documentary evidence that Seath reported any of the foregoing to Cochrane although Parisi states that he did so by telephone during his meeting with Seath on November 27. Seath denies that he did so.

Thus, in substance, a senior officer of the corporation, the Treasurer in fact, knew of the transaction sufficiently in advance to intervene and prevent the issuance of the cheques; or at the very least warn Cochrane or suggest he advise the Vice President Marketing of the improprieties being committed by his staff. It must be concluded that Seath was aware that the services plan was a sham or device to avoid the delay of processing the payment through corporate channels as an option acquisition. Seath must also have been aware that the Marketing Branch scheme was a violation of the spirit and purpose of the AFE regulations because the AFE was to be artificially divided into three for one of two reasons, both of which were improper. There is no evidence that Seath was aware that payment would be in advance or that the payments would be made to McGregor personally or to his company. He was aware, however, that the services program was adopted in place of the option plan and that the services were divided into three categories with payment being made by three cheques under separate AFE's all to the same person.

6. To digress for a moment, the role of Lindsay in the McGregor disbursements remain shrouded in uncertainty. He was the General Manager of Venturex but that company was not involved because Menard had directed that the matter should not be directed through Venturex. By the summer of 1974 Lindsay had developed a close relationship with McGregor by reason of recent close contact through the conduct of airline business with McGregor Travel. Through the climactic phase of this longstanding enterprise (which Lindsay had roundly condemned in a memorandum in November 1973) Lindsay was the mortar between all the bricks. He communicated the need for

funds to close the deal with McGregor to Parisi. By accident or design he was present when Parisi 'dictated' the three agreements. Lindsay also advised Seath, the Treasurer of the airline and a member of the Finance Branch, that the $100,000 was being paid for the three services which Parisi had described. He took the agreements to Menard for signature; his secretary took the agreements to McGregor for signature. He was aware the cheques had been issued. He asked Smith to accompany him to McGregor's office when, as Smith says in a memo written in the following week, they delivered the cheques to McGregor. Lindsay cannot remember delivering the cheques and explains his attendance at the McGregor office as the thing to do at the end of such a long transaction. Lindsay explains his participation in the details of the closing arrangements on November 28 and 29 as being at the request of Parisi who was going to be away from the office on holiday. Lindsay testified that despite all this and the telephone calls Lindsay and McGregor exchanged in the last days before the payment of $100,000, he did not appreciate the nature of the arrangement, that is, whether it was for 'services' or for an 'option' or both. Lindsay had no formal communication with or duty to Finance. His President at the time was Mr. Vaughan; he also reported to Mr. Menard as Vice President Marketing. He has not revealed any communication about the McGregor matter to his President Mr. Vaughan, either at the time of the November payout, the February crisis over the Menard villa and his subsequent resignation, or even in March and April when the matter was being investigated by Finance. His detailed involvement remains largely unexplained.

7. The Finance Branch must of course bear responsibility if the $100,000 disbursement occurred because reasonable finance and accounting procedures were not in operation at the time. There is however no reason to believe that any additional accounting procedures would have forestalled the determined though misguided, however well-intentioned, efforts of the Marketing Branch to carry off the deal. The Marketing Branch appear to have decided that if the transaction were discovered it would simply be presented by that Branch to the airline executive as a *fait accompli* generally falling within the corporate diversification plan; or perhaps the Marketing Branch hoped that by reason of the splitting of the AFE and the premature closing out of the AFE's in March 1975, the transaction would never be detected.

In any event, what is the condition of the Finance Branch responsibility for this unauthorized disbursement? The Bagg discovery was fortuitous. There is no documented functional responsibility for Bagg to do as he did and therefore one is not thereby led away from the conclusion that the AFE's were discovered in the first week in December by good staff work, by a person with a keen sense of duty to protect the well-being of the corporation and not by reason of any articulated functional responsibility. Bagg's instant conclusion that rules probably had been broken by the transaction stands in marked contrast to the action of almost all others in and out of Finance when first apprised of these AFE's.

It is idle to speculate as to whether these AFE's would have been netted out of the general flow by the Finance Branch Winnipeg Accounting Group, or by Anderson in Finance at Montreal, or by anyone else. However, we have no reason to believe that the control system would not have worked and therefore we do not fault the Finance Branch for not having in place at the time a system of controls which was reasonable and adequate for the task. There are other related accounting matters in the disbursement area which are commented upon in Chapter 12. So far as the McGregor transaction is concerned, the recommendations, if implemented, would not have prevented the payout or brought earlier detection.

8. There remains to be assessed therefore the response by the Finance Branch and its senior officers after the discovery of the AFE's and the real or potential wrong-doing they represented. When the AFE and the accompanying agreements reached the top of the Branch, the Vice President directed an investigation. Christmas holidays intervened shortly thereafter and no doubt delayed matters.

It should be observed as an aside applicable to a great deal of the areas we have examined, that holidays and holiday periods seem to be of larger significance in Air Canada than in most organizations. This appears to be so because of the fact in airline life that the pass or free transportation policy is generously applied in the industry. The headquarters staff with which the Inquiry mainly concerned itself is mobility personified. Seldom was there a meeting of significance which occurred throughout the McGregor saga and the Barbados negotiations, without the evidence indicating that someone was absent in the Caribbean, had just returned from Barbados, or was just leaving for some distant point. For example, at the time of the *ad hoc* meeting of five members of the Board of Directors on February 28 on the crucial issue of Menard's resignation, Cochrane was in Jamaica, d'Amours in Jamaica, Vaughan was in Barbados; and the previous week Menard was in Manila. This feature of airline and travel industry life generally was evident from our research which carried beyond Air Canada and it is a very real factor which must be acknowledged in evaluating some of the evidence on the issues which have been reviewed in this Inquiry. It should be added that we directed our investigation to the controls respecting staff transportation and passes and found them satisfactory and in line with industry practice. We conclude that by reason of the availability of free transportation to all employees and particularly senior staff members, an airline is an unusually difficult business to organize and manage.

In mid-December or early January at the latest, the internal audit staff of the Finance Branch had commenced their investigation. This investigation exhibited a strange lack of drive. Mr. Kruger in a memo, which in testimony he struggled unsuccessfully to explain, in simple language virtually directed the investigators to avoid any reference to "AFE splitting". Later the person generally charged with the investigation, Mr. Cobb of the Audit section, announced in a memorandum that because "of the unique circumstances" no further investigation would be conducted.

While none of this reluctance can be traced in the evidence to the doorstep of the Vice President Finance, it must be said that very little in a tangible sense resulted from the investigation between early December, when it started, to the Menard crisis on February 23, 1975. Thereafter Cochrane became more directly involved with the investigation and in the ensuing two months the following steps were taken.

(a) On March 7 Cochrane informed the Chairman in his office of the transaction and of the fact that it was being investigated. This meeting is discussed in detail below.

(b) On March 17 the Chairman, on returning to his office from Europe, asked Cochrane whether there was anything further to report about the investigation.

(c) On March 18, or one or two days thereafter, Cochrane met with Garratt, the Controller of Marketing, and Smith, the executive shared between Marketing and the President Vaughan.

(d) Some time before March 25, Cochrane spoke to Mr. Allen, a Director of Air Canada who was Chairman of the Audit Committee, to whom Cochrane proposed that the McGregor transaction be placed on the agenda for the next meeting of the Audit Committee scheduled for April 29.

(e) On April 14 Cochrane wrote to Allen regarding the agenda for the next Audit Committee meeting and which included references to the McGregor deal.

(f) On April 15 Cochrane directed Cobb and Bowman of the Internal Audit staff to examine Smith's McGregor file.

(g) On April 16 Cochrane met with McGill early in the day when McGill told Cochrane that the Chairman knew nothing about this transaction. Later in the day, Cochrane and McGill met with the Chairman and according to Cochrane the Chairman confirmed his earlier knowledge of the transaction.

On April 17 the matter was the subject of questions in the House of Commons.

There are three points at which it appears that there was an attempt by the Finance Branch to finalize the investigation and close out the McGregor file:

(a) The memorandum by Cobb on February 11, mentioned earlier, stated that by reason of the "unique circumstances" no further investigation would be made. The Menard resignation probably put the investigation back on the rails.

(b) On March 10, Parisi, at the request of Garratt, forwarded the necessary papers to Winnipeg to "close out" the three AFE's in the Winnipeg Accounting Centre.

(c) By reporting the matter to the Audit Committee in April, after Menard would have left Air Canada, the Audit Committee could perhaps be persuaded to take note of the transaction and perhaps direct some further changes in the AFE regulations for future purposes.

For reasons completely unexplained, and one would think unexplainable, the Vice President Finance did not raise the fact of the investigation at any Friday meeting of the airline Executive Committee from early December to mid-April. Nor did Taylor, Vice President Public Affairs, who by February 20 or 21 knew almost as much as the Vice President Finance, see fit to do so.

Equally unexplained and unexplainable was the failure of the Vice President Finance and the Vice President Public Affairs to raise the subject at any of the delicate meetings in the week of February 23, 1975 when Menard was placed under investigation by internal staff and External Auditors because of the villa purchase. Why these officers did not venture this fact when the Executive Committee, and particularly the Chief Executive Officer, was labouring with the question of whether to accept the proffered resignation by Menard, remains a mystery.

By March 7, 1975 the Vice President Finance concluded that the matter should be raised in a meeting with the Chairman. Conflicting versions of this meeting have been given but it does not advance our mandate to assess the financial controls of the airline to determine, if it were possible to do so, the actual facts of that occasion. Whether the Chief Executive Office happened to know something of the McGregor transaction from early November 1974 or not, the responsibility of the Finance Branch remained the same both as to the prospective and retrospective aspects of financial control. For the same reason it is not necessary to sift out of the facts of the later meeting between Messrs. Pratte, McGill and Cochrane the extent of each other's knowledge at various times of the McGregor transaction. Thereafter the state of Mr. Pratte's knowledge or the lack of it was not advanced as a ground for investigating the matter in one manner or another. It will of course become relevant in determining the adequacy of executive response to such disclosures as did occur.

Clearly the McGregor investigation lacked thrust and direction and cannot be compared to the investigation of the Menard villa episode which also started before public disclosure of that affair. No meetings were convened by the Finance Branch between the relatively few people concerned, all of whom worked in the Place Ville Marie headquarters of Air Canada, many on the same floor. No direct meeting between Cochrane and Menard was arranged or even suggested except by Whitrod in the lower level of the investigation and his report was ignored by his superiors both on this and on other points.

It cannot be said that this was too small an amount to be taken seriously. The transaction represented a real or potential flagrant violation of important corporate and accounting procedures. The services contracted for by Marketing invaded the precincts of the Public Affairs Branch. The option to acquire shares in McGregor Travel violated the area of operations of Mr. Vaughan, the President of the airline, and his 'acquisitions' staff. There were budget juggling implications. The Marketing Branch attempted to close out the AFE before the contract period for delivery of services had expired. There was an unexplained payment in advance for services to be rendered. The

services contracted for were concerned with influence of foreign governments and the Government of the Province of Quebec by a Canadian Crown corporation.

The investigation by the Finance Branch did not measure up to any reasonable standards having regard to the known circumstances surrounding this matter. The Vice President Finance ordered and followed the investigation and must be responsible for this accepted ineffectiveness. The investigation itself reached no conclusion by March 7. No report was made to the affected areas of the company and no interim report or warning was given to the Chairman.

9. For the same reasons as set out in the case of the Vice President Finance, Taylor, the Vice President Public Affairs, failed in his responsibility to communicate to his superior the Chairman and to his colleagues, his reaction to the transgression by the Marketing Branch of his precincts, Public Affairs. The unusual nature of the services to be provided by McGregor, relating as they did to Provincial regulations, make all the more unnatural his failure to report such irregularities to all concerned and to protest to Menard and the Chairman.

10. From an accounting viewpoint only, the period from about December 7, 1974 to March 7, 1975 may be reasonable for the conduct of the detailed investigation of the accounting and financial procedures involved in this affair. The Commission accountant, Mr. Lowden, said so. From the point of view of the flow of necessary managerial information at the top level of the company, the period was too long and too little was accomplished in that time. Management of an undertaking of the magnitude of Air Canada must at all times have available information relating to executive control and performance, violation of corporate authority, potential risk or obligations and any matter which bears upon the ability of the Chief Executive Officer of the organization to keep the organization under control. The McGregor transaction represented a concerted effort to drive a hole in the side of the corporate control structure and to pour out through that hole a considerable amount of money to an organization with which the airline regularly did business. The circumstances known to the investigators raised real and potential 'political' dangers and revealed financial risks and the purchase of unusual services. All this could and should have been reported on an interim basis to the affected colleagues on the Executive Committee and to the Chairman of the Board.

Apart from a short conversation on an elevator and a possible reference to the McGregor matter by Mr. Menard in the Fall of 1974, there is no record of Pratte having any awareness that Air Canada was either in the process of retaining McGregor's personal services, or of acquiring an option in his company, McGregor Travel. The general diversification program approved by the Board did not, in Mr. Pratte's view, commit the company to any particular project without further specific Board approval in the ordinary manner prescribed by the By-laws and administrative and financial accounting regula-

tions. Other diversification acquisitions in the hotel business for example were specifically authorized by the Board and no one sought to rely on the approval by the Board of the Diversification Plan so as to preclude specific authorization of these acquisitions. The evidence in this complex affair reveals, if anything, a concerted move in the Marketing Branch to keep this impending transaction away from the Chairman and at least in the early plan probably from the Finance Branch as well.

11. By March 7, 1975 when Cochrane advised Pratte of a possible failure by Air Canada to obtain value for their expenditure, the harm was already done and Menard was on his way. The Chairman's concern then was to ride out the storm of confusion in the Marketing Branch following Menard's resignation the previous week; hence the Chairman's comment to Cochrane that he had enough trouble and "not to rock the boat further than necessary in investigating the matter". In any case it is difficult to imagine what further "investigation" three months after the first discovery would reveal. Realistically by this time the money was gone, Menard was gone, and a new man was about to be brought into Marketing, and the Branch was late in getting out the 1975 summer schedule.

However by March 7 both Pratte and Cochrane knew enough (if we believe either version) to go jointly to Menard, his senior staff and McGregor and establish the entire story. Menard had resigned and was leaving the premises in a few weeks. Instead, very little was done and Menard was allowed to leave before any open, collective and concerted drive was made to ascertain all the facts and to take whatever action had to be taken to protect the corporation's interests then and in the future.

The involvement of Pratte and Cochrane in the McGregor transaction and the executive response to the revelation thereof can best be examined from the postion taken by both of them with respect to a meeting by them and only them in the Chairman's office on March 7, 1975 already mentioned above. Mr. Pratte is alleged by Mr. Cochrane to have volunteered information about an earlier stock arrangement in response to a comment by Cochrane that Menard agreed to communicate to the Chairman the details of such a proposed arrangement. Pratte denies this, as stated. Assuming for the moment that Cochrane is correct, then what did he do about pursuing the stock arrangement mentioned by the Chairman? He must have assumed the transaction never came off and therefore his expressed "relief" relates to something which did not happen anyway. Furthermore, as Vice President Finance he was in a position to know if an earlier stock acquisition had occurred and presumably therefore he knew that whatever the transaction was to which Pratte made reference (according to Cochrane's evidence) it had not happened. Assuming Cochrane's evidence to be true, how could Cochrane conceivably not relate the two transactions since according to Cochrane's evidence they both involved McGregor and Marketing and to his knowledge were being processed at the same time.

On the other hand, assuming Pratte's evidence is true, it is difficult to understand why he gave the lecture, which in his own words he gave to

Cochrane, for not advising the Chairman directly instead of relying upon other vice presidents to communicate matters to the Chairman when asked to do so by Vice President Finance, Cochrane. Since Cochrane did not know of the stock arrangement on March 7, it is logical that his conversation with the Chairman was limited to the services agreement. Since Mr. Cochrane did not relate the services agreement to the Menard conversation in November 1974 with reference to the stock option then the Chairman could not have been directing his criticism to Cochrane's failure to relay to the Chairman the stock arrangement but rather the services agreement. But Cochrane had not, according to his evidence or Pratte's evidence, asked Menard to discuss the current "services" problem with the Chairman.

These conflicts cannot be resolved and it is fair to assume therefore that whatever these two men knew on March 7, they both knew enough that a full exchange between the two would have revealed the entire transaction and the risks to which Air Canada was then exposed. Each executive therefore must be taken to have failed to respond in a reasonable manner to such information as did become apparent if either version of the March meeting is to be believed. This is particularly so as the discussion was held in the wake of the shattering Menard resignation episode. Because this touches upon an important aspect of this investigation, the verbatim transcript of the Pratte and Cochrane version of this meeting is set out in Chapter 6 above.

12. Pratte's reaction to the McGregor revelation by Cochrane one week after the Menard resignation and only a few days after the publicity and embarrassment in connection with it had died down, either was entirely out of character or was inadequate and slow. The desire to avoid further turmoil in the Marketing Branch is understandable. However his failure to remonstrate with Cochrane for his failure to disclose the fact of the investigation during the week of February 23-28 is not. The delay in penetrating the second 'Menard matter' seemed to be too readily accepted. The natural desire to rebound from the shock of discovery and attempt to recover the money was absent or at least not recorded in our Inquiry. The delay on McGill's part in coming forward with his knowledge, even after Jolivet called McGill on April 15, did not bring any critical response. Most difficult of all to comprehend was the Chairman's failure to go straight to Menard with Cochrane on March 7 to open up the matter directly with him and thereby bring to completion the investigation which had dragged on for three months by that time. Menard had resigned and was preparing to turn things over to his successor when appointed. The investigators had reported at least to the extent Cochrane reflected their reports to the Chairman and Menard should have been given the immediate opportunity to explain his actions. Indeed, McGill's promotion in the midst of all these still unexplained events and before all the implications and involvements were identified was premature. Symbolic of all these unrealities was the testimonial or farewell dinner for Menard which continued to be scheduled for April 17, the eve of his departure for Barbados, when it was cancelled by the Chairman an hour or two before the dinner was to commence.

13. It is impossible to conclude otherwise than that McGill knew at the earliest times of the outline of the McGregor negotiations. He is a boyhood friend of McGregor. He introduced McGregor to Menard. He also knows Dobson, the principal investor in McGregor Travel. He regularly saw and had lunch with McGregor. When negotiations became protracted into an 18 month marathon and McGregor's finances developed a serious sag and with Burke-Worldwide amalgamation fading, it is impossible to believe that McGregor never communicated his frustrations and anger to McGill. At that time McGill was Vice President Eastern Region but did not have his offices in the Head Office of Air Canada at Place Ville Marie. He was located about a mile away in downtown Montreal.

All this being so it was difficult to understand that McGill would not at least enquire of Menard where matters stood. Furthermore, McGill became Vice President Eastern Region in December 1973 and McGregor was the principal source of travel agent sales in that region. As the responsible officer for the Eastern Region it would be in McGill's line of duty to ensure the company did not alienate this important agent's goodwill. In fact McGill's superior Mr. d'Amours, the Group Vice President Sales and Services, reported to McGill an instance when McGregor seemed to be routing business to a competitor of Air Canada. In answering d'Amours' concern McGill did not reveal the invasion of the Sales and Services region of operations by Menard and the Marketing Branch to d'Amours even when the very fact of the inquiry revealed that d'Amours as a Group Vice President was not aware of the transaction and the payout of $100,000 to McGregor Travel. McGill must therefore have known not only the nature of the deal but also that it was unknown to the Executive Committee membership. This placed McGill in a very awkward position as Vice President Eastern Region in that he knew of a transaction between the largest Montreal travel agent and Air Canada, of which his superior, a Group Vice President, was unaware. It also placed McGill in the awkward position of knowing that some deal had been made with a travel agent after Mr. Pratte's memorandum of June 1972 directing the staff of Air Canada to adhere to the IATA Regulations prohibiting kickbacks, etc., to travel agents. McGill therefore either had to know of the McGregor transaction or be reckless as to whether or not it offended Air Canada regulations. Yet he was the Regional Vice President responsible for McGregor Travel as an Air Canada sales agency. In these circumstances he testified that he did not obtain an explanation from Vice President Marketing or report the matter to the Group Vice President Sales and Services, his superior.

When it came time to investigate the McGregor matter on April 15, 1975 McGill again found himself in an awkward position. The Chairman had authorized him to see McGregor and he had also been instructed in the takeover of the Marketing Branch from Menard to discuss with Menard all outstanding matters. This of course included the McGregor transaction. Yet McGill knew a great deal about the transaction months before this, or if he did not, he should have inquired of his superior or of the Vice President Marketing, or even McGregor.

By his letter of May 23, 1975 to the Chairman of the Association of Canadian Travel Agents, Mr. J. D. MacLean, McGill stated that Air Canada never authorized the acquisition of an interest in a travel agency. He must therefore have known that it was for some other purpose that McGregor received his payment. If it were not a kickback, and he stated that Air Canada did not make such payments, he must have known the nature of the payment on December 5. McGill testified that he knew of some sort of integration or network of travel agents. This fragmentary information would of course be sufficient for him to take the matter up with some authority with Menard when McGill was appointed on March 25, Vice President Marketing. By the time the Air Canada headquarters was engaged in a frantic investigation commencing April 15, Mr. McGill should have been in a position, and indeed may have been in a position, to come forward with a complete explanation, but such was not the case.

His position therefore rests upon a very strict technical view of his area of authority and channel of communication. The matter was primarily within the scope and authority of the Marketing Branch as far as he was aware and he found it in his own best interests, and presumably in the interests of the corporation, not to interfere. It should be observed in fairness to Mr. McGill that he was not a member of the Executive Committee until the end of March 1975, so that unlike other members of the senior management of Air Canada he did not have that regular channel open to raise this matter for clarification.

14. Finally it must be concluded that the McGregor deal showed an intent on the part of the Marketing Branch to avoid the review of the transaction by the Finance Branch and its inevitable detection. The Marketing executives did not apparently realize that the Winnipeg scrutiny of AFE's over $25,000, inaugurated in September 1974, was in operation. As they understood the regulations, the McGregor transaction, as the Marketing Branch had constructed it, would escape the delays of Finance review and the detection by the finance control procedures. There is nothing to indicate any motive for all of this except a desire to carry out Menard's plan to establish some kind of ownership relation with McGregor Travel.

(b) *Barbados Leases*

This unhappy experiment was founded in the virtually undisciplined Venturex Limited, was taken over by Air Canada for what reason no witness could explain, and culminated with the surrender of the right to renew the several leases when Menard had departed and about $1,000,000 had been lost. Again this was a Marketing Branch matter, the head of which throughout almost the whole of this transaction reported directly to the Chairman. It does not appear that this channel of communication was employed by Menard to keep Pratte informed. According to the Chairman's evidence, the Chairman's first recorded contact with the Sunset Crest leases came in January 1974 when Mr. William Allen, a member of the Board of Directors of Air Canada, learned while holidaying in Barbados that Air Canada had some kind of an

involvement in the hotel business on that island. The only evidence of any earlier knowledge on the part of the Chairman was that given by Mr. Vaughan who stated that he believed he advised the Chairman in early 1973 about the negotiations but he could not be certain. On Allen's return to Canada he enquired of Mr. Pratte what Air Canada was doing there as he could not recall any such matter coming before the Board. The Chairman asked Menard if Air Canada owned any property in Barbados, was advised that it did not, and Mr. Pratte left it at that. (No one seemed to regard Air Canada's one third interest in Allied Bermuda as an interest in property in Barbados, notwithstanding the fact that Allied Bermuda is the owner of a Holiday Inn on the island.) It is profoundly difficult to understand why this enquiry would not have come up then or subsequently at an Executive Committee meeting where the Chairman, the President Mr. Vaughan, the Vice President Mr. Menard, the Vice President Finance and probably most of the other members of the Committee knew about this leasing program. At any rate Mr. Pratte did not pursue his enquiry with Menard or otherwise until renewal of the leases was brought to the Board on April 30, 1974. It may be of some significance that Menard was not called into the Board meeting on April 30 when the lease renewals were authorized, bearing in mind that he was the officer in charge of lease negotiations and the project generally.

At that meeting, and in the preparations therefor, Pratte learned the history of these transactions. For example, it was discovered that Messrs. Menard and Vaughan ordered the initial negotiations and later on participated in the assignment of the leases to Air Canada, all without any kind of Air Canada approval either as to the project in the first instance or the acceptance of the assignment from Venturex. By April 30 the annual rental obligation was about $1,000,000, far too large to be undertaken by the airline without a complete financial and marketing analysis and Board approval.

The Chairman did not react in as firm a manner as one would expect from his reaction in other situations examined by this Inquiry. For example, Venturex was not immediately put in for legal overhaul; the role of subsidiaries and their subjectivity to or immunity from AFE regulations and the Air Canada By-laws were not put in question; and the gyrations of the Marketing Branch in and over the domain of other Branches were not made the subject of any executive directive or Executive Committee discussion. In fact nothing was done by the Chairman from January 7-10, 1974 to April 30, 1974 when it reached the Board for the first time. The item was placed on the Board agenda by the Corporate Secretary, Mr. Fournier, and it is not even clear that this action resulted from the Chairman's intervention. There is no record of any investigation of the project in this interval or any discussion of it in the Executive Committee. Furthermore no discussion appears to have arisen between the Chairman and the top executives of Air Canada as to how Venturex undertook such a transaction without the approval of the Air Canada Board of Directors, or at least the knowledge of the Chairman. No such discussions arose as to why and how it was determined to assign the

project from Venturex to Air Canada and why this was done without any approval by the assignee, Air Canada, of the undertaking of such obligations by it.

Perhaps even more startling is the failure of the airline's executive group to take positive action after its confirmation of the renewal of the leases was given by the Board in April 1974 and before the hectic decision in April 1975 not to further renew the leases, to regularize Air Canada's position by either finding a proper method of marketing this accommodation within or without the airline, or for terminating the leases. In short the Barbados transaction was never brought within the Air Canada management structure even after all the facts past and present, as well as forecasts, were either known by or available to the Chairman.

Barbados represents perhaps the clearest illustration of the serious lack of communication between and amongst the senior officers of the airline and between the Branches at the Head Office of the airline. There is a striking lack of material submitted to the Board of Directors for the meetings on April 30, 1974 and again in April 1975 when decisions were made to and not to renew these leases, respectively. The comment should also be made that there was a surprising lack of documentation of these transactions supplied to the Chief Executive Officer of the corporation. This adventure was no doubt undertaken in the best interests of the airline but was done without any attempt to conform to the general corporate procedures and lines of authority. In its operation the Barbados affair further illustrates how a large transaction even though launched without proper authority can be carried off and substantial expenditures made without any reaction from the different segments and levels of the Finance Branch who, in the final analysis, made the actual rent payments.

Although it may appear paradoxical, the record discloses that this transaction was undertaken with the best of intentions by senior executives who appear to have had the interests of the corporation in mind throughout this ill-starred program. There is no indication that the various and repeated failures to channel this succession of transactions into the proper lines of corporate procedures was the result of any improper motives by any executives, senior or junior or that any pecuniary advantage was ever attained or sought by any airline personnel at any time.

When renewal of the Sunset Crest leases did finally come before the Board in April 1974, two studies by the Marketing staff most concerned with the overall program were not placed before the Board. One of them, a memo dated April 29 comments unfavourably upon the proposal to renew the leases (see Chapter 7, supra) and the other accurately predicted losses in the renewal year in the order of $500,000. Neither of these memoranda were in fact communicated to the Chairman.

The defence or explanation for all of this was that the leases, being in the "ordinary course of business", were exempt from the requirement of Board approval. This explanation must be utterly rejected. The venture

was something new in the airline's 40 years of operations. In scale it was a large undertaking absorbing large financial and personnel resources of the company.

A second justification was advanced. The losses on accommodation were in substance and effect advertising or promotion expenses. This would make some small sense if:

(a) the gross seat sales revenue on the Barbados scheduled runs from passengers using this accommodation during the period in question was not less than the 'promotion losses', and

(b) if the promotion expense had been predicted and consciously approved prospectively after expert consideration of the disproportionate promotion accorded to a very small part of the scheduled runs in the airline's overall picture.

Faced with these foreseen losses it is an odd (and unexplained) fact that the help of the Sales Branch was not enlisted in an attempt to find a marketing device which would be profitable or which, at least, would reduce the losses. It must be remembered though, that Messrs. d'Amours (Group Vice President Sales and Services) and Callen (Vice President Central and Southern Regions) were on the Venturex Board when the Barbados arrangements were approved and subsequently assigned to Air Canada. Mr. Vaughan of course was either Secretary or Director and President of Venturex throughout that company's association with the scheme and was designated by the Chairman as the officer of Air Canada responsible for overseeing the Venturex operations. Thus the management team of Air Canada was aware of this Caribbean adventure from the outset and it must be assumed that some or all of them were conscious of the losses to be encountered.

In any event the Chairman did not react in any of these directions in April 1974 and the losses rolled in. By April 30, 1974, there had been only four months experience in the business but accurate forecasts were available. The veil of silence, apparently spread over this deal by the Marketing Branch and Venturex personnel, could have been penetrated by executive probing from the top. In this matter the Chairman is directly concerned.

Vaughan's position is more difficult to assess, but only from a technical viewpoint. He has no operational responsibility and no authority in the area in which this venture operated. He was, however, charged by the Chairman with overseeing Venturex when the Barbados action was initiated. He is the President of Venturex and the President of the airline and he does sit on the Executive Committee and he did know that the Barbados losses had become a burden to Air Canada. He attended the Air Canada Board of Directors meeting on April 30, 1974 when the renewal of the leases for a further 12 month period, that is to say from December 1974 to December 1975, was approved and yet failed to act in any manner whatsoever.

After April 30, 1974 the losses suffered from this experiment grew and finally amounted to about $1,000,000 by April, 1975 when the leases

came up for renewal once more. Again nothing was done at the Executive Committee meetings or by the Chairman to reassess the transaction or to explore alternative methods of exploitation by charter services, etc. In the area of budgeting it must be pointed out that the Marketing Branch made inadequate provision in the amount of $155,000 for the predicted losses in its 1974 budget but made no provision whatever in the 1975 budget even though a loss of more than $400,000 was anticipated. It should be pointed out that provision was made in the 1975 budget for promotional expenses, Barbados taxes, and on-site administration. The Chairman personnally approved the Marketing Branch budget and the records indicate this budget was the subject of much discussion by the Chairman with Menard, the Vice President Marketing. The Finance Branch similarly reviewed the Marketing Branch proposed budget. Eventually the losses were accounted for by charging them against the Marketing Branch budget for promotion and advertising, which makes a mockery of the budgeting procedures at least inside the Marketing Branch. We have already seen that this device was resorted to in the case of the McGregor transactions and the Venturex AFE for $145,-000. In effect several of the promotional, advertising and services budgetary provisions have been converted by the Marketing Branch into an elastic petty cash fund. With such latitude in its budget the Marketing Branch budget cannot be taken seriously under present procedures as a control mechanism of any kind. It would be more accurate to describe at least an important segment of that budgeting as a well-endowed petty cash fund, or a corporate cushion to be resorted to when all else fails.

(c) *Venturex Limited*

In this transaction the corporate lines of authority and communication were non-existent. Mr. Vaughan's staff was active in the formation of the company from the technical viewpoint and was also active in the discussions concerning the future activities of this company. Mr. Menard was the first president of the company and actively participated in its affairs. For example, three months after it was established he directed the General Manager of Venturex to open negotiations for leased accommodations in Barbados. At the same time (that is when the company was formed) the Chairman, Mr. Pratte directed that Mr. Vaughan, as Secretary of Venturex, be responsible for its functions. This somewhat illogical arrangement, *ad hoc* in nature, is very much like many of the other arrangements concerning the organization, accounting controls, channels of communication, authority of officers, membership of the Board and other operating details of Venturex. The company started as an illegitimate child of the airline and never did fit into the control apparatus and management web of Air Canada. The Board in the first year was predominantly made up of Marketing personnel. Two unexplained exceptions were Messrs. d'Amours and Callen from the Sales and Services Branch. In 1974 Menard was replaced as President by Vaughan and by that time the Barbados dealings had been entirely removed from Venturex.

Shortly thereafter, Venturex undertook the entry into the ground reception service business, both by establishing its own organization and by acquiring Touram Inc. and some of its staff. The latter acquisition illustrates the complete lack of corporate precision in the Venturex affairs. The acquisition directorate in Mr. Vaughan's department did not conduct the Touram acquisition. Neither was any semblance of Air Canada authority obtained by any corporate or accounting procedure for this venture either as a formative or acquisitive undertaking; and no one in any Branch at any level complained.

This was a small adventure entailing by December 1974 expenditures on one account or another of about $180,000, of which $145,000 represented a loss on operations and the purchase price for Touram. But failure to apply corporate controls and the failure to recognize a lack of proper authorizations is no less real and important in smaller transactions. Here the President's responsibilities are inextricably interwoven with those of Marketing for the failure to prescribe proper ground rules for Venturex in the first instance and the later failure to recognize the lack of retrospective controls.

Here and there we have touched upon the Law Department and its function. This Department comes under Mr. Vaughan, President of the airline. One characteristic commonly observed in the record is the lack of reference of matters to the Law Department by the other Departments, particularly with reference to corporate powers, corporate authorizations and, in the case of the McGregor transaction, the contracts with McGregor Travel. The Law Department does not seem to recognize, as part of its function, the duty to respond to evidence of unauthorized dealings, abridged procedures, questionable signing authority, and inadequacy of by-law provisions. This is made not only in criticism of the Law Department itself, but of the lack of utilization of that Department as a corporate control. It may well be that the responsibility for this lies in the design of the corporate structure which has left the Law Department as simply another directorate reporting to the President. From our viewpoint, the only relevant aspect of this facet of the evidence is that the Law Department has not been invoked as a prospective or in the case of the conflict of interest investigation, mentioned below, a retrospective control.

The most dramatic aspect of accounting and financial unreality in Venturex is, ironically, the least significant element in the long run. Clearly Venturex was established initially to carry Air Canada into the new charter business, ABC. By mid-summer 1973 members of the planning staff in Mr. Vaughan's 'branch' had other ideas but the ABC business nevertheless was still the *raison d'être* for Venturex. Despite the fact that staff at all levels were aware of the large losses to be incurred in the ABC operations, no plans, long or short range, were devised to transfer such losses into the accounts of the *de facto* parent company, Air Canada. Much later it was realized that for potential tax considerations and to clear Venturex throught CTC as a licensed charterer, it was essential to transfer the ABC losses to the airline's accounts.

But it is imperative to remember the other side of the story here. Air Canada's confusion on the subject of ABC's was in large measure due to the strange regulations of the CTC and the even stranger interpretation of those

regulations by the ATC (Air Transport Committee) staff. It is easy to comment critically, it is much more difficult to detail the whole story without losing oneself in a morass of statutes, regulations and explanations. The CTC Regulations appear to reflect the international scene (at least so far as it comprises the European air industry) and the political need to give the demanding public the alternative of lower cost charter service and still maintain a viable scheduled airline service across the Atlantic; hence the ABC regulations and the administrative uncertainty surrounding their application. In turn, the Air Canada dilemma created under these regulations flowed into Venturex. The airline's limited area of fault in this aspect of affairs lies in the failure of senior management directly charged with organizing the Venturex affiliate to recognize the accounting and financial control demands arising from the use of an autonomous body which was not in law a subsidiary. Senior management failed (a) to incorporate this affiliate and its business into the management web of Air Canada, including the financial and corporate controls and regulations of Air Canada, and (b) to anticipate the loss transfer problem as a result of which a great deal of executive time and expense was entailed in what otherwise would be a routine inter-company consolidation of accounts.

It is inherent in all that has been said that the Chairman and the President of the airline did not take a sufficiently active part in guiding the staff at Head Office in the formation of Venturex by Air Canada and thereafter in its integration into the Air Canada group management and accounting control and communication systems. It is surprising that a corporation headed by two lawyers would not have explored more fully the many considerations for and against the use of an affiliated corporation for operations which require management integration. ABC business probably could have been carried on through a direct subsidiary which would reduce the resultant problem. The other Venturex business would not appear to require the use of a subsidiary, but if a separate corporation were utilized the accounting problems would have been simplified because the associated losses could be eliminated without the complications arising under the ATC rules.

The consequences in the areas of taxation, accounting, consolidation and reporting to the Minister and to Parliament do not seem to have been thought out, indeed even considered, by the Chief Executive Officer, the President or the Branch and directorate heads concerned. Again it was argued during the Inquiry that a 'subsidiary' operation required more flexibility than in the case of the large 'parent' and hence independence from the controls and protective procedures of the parent. The slightest glance at the commercial world in which Air Canada asserts the right to compete on a profit oriented basis, shows the fallacy of such a plea. Corporate flexibility is not to be bought at the price of accountability, particularly in a company which is owned by the taxpayers whose money in the final analysis is at risk. It is significant that Mr. Pratte himself advanced no such idea but rather, and we believe properly, pointed to the establishment in November 1974 of a Committee of the Board of Directors to oversee subsidiaries and affiliates, as proposed by the Director, Mr. Allen in his January and February 1974 talks

with the Chairman on this subject. Indeed one of the causes of the Venturex confusion was flexibility itself. At one moment the executives of Air Canada regarded Venturex as a branch or division of Air Canada; the next moment as a separate entity. The Payroll accounting is but one illustration. Lindsay's ubiquity in the Marketing Branch operation is another.

But it is the Chairman of the corporation who in the last analysis must give leadership in (a) the extension to Venturex of the AFE and other financial and management controls of Air Canada, including its By-laws; (b) the establishment, where the law permits and perhaps requires of genuine subsidiaries under section 18 of the *Air Canada Act* as distinct from affiliates of doubtful parentage; (c) the creation of practical channels of communication between 'subsidiaries' and Air Canada for the flow of information and for obtaining Air Canada Board of Executive approval where required by Air Canada By-laws, regulations and policies had the project in question been conducted through the parent itself; (d) the complete response to or rejection of the Finance Branch proposals made in a series of memoranda by the immediate past Vice President Finance, the present Vice President of Finance and the former Controller of the Finance Branch; and (e) the prospective adoption of such accounting procedures as may be required to extricate the Air Canada group from the hardening of its financial and accounting arteries induced by the ABC regulations of the CTC. (We make no comment on the propriety or otherwise of these regulations but only on the responsibility for the response thereto by Air Canada).

With reference (c) the breakdown of communications cannot be better illustrated than by reference to the fact that the Board of this company has not met for any purpose since July 1974.

With reference to (d) above, the implementation of these recommendations might well have prevented the launching of Canaplan and the associated Touram acquisition without the approval of Air Canada and the appropriate prospective adjustments with reference to the matters dealt with in the aforementioned AFE in the amount of $145,000. Again however it must be said in fairness to the personnel involved in this operation, that they were limited in extent, involved no loss of funds by Air Canada in the ordinary sense, and were approved by a large number of Air Canada executives in their capacity as such or in their capacity as Venturex officers or directors.

With reference to (b) above, be it noted that the ultimate owner, the Government of Canada, had no notice (excepting only one typically ambiguous minute in the minutes of a Board meeting held on January 30, 1973) of the establishment of Venturex by the joint action of the two Crown corporations, the CNR and Air Canada. The financial statements of neither company reflect by consolidation the accounts of Venturex, although, in the case of Air Canada, the accounting reflects the operations of Venturex by a form of consolidation without any footnote or other explanation, as though they had been carried on as a branch of Air Canada. The annual report of Air Canada, filed with Parliament through the Minister of Transport, does not refer to the corporation. Neither the Board of Directors of Air Canada

nor the Board of Directors of CNR authorized the formation of the company by resolution although both Boards were advised of the formation of Venturex after the fact.

The criticism being made here with reference to the creation or parentage of Venturex is not so much that the operations of the company are not reported separately from those of Air Canada but that the combination of events above described resulted in a dangerous autonomy in the area of self-authorization for the incurring of substantial obligations for the eventual account, if not in the name, of Air Canada. This produces the anomalous and very undesirable situation wherein a group of Air Canada officers with very precise and limited authority in their primary capacity as Air Canada employees, instantly acquire unlimited authority to incur obligations when sitting in a group on the Board of Venturex. In the final analysis these become the obligations of Air Canada although incurred without the approval of the Board of Air Canada. Similarly By-law 1, section 28 of Venturex By-laws gives the General Manager authority which is disproportionate to that of the Chief Executive of Air Canada itself.

With reference to the aforementioned AFE in the amount of $145,000, we repeat the conclusions reached in Chapter 8. The practice of the Chief Executive Officer approving AFE's over $50,000 in amount without reference under the AFE procedure to the Finance Branch for proper comment of course results in a serious undermining of the morale and effectiveness of the Finance Branch and its position on the corporate scene. More importantly the deliberate creation of unreality by the descriptions adopted in both the McGregor AFE's and the AFE for $145,000 is dangerous in a company where communication between and within Branches of accurate and understandable information is vital. This practice, however justified and rational it might be in a particular instance, or even how inconsequential a particular AFE might be, invites the adoption thereafter of misdescriptions which will render the scrutiny and surveillance techniques of the corporation much less effective.

(d) *Conflicts of Interest—Menard villa, etc.*

The 1973 purchase by Menard of his villa started a chain reaction which ultimately resulted in this Inquiry. The villa is located in the Sunset Crest Development where Air Canada leased extensive accommodation as described in Chapter 7. A few short weeks after Menard obtained possession of his villa in Barbados, the Chairman and some members of his family vacationed there for ten days. Given Mr. Pratte's great knowledge of detail of the business of Air Canada, which was exhibited in three days testimony by him before the Inquiry, it is reasonable to conclude that he knew of the Sun Living Program of Air Canada in some detail. Mr. Pratte's explanation of his failure to react to the knowledge in December 1973-January 1974 of Menard's ownership of the villa is that he did not know of the Sunset Crest contracts at the time of his visit and understood that any

Air Canada arrangement in the Sunset Crest area was the same "blocked accommodation" arrangement as elsewhere in the Caribbean. A further explanation advanced by the Chairman and others, including Mr. Vaughan, who also knew of Mr. Menard's villa, was that it was not known that the price had not been paid in full. Mr. Pratte, for example, did not know that the mortgage as arranged by the vendor, Sunset Crest, had not been advanced by the mortgage company and that regular payments had not been made on it by Menard, the purchaser.

These rationalizations are not adequate. Menard was the senior Air Canada officer in the discussions which led to Air Canada leasing extensive accommodation from the Sunset group. The purchase by this officer of a villa from the lessor to Air Canada was a gross indiscretion and should have been instantly recognized as such. Had Menard paid all cash, on signing the contract in May-June, 1973, the situation would have been no different. The doubt as to whether Menard paid a proper price would still persist. Not only must an employee, particularly a group Vice President, avoid a position of conflict between his interests and those of his employer but he must not place himself in a position of apparent conflict. Where an advantage might accrue to the employee by reason of his position in the employing corporation, in circumstances difficult to detect, the employee may not enter into such a transaction. Where any such advantage does accrue, it belongs in law to the employer. Where no advantage accrues in fact the employee's position is not improved. His action still creates an improper conflict.

Thus the conflict of interest in the purchase of this villa is clear. That conflict arose because of Menard's senior position in Air Canada and not because of the manner in which the price for the villa was paid. Even if Air Canada's only relationship with the Sunset group, the lessor, which received about $1,500,000 rent from Air Canada over the life of the several contracts and leases, had been that arising in a "blocked accommodation" transaction, the result would be the same. A significant payment of Air Canada funds under Menard's direction would have been involved in this case as well and the recipient would have been Sunset Crest. Mr. Pratte and Mr. Vaughan and apparently a great number of senior head office personnel knew of the purchase by Menard of his villa in Barbados. On any interpretation of the facts of the purchase, Menard's action was in conflict with the airline's interest. Of equal significance is the fact that while many executives knew of Air Canada's relationship with the Sunset Crest development and of Menard's ownership of the villa, no one (not even those with legal training) considered it important enough to raise a question in any of the forums available to these persons within Air Canada.

Even if all the foregoing reasoning were inapplicable, by the time of the Board meeting of Air Canada on April 30, 1974, and the preparations therefor in which the Chairman participated, the full history of the Barbados dealings was known to the Chairman, Mr. Pratte. He then knew of Mr.

Menard's leadership in the program, Sunset Crest's role, and the timing of Menard's purchase of the villa during these negotiations.

All that is said here about the Chairman in this matter can be said with almost equal emphasis about the President, Mr. Vaughan, and probably several others who regularly sit around the table at the Friday Executive Committee meeting. In Mr. Vaughan's case, his connection with the Barbados transactions and his knowledge of Mr. Menard's leading position therein goes back to the very first meeting in March 1973 between Messrs. Menard, Vaughan and Lindsay, then wearing their Venturex hats, when Lindsay was sent to Barbados to obtain leases for Venturex. Later when he first learned of Menard's villa in the Sunset Crest development he asked Menard only if it "was clean". Satisfied with Menard's affirmative reply he did nothing and he said nothing. Vaughan raised no question at the Executive Committee about these Barbados leases or how the project was coming along in the profit sense, and apparently never discussed the matter with Menard again after the Venturex assignment to Air Canada had been authorized. The leadership which Mr. Menard lacked in this area was shared in a passive sense at least by many of his colleagues.

We come then to Mr. Menard's resignation and its acceptance by Air Canada represented by the Chairman and informally by five directors convened to discuss the matter. On the facts as later known, but which could have been quickly and easily established in the week of February 23, Menard probably could not have been discharged. Indeed, the corporation may well have waived any such rights that had arisen by reason of the knowledge of the villa ownership by management since the earliest days and by reason of the Board approval of the Sunset Crest leases some time after the purchase by Menard of his villa was well known by senior management of the company. Acceptance of his resignation may therefore have been an unduly harsh consequence if such resignation had been obtained by pressure based solely on the villa purchase. Ironically however, the actions by Menard reviewed in Chapters 6 and 9, and which later became known to the Board of Directors, fully justified the prior action of the company in accepting his resignation.

It is perhaps illuminating of the general failure of the corporation to utilize the services of the Law Department in the general corporate control machinery, that the investigation of the Menard villa, involving as it did a series of legal documents, was undertaken by the corporation through the Finance Branch internally and the corporate Auditors externally, without any revealed reference to members of the Law Department.

These comments relating to the villa incident should not close without stating clearly that

(a) there is absolutely nothing in the evidence to indicate Mr. Menard received any benefit in fact of any kind from the vendor company which sold him the villa, or that he purchased the villa with any such expectation; and

(b) Air Canada has since adopted a set of guidelines for its employees on the subject of conflicts of interest, and has done so ahead of many large employers, most of whom have relied to date, as did Air Canada, on the generally understood rules of the business world in this connection.

To collect and summarize our conclusions regarding Menard's part in the other matters herein reported upon, it need only be said that all four trouble spots occurred within the Marketing Branch for which he as Vice President was responsible. This Branch was the Branch in control of the McGregor transaction and the Barbados leasing arrangements, and the conduct of Venturex dealings in ABC charters and Canaplan including the Touram acquisition. The Barbados and ABC transactions started in Venturex when Menard was President, and the Canaplan and Touram matters when he was a Director. It was the Marketing Branch which desired Venturex to get into the Canaplan business and it was against the Marketing Branch budget that the $145,000 AFE reimbursing Venturex in respect thereof was charged. Thus it was the Marketing Branch and its budget that was used on the Air Canada side of the Canaplan transaction and it was Menard who originated the AFE for $145,000 which we have already found was improperly processed and did not on its face reflect the true nature of the transaction.

On the evidence it must be concluded that Menard acted improperly as a senior officer of Air Canada, and particularly as one of the level of Group Vice President, when he introduced his former employers Herdt and Charton, to the officers of the Eastern Region responsible for the purchase of wines for the airline. No amount of explanation to these junior executives by a Vice President can ever restore the balance of propriety and assure that no unfair advantage has been given to one supplier over another. As stated earlier, the appearance of conflict and inequity must be avoided as well as the realities. The Chairman, President and other senior executives knew nothing of this activity and had no way of knowing.

The use by Menard of an automobile supplied by his former employers, while he was employed by Air Canada, was of course improper, and Menard's failure to recognize this and to discipline himself accordingly perhaps shed light on his judgment when he failed to appreciate the need to communicate some of his Barbados and McGregor decisions to his superiors and to his colleagues. The failure of the junior executives in the wine purchasing transaction to report to their superior Mr. d'Amours, then Vice President Eastern Region, was understandable and again supports the conclusion that none of these matters ever reached top management. We could find no sign of any pecuniary advantage at the expense of Air Canada to Menard or to any Air Canada employee by reason of these matters. They were bizarre judgment errors by the former Vice President Marketing.

On the positive side of the ledger, there is nothing in the very extensive evidence and several hundred documents to indicate Menard obtained any funds from Air Canada improperly or that his actions occasioned others to

profit at the expense of Air Canada by reason of any conspiracy or improper dealings with Menard. We did find on the contrary that he commanded great loyalty from his staff and was an inspirational leader of the Marketing Branch. It may be that Menard, by maintaining the validity of the three McGregor service agreements when confronted by Pratte on April 17, following the disclosure of the McGregor transaction in the House of Commons, was repaying some of the loyalty shown to him by his staff. In his own way he displayed loyalty to his superior Mr. Pratte and to the corporation. His lack of a sense of reality in some aspects of the business of the airline is illustrated by his collision with field operators over the principle of buying into a travel agency. Even during the hearings of this Inquiry he maintained his belief that this would not alienate travel agents, and indeed for a time that seemed to be a part of Air Canada's defence or explanation of the McGregor transaction. He also maintained in isolation that a travel agent could not divert business to or from an airline.

On the whole there seems little doubt that in fact Menard was accepted as the vibrant leader of his group but as an instrument of corporate control he was not. The details of the AFE machinery, the contents of the corporate By-laws and policies were matters in which he had not the slightest interest. The use of the Executive Committee to coordinate with the other Branches of the airline was a concept apparently totally foreign to him. The other members of the Committee did not, according to the minutes, ever challenge his practice of ignoring the communication function of the Executive Committee.

4. *Marketing Branch Generally*

After examining some 55 witnesses, taking 8,900 pages of evidence and receiving about 600 exhibits, the only significant area of inadequate financial, accounting and managerial controls, in which there was exposed a failure to comply with applicable laws and regulations, was the Marketing Branch. Had the Inquiry been able to extend its investigations as fully into revenue accounting as was done in the case of disbursement accounting, other areas might have been exposed. However, our limited survey of the revenue accounting of the airline gave no such indication.

None of the four implicating matters were the subject of any investigative review by the order of the Chairman of the Board at the time of public exposures in February and April 1975. Menard, as stated, reported from January 1, 1973 onwards directly to the Chairman. Menard's style of visionary leadership management inspired loyalty in those below him and faith in those above. Eventually this led both levels into disaster. Understandable though this circumstance may be, nevertheless it is the duty of the Chairman, on making the Vice President of Marketing a direct subordinate, to supervise that subordinate. There is no evidence that Menard suffered from any 'non-access' policy by the Chairman. In fact Menard seems to have taken advantage of the Chairman's confidence and carried on without communicating

important policy decisions to him despite the ready availability of the Chairman on an informal basis, and the various corporate forums already mentioned.

That all Menard's ventures and negotiations could escape the Chairman's attention over a period of two years is all the more amazing when one is made aware, as was this Inquiry during Mr. Pratte's three days of testimony, of his complete familiarity with the almost infinite number of corners and pockets in this large airline and its extensive operations. It would be difficult to find a Chief Executive of a company with annual revenues in the order of $1,000,000,000 who had a similar grasp of such a vast array of detail, personnel, practices, policies and of the industry in which the company operated. Nonetheless, on the evidence before this Inquiry, the fact is that Mr. Pratte in his evidence was not aware of the three major transactions investigated and described in Chapters 6, 7 and 8, until late in their respective histories.

Perhaps one more conclusion should be added to complete the picture with reference to the Chairman and the Marketing Branch problems. The head of a corporation must, when he ascends to high office with its commensurate rewards and perquisites, assume responsibility for matters not directly under his control or power of control. This is the vicarious responsibility for corporate failures and mistakes, due not personally or directly to the acts or omissions of the Chief Executive Officer, but to the action of those under him for whom he must answer. This is not the legal vicarious liability of a master but rather is a principle of management well understood by participants in corporate commerce from the shareholders up or down. This responsibility of course does not extend to the criminal, tortious or other wrongful and unlawful acts of the corporate staff unless some peculiar circumstance associates the executive with the acts or troubles in question.

Vicarious responsibility includes the duty in the executive to engage proper personnel to lead the divisions or branches of the corporation. We examined the personnel records of Air Canada with reference to the hiring of the Vice President Marketing, Yves Menard. Its records revealed nothing but first class recommendations from former employers and associates. The normal and usual inquiries were made. Mr. Menard came highly recommended. The Chairman was, on such evidence, completely justified in engaging Menard and assigning to him one of the top positions of authority and leadership in the airline. It is clear that the first line of financial and managerial control, namely, the engaging of qualified executives, was properly attended to by the Chief Executive Officer when he recommended to the Board the appointment of Mr. Menard.

The trouble came later when Menard was given the necessary latitude and autonomy to undertake operational roles and projects for which, as it turned out, his training, experience and temperament were not adequate. The Chief Executive Officer to whom Menard reported directly, and therefore by whom he was supervised, is answerable to the extent indicated for the several failures in the Marketing Branch performance.

5. *Finance Branch Generally*

As we have seen, the actions of some members of the Finance Branch have been commented upon critically with respect to both the period before and the period after the payment of the monies to McGregor. In the Barbados transaction the budget procedures performed no useful control function nor did any of the control procedures of the Finance Branch bring to attention the fact that this large transaction was proceeding without authorization from the Board of Directors and without any appropriate or readily discernible budgetary provision. In the result the Finance Branch, regularly and without question, issued monthly rental cheques at first in the order of $50,000 a month and in the second year $100,000 a month. Indeed the process was directed by a single memorandum issued by Miss L. Courtemanche, Manager, Contracts and Agreements, of the Finance Branch. No AFE was raised for any of these leases although each lease obligated the corporation to a very substantial amount of rent. The Finance Branch at no time suggested an AFE was necessary, although during and after the negotiations, Banks, Burns and Courtemanche of the Finance Branch were continuously involved with the project. Very early in the Barbados negotiations the then Vice President Finance received a memorandum from a subordinate asking that the Vice President raise the matter at an Executive committee meeting in April 1973. The minutes of that meeting do not reveal that this was ever done by the then Vice President Finance or anyone else. A copy of this memorandum was forwarded to Cochrane, then Controller of the airline.

When losses in the marketing of these units of leased accommodation in the total of about $1,000,000 were encountered, they were accounted for in a suspense account, which by itself was by no means improper, but it delayed the realization of the extent of these losses by non-accounting personnel and by persons in the Branch concerned. Finally these deficits were charged to promotion and advertising in the Marketing Branch budget. The variance procedures within the Marketing Branch budget alerted no one outside that Branch because over the whole year in question the Marketing Branch remained within its total budget. Thus the Finance Branch did not follow the Sunset Crest transaction as a separate and large unit of corporate business and were not able to appreciate and to react to the losses of 1974 and 1975, either actually or as forecast.

As to Venturex, the Finance Branch had through two Financial Vice Presidents (Messrs. Orser and Cochrane) and Controller (Sheehan), repeatedly recommended the introduction of controls for subsidiary companies and their operations. However, Cochrane's memo was requested by Pratte who thereafter in November 1973 stated he was "counting on" Cochrane to implement the necessary measures to correct Venturex's accounting weaknesses. Furthermore the Chairman immediately thereafter caused the Board of Venturex to be reconstituted and in the process Cochrane was placed on the Board to strengthen the position of the Finance Branch in Venturex

accounting affairs. By July 1974 Sheehan, the Controller, nevertheless, was still pointing out the deficiencies of Venturex accounting and financial procedures. The Finance Branch did require Menard to submit an AFE for the inter-company settlement with Venturex in the amount of $145,000. Unfortunately the Finance Branch personnel in Montreal did not persevere and require the originator to submit the AFE to Finance Branch Montreal for comments before submitting it to the Chairman for authorization, as required by AFE procedures.

After one brief mention of this AFE in an investigator's report in February 1975 the matter dropped from view. The Finance Branch, charged as it was by the Chairman's memo of January 1974 to review and comment upon AFE's over $50,000, might have advised the Chairman, on learning of the AFE, that it had not had an opportunity to comment upon it. If the Vice President Finance is not required in his line of duty to complain to the Chairman about the execution of an AFE by the Chairman without the benefit of Finance Branch comments, he should in any event have raised the matter with the Chairman because of the possible embarrassment to Air Canada and to Venturex in their dealings with the Air Transport Committee. Both these senior officers were aware of the ABC deficit accounting problems in Venturex and the processing of the AFE for $145,000 would in any case have aggravated this already serious problem in Venturex. This is another important illustration of the failure of communications between the Finance Branch and the Chief Executive. The Chairman by a simple telephone call to Cochrane could have obtained his comments on the impact of the delicate ATC situation which this inter-company charge might have before signing the AFE.

There seems to have been no final check in Montreal or elsewhere to ensure that a Finance review of this AFE had been undertaken. In the case of the McGregor transaction, the Winnipeg Accounting Centre did not, even when it received Parisi's letter of March 10 purporting to close out these AFE accounts, associate the three split AFE's and require Marketing to submit them to Finance for comments. The Finance Branch did however institute in September 1974, as part of the AFE checking system in Montreal, a system whereby all AFE's over $25,000 were sent to the reviewing authority in Montreal to check for any splitting of AFE's. It should be concluded that this system would have picked up the McGregor AFE's although not as soon as they were in fact picked up by Mr. Bagg in Purchasing and Facilities. This system did not however appear to pick up the $145,000 AFE mentioned above.

This AFE illustrates a further cause of failure of communications in the Head Office of Air Canada. The language employed on the face of the AFE to describe the project authorized is still another example of what seems to be a deliberately adopted style to prevent a third party from discerning the true nature of the transaction by reading the AFE itself. This practice, commonly seen in the minutes, documents and correspondence of

Air Canada, unfortunately inspires suspicion in the mind of the reader and creates the impression that the descriptive language was deliberately misdescriptive to obfuscate superior authorities' attempts to supervise.

Again the Marketing budget for promotional and advertising expenses was used to take up the losses of Venturex incurred in its ground reception business and related Touram acquisition. The use of the Marketing budget to perform this function in connection with McGregor Travel, the Sunset Crest leases, Canaplan and Touram without in any way violating the budget variance rules or alerting the budget section of the Finance Branch, should be the subject of very serious reappraisal by the Vice President Finance and his senior staff.

The Chairman at the end of 1973 made changes in the Venturex Board to ensure amongst other things closer financial supervision of Venturex. As regards actual control of expenses, the Controller of Venturex maintains a direct and complete control of every disbursement by the company. The critical conclusion with respect to Venturex relates to the prior incurrence of obligations which expose the parent corporation to the expense or loss however thorough the former's disbursement controls may be. Furthermore the Board of Venturex in fact ceased to function from July onwards.

The Finance Branch established and administers the AFE system. Somehow the Chairman's directive of January 1974 establishing levels of authority for the issuance of an AFE was not consolidated into Manual 300 in the July 1974 consolidation. Consequently some staff members in and out of Finance were unaware of the prescribed levels of authority in the AFE system. More generally the AFE procedures should be made clearly applicable to all affiliated and subsidiary operated companies. This system should be clearly made applicable to all leases where the total rent or other financial obligation reserved thereunder exceeds the minimum limits specified in the AFE regulations. The conflict between the By-laws of Air Canada and the AFE regulations described in Chapter 5 should be resolved.

On the other side of the ledger it must be concluded that the general financial control system established by the Finance Branch is effective when honoured by the senior executive staffs. The enforcement of this control system raises a fundamental question. For the Finance Branch to act authoritatively it must be constantly informed on a timely basis of the financial facts within the corporation's operations. The functional reporting system, as we have seen, did not perform this role either directly or in a complementary sense, as it should have done according to the description of that system given in the evidence by witnesses from the Finance Branch.

In the McGregor transaction the failure of the functional reporting technique led directly to the payment of $100,000 by Air Canada to McGregor. In the Barbados transaction the failure of the functional reporting system led to a very late recognition of the necessity for Board of Directors' approval of these large leases and probably contributed to the total absence of inter-branch communication and cooperation in salvaging

this operation. In Venturex the functional reporting system did not operate in 1973 in connection with the Barbados adventure and hence the Finance Branch was not alerted to the budget and other ramifications of this new venture. In the second year of Venturex operations (1974) the Vice President Finance was a member of the Board of the company and no adjustment seems to have been made requiring functional reporting to him in that capacity or in the alternative to the Controller of the Finance Branch. In any case it must be concluded that the 'functional duties' of the Controller resident in the branch, region or affiliated company were not articulated in any regulation, directive or job description. The testimony by these disseminated controllers did not reveal an awareness of a formal duty and channel to report directly to the Finance Branch on matters arising within their own Branch.

However one may choose to describe the functional procedure, it is a spy system. When its performance is the most vital, the strain on human relations is too great to permit it to function reliably. Indeed the local controller's usefulness as a staff officer in his branch or region will vary inversely with his performance as a 'functional reporter'. Either the system should be fully elaborated and installed in the formal regulations and job descriptions or it should be dropped entirely. This Commission would prefer the latter but to come down firmly on this issue would require an investigation into all operations of this large corporation which is well beyond the mandate of this Inquiry.

The post-audit and investigation function of the Finance Branch is a difficult one to perform. As we have seen in the McGregor transaction, this system sometimes involves the investigation of their senior personnel in other Branches. Sometimes it requires the investigation of the investigators' own superiors within the Finance Branch, including actions by the Vice President Finance and the Corporate Treasurer. The reticence naturally arising in the investigators stalled or at least delayed the McGregor investigation and probably the investigation of the AFE for $145,000 relating to Venturex. Consideration might be given to removing this entire function from the Finance Branch and setting it up as an Internal Audit unit directly under the President of the airline. It should be recognized that in commercial corporations the internal audit service generally reports to the chief financial officer. The larger the corporation the more feasible it is to achieve the theoretically more desirable situation where the service is situated outside the finance department. This will remove the risk of impasse or subservience and will no longer require the Audit staff to investigate persons who at times will be the same persons who control their salary and promotion. The above conclusion has been reached on the basis of theory and practicality and not on the basis of demonstrated experience to date excepting only the extent to which the slow, unenthusiastic, and ineffective investigation of the McGregor transaction can be explained by this fact of human relations.

We have not concluded that in the overall sense, the role and function of the Finance Branch has been downgraded in this corporation. It may be

that the style of management of the Chief Executive Officer has produced a formality which gives the appearance of diminution of stature of this Branch but our investigations do not in fact support any such conclusion.

6. *McGregor Travel*

As regards the McGregor side of this transaction, it is very clear, when all the evidence has been sifted, that McGregor intended to and thought he had sold Air Canada an option to acquire 10% of the capital stock of McGregor Travel on the payment of the nominal sum of $1.00. He believed and appears to believe still that he gave good value for the $100,000 advance. We were told in the course of the hearing that Air Canada intended to bring action to recover the $100,000 and Mr. McGregor gave every indication that he intended to defend the action on the basis that he was fully entitled to retain the monies which, so far as he was concerned, had been properly paid to him after lengthy and *bona fide* negotiations.

The McGregor role is not on all the evidence that simple. While he is telling Air Canada officials that the arrangement is an option on McGregor Travel shares, the only reference in the McGregor Travel Minute Book to these discussions is a report from McGregor to the Board in which the arrangement is referred to as one "relating to consulting fees". The same minute does however make reference to a possibility that Air Canada will buy shares of McGregor Travel. Dobson in his evidence repeatedly refers to a share transaction and McGregor stoutly maintained throughout all the hearings that he at no time intended to deliver the services described in the three agreements.

So far as the McGregor Travel treatment of the $100,000 payment from Air Canada is concerned, it mattered not whether the monies were received as capital or income. In neither form would it be taxable. However, since the payor, Air Canada, had classified the payment in its accounts as an expense it was no doubt wisdom on the part of McGregor Travel to treat it as income and thereby avoid embarrassing the payor from whom McGregor Travel hoped to receive further monies as their corporate reorganization and amalgamation plans unfolded. Indeed the Board of McGregor Travel agreed to pay a commission to McGregor personally with regard to future payments received from Air Canada. Whether or not McGregor Travel and its outside auditor were correct in routing this payment back into the accounts ending the fiscal period September 30, 1974, is a matter of no consequences so far as this Inquiry is concerned, although if we were required to comment thereon we would feel compelled to conclude that it should have been classified as part of the receipts of the fiscal period commencing October 1, 1974.

McGregor has not been shown to have done any wrong. He signed documents he was asked to sign by Air Canada. He negotiated in good faith. As a result of these negotiations he has become involved in a lengthy

and expensive hearing and no doubt received much harmful publicity, all apparently undeserved and without recourse.

7. *Office of the President*

The Chairman, Mr. Pratte, has testified that in his view there is no need, and indeed no room, for any division of operational executive function between the Chief Executive Officer and the President. Accordingly when Mr. Baldwin left the airline at the end of 1973, Pratte organized a corporate structure in the headquarters of Air Canada which reduced the office of the President to staff and advisory functions without any operational responsibility. It is beyond the purview of this Inquiry to assess and to reach a conclusion on that paramount issue as such. We are required, however, to consider, in the area of financial control and adequacy of executive response, the efficiency of the office of the President and the staff associated therewith as presently constituted. In our view the Venturex, Barbados and McGregor affairs reveal a lack of function in the office of President and a lack of initiative and reflective response to events flowing past and around that office. There should be a clear cut allocation of leadership responsibilities in the acquisition field and in the government of subsidiary and affiliate corporations and some articulated responsibility with reference to the guidance of the corporate thrust in new directions, be it by expansion or formation of enterprises or by the acquisition of other entities.

The control effectiveness, indeed the apparent as well as the real authority, of the President to exercise his high level of responsibility, on any interpretation of his function, is seriously damaged by the fact he is a spectator at and not a member of the Board of Directors of the airline. Surely the Government of Canada or the CNR could arrange to include the President of Air Canada as one of their respective five and four nominees to the Board of Air Canada. In the case of the CNR Board of Directors, the Chairman of Air Canada has been included as a nominee at the expense of one more geographical representative on that Board. The need of having the Air Canada President as a responsible member of the Air Canada Board would appear to be the greater. The President had always before 1968 been a Board member.

Some time in 1973 Mr. Vaughan and Mr. Menard agreed to share the services of J. J. Smith, the Director of Corporate Development. Mr. Vaughan appears to have regarded this as for all purposes a transfer of Smith to the Marketing Branch. Thereafter he did not read Smith's monthly reading file, nor did he call upon Smith for any reports or other writing on any of the work undertaken in either the presidential staff area or the Marketing Branch. There is no satisfactory explanation of why a Corporate Development officer experienced in acquisitions would be turned over to the Marketing Branch whose functions did not include acquisitions. Certainly there is no record of any inquiry by Vaughan of Menard as to what projects

he had Smith working upon, or whether any corporate approval or authority would be required in respect of his Marketing Branch projects. In his testimony Vaughan said that he knew the staff of Air Canada were discussing many transactions but that they would have to come to him for approval when there was something which required approval. His last contact with the McGregor deal was June 1974 when he understood from a memo sent by Smith to Menard that the matter was dead. Had he read Smith's reading file, or called for regular reports from his Director of Corporate Development, he would have known otherwise.

Vaughan and Menard instructed Lindsay as an officer of Venturex in March 1973 to undertake the initial negotiations with the representatives of Sunset Crest in Barbados for accommodation leases. At the time Vaughan was the Secretary of and responsible to the Chairman for the operations of Venturex. He continued in these roles when the Board of Venturex approved the Sunset Crest transaction generally and later when the Venturex Board approved the assignment thereof to Air Canada. He knew that the assignee of these expensive leases, namely Air Canada, had not been asked to approve of this assignment to it.

As the officer responsible for Venturex in the Air Canada group he took no action to head off the accounting difficulties and the CTC difficulties which would arise from the ABC business losses in Venturex. He was aware of the Touram matter but approved of it as a Venturex acquisition because it was below the $50,000 limit, which was Vaughan's level of authorization in Air Canada. Touram, however, was a corporate acquisition conducted by the CN Law Department. It was not processed through the Air Canada acquisition procedure, or the AFE procedures.

Vaughan is responsible for the Law Department. The Law Department played no role in the investigation of the legal issues surrounding the Menard villa, the Touram acquisition, or the McGregor contracts. The Law Department played a small and insignificant role in the establishment of Venturex and does not seem to have been asked to marshal the considerations, legal and otherwise, surrounding the use by Air Canada of CN subsidiaries and the tax and corporate consequences thereof, or the resulting position of Air Canada under the *Air Canada Act* on the question of reporting the existence and operations of Venturex and Allied Bermuda to the Minister of Transport and the House of Commons.

Mr. Fournier, the Secretary of the corporation, reported to Mr. Vaughan. In fact he succeeded Vaughan as Secretary and testified that he carried on the system of corporate minuting and Board procedures established by Vaughan. The usefulness of the Board of Directors and the information provided the Minister and the House of Commons depends in part on the minutes of the Board meetings. Air Canada minutes represent the acme of the art of non-communication. Two examples will suffice. In April 1975, as we have seen, the Board of Directors of Air Canada determined on the recommendations of the Vice President Marketing and the Chief

Executive Officer not to exercise a right to renew the Sunset Crest leases representing accommodation rentals of about $1,000,000 for the year 1976. Coming after the Menard resignation and the failure of the Marketing Branch to obtain timely Board approval of these leases in the first place, the item was of some significance. No mention is made of the matter in the minutes of that or any other Board meeting. The explanation by Mr. Fournier is that it is not company policy to record in the corporate minutes negative decisions. A second example appears in Board item number 1552 on the minutes of the meeting of the Board of Directors held on March 26, 1974 which states:-

> "No. 1552 Upon consideration, approval was given to certain planning guidelines for the year 1975, as detailed in a memorandum filed with these minutes."

There is nothing attached to the minutes. This minute was advanced as a basis for the authorization relied upon by Menard and others for acquiring the 'option' on McGregor Travel shares. The practice of referring to documents not attached to minutes is followed generally in the Air Canada minutes.

If minutes are to serve any purpose they must communicate information. If these minutes are kept in such a guarded style in order to limit this communication, such a policy must be aimed at reducing the flow of information to persons having access to the minutes of the corporation, including the Minister of Transport. Should this be the case the minutes should either not be circulated to the Ministry of Transport, or they should be complete and comprehendable by the reader. The issue of circulation is outside our domain; the requirement of communication of information through the minutes and their lucidity is not. Vaughan is the executive responsible for this matter. In his defence the evidence is that no one complained. We conclude that the minute-keeping policy is part of the communication difficulties of Air Canada management and, as will be mentioned later, communications are inextricably entwined with the proper financial control and executive response.

In reaching these several conclusions the other side of the issue must be mentioned as well. Mr. Vaughan, as discussed above, suffers from the fact that neither the CNR nor the Government of Canada include him in the nominees to the Board of Directors of the company. While he attends all the meetings and no doubt is free to speak his mind, he does not have a vote and does not have the status of full membership. He also suffers from the fact that his role and duties in the corporate structure have been so truncated as to render his function in most respects meaningless except as the highest advisor to the Chief Executive Officer of the airline. We have seen the uncertainties and confusion which result from the President having no precise terms of reference and responsibilities. It would be better to abolish the office than to continue it as a titular illusion. The office, as presently established, represents little if any senior corporate control of the assets and functioning of the corporation.

8. *Communications*

As a general conclusion we feel impelled to conclude on the basis of all the information collected, that Air Canada suffers from a shortage of management communication, a very basic element in financial and managerial control.

At many junctions in recorded negotiations and transactions a breakdown of vertical and horizontal communication was disclosed. This breakdown recurred in the face of several institutions and much apparatus carefully installed by management, including the following. The Executive Committee (11 of the most senior executives of the airline) meet every Friday morning in Montreal. Several of the Vice Presidents and the Chairman meet every workday morning for operational purposes. The Board of Directors meets once a month and elaborate preparations are made by the staff for such meetings, in the form of meetings of the Agenda Committee and a circular to all branches seeking items requiring Board reports or Board approval. At least quarterly the Committee of Management meets, which Committee includes all Vice Presidents of Regions and their senior staff. In Montreal, in the vicinity of the Head Office of the company, the company operates a staff dining room for senior executives and the evidence is that the senior staff of the airline avail themselves of this facility regularly. This is a small dining room and it is difficult to see how such notorious matters as the Barbados Sunset Crest leases and their associated marketing problems, the novel McGregor Travel concept with its long negotiations, Venturex and Mr. Menard's now famous villa, could not have spread through that small room like an epidemic.

If even the fact of an AFE investigation had been made known to the executive level through any means, including the Executive Committee, or if the availability of Barbados accommodation had been likewise made known, much of the present difficulties would have been avoided. The presence of this disease is easy to detect. The explanation of its cause is more difficult. Why did Taylor, Vice President Public Affairs, not immediately assail the Vice President Marketing on February 20 or 21, 1975 when he learned of an apparent invasion of his sensitive sphere of operations? It was on that occasion that the Vice President Public Affairs saw in a memorandum from the Internal Audit investigators that Menard's staff had somehow engaged an outside agent to represent the airline in some political role with the Quebec Government and with travel associations. Perhaps part of the answer lies in the fact that, though some Vice Presidents testified that they have 15-20 daily contacts with the Chairman, others appear to operate on the basis of formal appointments. Some Vice Presidents, as for example McGill, seem to have found the Air Canada atmosphere encouraging of silence, rather than of raising questions not absolutely in his path. That is not likely a complete or even a useful explanation because good organizational habits in senior management would have excited a flow of information on the delicate matters which eventually built up such internal pressures that information leaked out to press and Parliament. This infor-

mation should have long since proceeded up the pipelines of management communications to the top. It is easy to blame it all on Menard but the evidence does not permit that solution.

All the controls that can be devised will avail the corporation nothing if the communications through all the managerial nerve systems of the body corporate do not constantly flow. The very size of the Executive Group, a chairman, a president and seventeen vice presidents suggests a formidable problem. The size (or necessity for such size) of the management structure is not within our orbit. The gravity of the problem is illustrated by the McGregor negotiations and the Barbados leases. By the time each process had reached its climactic stage, at least 28 persons in the case of the Barbados leases and 15 in the case of the McGregor transaction, located in Air Canada headquarters knew of these matters, but neither project ever penetrated to the weekly Executive Committee meetings or to the Chairman, according to the evidence. Thus the ultimate control in the company, the Chairman to a defined level, and the Board of Directors thereafter, was kept in the neutral gear of complete ignorance. If we had to venture a theory as to why this result occurred in Air Canada the most likely one is that the style of management which has grown up in Air Canada does not encourage and force vertical and horizontal communication. There is a tremendous burden on the Chief Executive Officer in this style. The company's record in seven years makes it impossible to damn such managerial style in any outright sense. Neither does the command of detail and the breadth of knowledge of business of the Chairman support any arbitrary conclusion on this subtle issue. The communication deficiencies of Air Canada's corporate control structure are manifest in one major area, the Marketing Branch, and to a less significant degree in the areas of the President and the Finance Branch. Marketing reveals a lack of supervision and a sense of corporate teamwork. The presidential segment of the company has no vitality of function and has responded accordingly. While the branches and regions are making headway in the swim, the presidential segment is treading water. As stated earlier this is a by-product of the designed non-line role and should be rectified. The Finance Branch role has not been interpreted by the Branch in quite the vigorous way that the Chairman has understood it should be. This is an observation of shades and degree and not an institutional criticism. In this case it takes two to communicate and the solution lies in mutual action by the Chairman and the Vice President Finance.

As already pointed out, the AFE for $145,000 authorized by the Chairman in December 1974 employs wording which appears to have been adopted in order to conceal the true nature of the transaction. Presuming the Chairman could have discerned the purpose of the AFE from the terminology used therein or by conversation with the Vice President Marketing who presented the AFE to him for authorization, the subject matter of the accounting treatment for losses or reporting these in Venturex, whichever the case may have been in reality, could have been taken up directly by the Chairman with

Cochrane by a simple telephone call or conference. For some reason this was not done.

All the areas and personnel mentioned in these conclusions contribute in some way to the communications inertia. The burden of this condition is spread evenly, but the ultimate burden in the rule of the business world is, as already stated, at the top, where the shortcomings of the supervised become those of the supervisor.

9. *The Board of Directors*

This brings the scan of this Inquiry around to the ultimate control in any corporation, the Board of Directors. In a public company this is an easy role to describe. The directors manage the undertaking, the shareholders appoint and remove the managers of the company but do not themselves ordinarily manage. The statutes make this clear in all jurisdictions in this country. Where, however, the shareholder of the corporation is the CNR which in turn holds the shares for the account of Parliament, a different set of questions arises.

Before this matter is dissected let it be said that in the areas authorized for investigation by this Inquiry, we have found that the Board of Air Canada has performed well considering the lack of articulation of their role in any applicable statute, the size of the Board, the complexity of the undertaking and the geographic spread of its members. Nothing that is hereafter proposed should be read as a lefthanded criticism of the present Board of Directors, its membership or its performance. The purpose of the following comments is to suggest some ways that the corporate structures of Air Canada might be revised in the areas of financial, accounting and managerial control for the better functioning of this important national undertaking. It should also be added that many of the present Directors, and particularly the Chairman, volunteered many thoughtful comments on the novel questions which now arise.

The Board is presently appointed by the Governor in Council, as to four members, and by the CNR, the shareholders of the airline, as to five members. These three questions arise at once:

(a) To whom are the members responsible, if to anyone?

(b) What is the role in policy or financial control of the Governor in Council, the Minister of Transport, or Parliament?

(c) What is the channel of communication between the Board of Directors and the Government of Canada?

At the present time the Board is appointed for a term of one year in the case of the CNR and three years in the case of the Governor in Council. They are generally appointed on a geographical representational basis: one from British Columbia; one from Manitoba; one from Nova Scotia; four from Quebec and two from Ontario. There is no annual shareholders' meeting in

the ordinary sense but in lieu thereof the Act requires an annual report to Parliament through the Minister of Transport. The Board is apparently not selected according to any standard of experience in business or professional life; the majority are lawyers, the remainder retired or active businessmen.

In a publicly owned commercial corporation the Board reports publicly to shareholders who at least in theory may question this report at the annual public meeting and if dissatisfied, the shareholders can replace some or all of the Board. The act of replacement or resignation on a policy issue is a thunder clap in the corporate community and the possibility of such an event is itself a stern discipline. The independence of such a commercial board is real and the trend in the Provincial and Federal business corporation legislation, has been to ensure that the board is an independent control agency acting on behalf of the corporation itself and its shareholders.

The parallel in a Crown corporation is difficult to draw. The Members of Parliament, as the real owners representatives, are entitled to examine the directors. In fact the Transportation Committee of the House of Commons questions management and perhaps in effect the Ministry of Transport as well. The directors are not in this arena.

Management, through the annual budget function, as well as regular contact arising out of the minutes or business generally, and in other years financing arrangements, is in contact with the Executive Branch of Government, that is the shareholders representatives of the beneficial shareholders, while the directors are not. The auditors represent the closest parallel. They are appointed by, and report through the Minister of Transport to, the ultimate shareholder, the taxpayers, or their representative, Parliament. This is the same role and reporting structure as in a commercial corporation.

The greatest difficulty in establishing a relationship between this considerable business undertaking which Air Canada represents and its owners arises by reason of the conflicting needs:

(a) for some means to assure the Government and Parliament that the assets of the corporation are being employed in a manner consistent with national policy as regards transportation, geographic and regional development, support of domestic industry, the bilingual program, international relations and many other policy matters; and

(b) for the undertaking of the corporation to be conducted on a business basis free from 'political' interference or influence not related to the implementation of government policy.

The position of the Board of Directors is vital in realizing each of these two goals or standards. It is perhaps permissible to observe that the basic pattern and structure of the *Air Canada Act* has remained untouched since 1935. The air transportation business has so changed in nature and the position in our commercial and cultural community that the Act should now come back to dry dock for overhaul. For example we have seen the turmoil the airline management has been in over the "diversification program", the use of sub-

sidiaries and the constant uncertainty of the airline's legal position in conducting some integral parts of its business. The carriage of passengers in chartered aircraft is another example of an important feature in today's airline industry not present in the 1930's and consequently not clearly included in Air Canada's corporate powers. The application of the doctrine of *ultra vires* to this Crown corporation might be reconsidered. The opposite view, also presented in the evidence, is that taxpayers money was applied to fill the gap in the national transportation industry not then at least susceptible to filling by non-government enterprise. The statute spells out the boundaries of the government enterprise so as to limit the drain on tax collected capital and the exposure of that capital to commercial risk. According to this school of thought, the Crown corporation should be required to come back to Parliament before undertaking a hotel ownership investment adventure, for example, to obtain the necessary authority. In this view such recourse is properly required whether or not current finances of the airline are sufficient for the proposed undertaking because in the final analysis it is the resources of government which will be called in to meet any capital deficiency in the future.

Perhaps the two opposing schools of thought could be brought into the same mould by describing the objects and powers of the corporation in terms of all other related activities which airlines comprising the world airline industry regularly undertake. The rationalization now necessary to allow management to compete in the present world and domestic airline industry environment presents a very bad example for a large staff organization which must at the same time be asked to conform to the managerial and accounting internal control disciplines.

The independence of the Board in its role as the ultimate internal element of corporate control should be implanted securely and obviously in the statute. At the same time Parliament will no doubt wish to consider some procedure or mechanism which will establish the clear right and duty of the Executive Branch to direct the deployment of the resources of the corporation to best service the national interests, as interpreted from time to time by the Governor in Council or the responsible Minister. This procedure is already present in some statutes such as the *Broadcasting Act,* sections 22 and 27.

Finally, the method of appointing directors should be examined. The operation of the corporation has now attained such proportions as to be a top ranking national asset. Thus the Board performs a fiduciary role of such importance that consideration should be given to its enlargement and to some prescribed standards of qualifications or experience, prohibited interests, tenure, etc., to ensure in the future a high level of Board competence and independence. There seems no longer to be the original need to have a majority of the Directors of Air Canada chosen from the membership of the CNR Board. Certainly the Office of the President should be placed on an articulated basis or abolished. If retained he should be a member of the Board.

The capital budgeting process at present links the airline annually with the Ministries of Finance and of Transport. This link was vital in those times when operations of the corporation were financed by Government loans and when losses were the rule and not the exception. The complexity and magnitude of airline operations now require such information and explanations that delays have arisen in obtaining capital budget approval. For example, the 1974 capital budget was submitted by the corporation to the Ministry of Finance in final form in the Fall of 1973 but was not approved until early 1975. It does not follow that Air Canada suffered capital paralysis during 1974 but it does demonstrate the futility of this type of control in the present corporate operations. The need for liaison and control in a manner different than that prescribed in section 70 of the *Financial Administration Act* should be examined. This Inquiry did not have the resources, the time or indeed the explicit mandate to explore this terrain in much detail. Many alternatives suggest themselves at once. The Ministries might have a permanent budget representative in the Finance Branch. This would not add to the information now going to the Ministries but might forestall many inquiries by ministerial staff which presently delay the approval process. Another alternative might be to require only specific approval for capital budgetary items beyond specified project levels. We believe our function is fulfilled by raising for discussion the present capital budget procedures under the current statutes.

Returning to the role and status of the Board of Directors, the end, in summary, should be to establish a set of rules or standards which will guarantee the continuance of the Board as the dominant governing force in the corporation's management structure. It would appear to be appropriate to ensure the appointment of personnel of such stature with specific tenure as will result in an independence of thought and action commensurate with the present importance of the position. At the same time Government should have the right to communicate by prescribed technique, policy directives which would become in effect a statutory directive and within which the independent Board would conduct the affairs of the corporation. The shareholder review should remain as at present. In the result, the Board would be the top agency of corporate government generally including of course its role as the prime element of financial control.

10. *Activities Undertaken in the National Interest*

As stated earlier, the management of Air Canada, as a matter of fundamental policy, seeks to operate the airline on a profit basis. The organization and its personnel are attuned to this mode and efficiency, and projects are measured by that standard. Where the national interest requires the corporation to undertake routes and projects which are axiomatically unprofitable, the airline should undertake them for the account of the Government and be reimbursed accordingly. We understand such to be the case with Airtransit operations and with other Crown agencies such as the CBC who are reimbursed in full for the operation of the International Services for the Government of Canada. We believe this would be a significant aid to

the airline management in maintaining the force and drive necessary to allow this large business organization to discharge its role effectively in this country and to compete in the airline industry here and abroad.

To some extent the same reasoning would lead one to consider a reconstitution of the debt/equity capital of Air Canada so as to put the corporation on the same footing as regards debt/equity ratio as in the case of commercial organizations. It would facilitate both management and owners to accurately and quickly scale the success of the airline to that of its competitors and similar transportation agencies. This aspect bears only indirectly on the fiscal issues which this Inquiry has been studying and to advance this subject is perhaps the extent of our mandate.

11. *The Air Canada Act*

We have earlier remarked in several instances on the advisability of a reappraisal of the *Air Canada Act*. The corporation has outgrown the mould of the 1930's in many important respects. Its relationship with the CNR has become an historic anomaly. In similar circumstances government action has been taken to free a subsidiary of a Crown corporation by giving a direct communication to the Minister of Transport and thence Parliament. This should be seriously examined in the case of the relationship between the CNR and Air Canada.

For reasons already discussed, there is a serious corporate powers problem which directly affects the main undertaking of Air Canada. The statute outlines the powers and objects of the corporation rather precisely and, for reasons discussed earlier, the doctrine of *ultra vires* would appear applicable to this statutory incorporation. The recourse to the use of CNR subsidiaries by the airline is an instance which illustrates the problem. This expedient does allow the project in hand to proceed as we have seen in the case of the investment in Allied Innkeepers (Bermuda) Limited, which is described below and in Chapter 10. However, the price paid in inefficiencies, distorted channels of communication, corporate control and accounting problems is very great. Furthermore, such corporate organizational devices set a tone which leads management to other rationalizations. The atmosphere which results makes the practice of AFE splitting and the adoption of misdescriptive terms in documents and reports less surprising and perhaps even understandable.

References in this chapter to the structure of the Board of Directors in other matters relating to the need for a reappraisal of the *Air Canada Act* are not repeated in this section 11.

12. *Allied Innkeepers (Bermuda) Limited*

The investment by Air Canada in Allied Innkeepers (Bermuda) Limited is an example of the difficulties, accounting and legalistic, which present themselves and must be rationalized when the company moves into new areas.

In the Allied Innkeepers transaction, Air Canada made an investment in 1972 of about $240,000 by way of a loan to CN Realties.* That company in turn invested the money in Allied Innkeepers under an agreement with Commonwealth Holiday Inns of Canada Limited ("CHIC") and Commonwealth Development Corporation in which each of the parties agreed to would not be called upon to make payment under the guarantee before guarantee one third of the bank loan of Allied Innkeepers except in no event would any party be required to pay more than £67,000 sterling (approximately $150,000) under this guarantee.

In a letter from CHIC to Air Canada, CHIC agreed that CN Realties would not be called upon to make payment under the guarantee before November 1977, or in the event that CN Realties was called upon under the guarantee funds would be advanced by CHIC. Then by an inter-company agreement Air Canada was given an option to buy the Allied Innkeepers' shares from CN Realties for $1.00. The agreement further provided that in the event the option was exercised, CN Realties would be deemed to have repaid its loan to Air Canada.

This transaction is reflected in Air Canada's 1972 financial statements as an account receivable from CN Realties as opposed to reflecting it as an investment. The statements in 1973 continue this treatment but contain no note to reveal the existence of the option, the contingent obligation with respect to bank loans, or the fact of substantial losses in Allied Innkeepers in 1973. In 1974 Air Canada wrote off the receivable from CNR as a bad debt expense but no note to this effect appears in the financial statements revealing this fact or the fact of substantial losses in Allied Innkeepers in 1974.

It seems to be patently wrong for one Crown corporation to write off as a bad debt a receivable from another Crown corporation. The existence of an indemnity agreement between the CNR and Air Canada with respect to any losses which might be suffered by CN Realties by reason of the holding of the Allied Innkeepers' shares, does not support this course of action or the method Air Canada has adopted for accounting for this transaction.

The CNR treatment of these events should be noted. CNR consolidates its subsidiaries in its annual financial statements. Because the CNR has no substantive position in this transaction however, the CN Realties' interest in Allied Innkeepers does not appear in the CNR consolidated statements. Nor is the fact of this transaction reported in the CNR Board of Directors' annual report to the Minister of Transport and Parliament. By this comment, no inference is made that the transaction should be so reported by the CNR.

Air Canada however has reported only on the basis of the form of the transaction. The CN Realties' investment in Allied Innkeepers has not been consolidated into the Air Canada financial statements because CN Realties is not a subsidiary of Air Canada. The substance of the transaction was an equity investment by Air Canada and it should have been reflected as such in the financial statements. For an investment of this type, the "equity method" of accounting is used by which the investment is carried at cost

* Actually the loan was made to the CNR.

plus the proportionate share of profits earned by the investee, less the proportionate share of losses and dividends received. This is the method by which CHIC reflected its investment in Allied Innkeepers. Had Air Canada followed the same method it would have reflected as a line item in its income statement its share of the losses and applied those losses, first to reduce the carrying value of its investment to nil, and then to provide for its non-current loan commitment of £67,000 sterling (approximately $150,000). There would be no need to recognize in 1974 its share of losses beyond this total of approximately $390,000.

The report of the Board of Directors of Air Canada for the year 1972 describes the transaction, but as seen in Chapter 10, it is not clear from the description in that annual report whether the CNR or Air Canada put up the money for this venture. The report gives the impression that this was an investment in a hotel company but in its accounting Air Canada has treated it as a current asset. There is no mention in the annual reports of Air Canada for 1974, either that made by the auditors or that made by the Directors, that the "account receivable" has been written off.

As mentioned in Chapter 4, sections 77 and 78 of the *Financial Administration Act* direct the auditors of Air Canada, who are of course the auditors of the CNR as well, to

> "call attention to any other matter falling within the scope of his examination that in his opinion should be brought to the attention of Parliament"; and
>
> "in any case where the auditor is of the opinion that any matter in respect of the corporation should be brought to the attention of the Governor in Council, the Treasury Board or the Minister of Finance, such report shall be made forthwith through the appropriate Minister".

The auditors did not avail themselves, perhaps by accounting standards justifiably, of these statutory directions to make reference to the Allied Innkeepers transaction.

In the result, the Minister of Transport and Parliament, the latter being the ultimate owners of both the CNR and Air Canada, have no information channel which has succeeded in apprising them of the complete nature of this investment transaction, the progress of the venture, or its current status.

It may be that financial statement disclosure of the substance of the transaction by Air Canada was not required on the basis of the relatively small amounts involved. The same comment may be applicable to Air Canada's failure to reflect its contingent commitment to supply further funds. The fact remains, however, that nowhere in the financial statements of either Air Canada or CNR is the true nature of these transactions disclosed.

These comments are in no way directed to the question of the wisdom of the investment or the skill of management exhibited in the negotiations, or any other matter connected with the transaction other than the corporate powers difficulty of the airline and the resultant lack of meaningful communication by management to the corporation's ultimate owners. This

transaction flew back and forth between the CNR and Air Canada as though on a flying trapeze, yet neither the auditors nor the Board of Directors of either company made any reference to the transaction in their report "to the shareholders" in any of the years 1972, 1973 or 1974. Because the transaction, by reason of its artificial structure is always in mid-air, for accounting purposes it never alights in either corporation.

13. *Lockheed*

It came to the attention of the Inquiry during the course of its work that Lockheed Corporation, whose Lockheed 1011 aircraft Air Canada purchased in the period 1968-1973, would be involved in public exposures in the United States concerning possible bribes to aircraft purchasers. Procedures for acquisition of aircraft by Air Canada had been touched upon during public hearings and the procedures outlined were not explored and warranted no further inquiry. However the investigations of an Agency of the United States Government and Committees of the United States Senate revealed that payments of some kind might have been made by the Lockheed Corporation to officials of airlines or governments which had purchased the Lockheed 1011. We pursued the matter and found not the slightest bit of information which warranted the resumption of public hearings or any other kind of investigation. There is nothing to indicate any payments in the nature of kickback, compensation, commissions or hidden rewards of any kind have been made directly or indirectly, inside or outside Canada, to any employee of Air Canada, past or present. Air Canada, its personnel and records have been examined at length and at depth by the staff of this Inquiry, in public and in private, and unless some real indication of financial impropriety was first obtained we determined not to deal with the matter publicly. Unfortunately the news releases from the United States subsequently put Air Canada and its officials under another cloud which our information indicated was wholly unwarranted. We maintained our initial decision nevertheless and can report that there is at this date no information here, or to our knowledge in the United States, which indicates any such payments having been made to an Air Canada employee past or present.

14. *Allegations Concerning Kevin Drummond and the McGregor Transaction*

In the course of the hearings conducted in this Inquiry a newspaper in Montreal published an article pointing out that the Minister of Agriculture in the Government of the Province of Quebec, the Honourable Kevin Drummond, was a debenture holder in McGregor Travel. Very early in its investigations the Inquiry staff reviewed the financial and corporate records of McGregor Travel, including ledgers, books of account, corporate minutes and by-laws. In the course of this review it was learned that Mr. Drummond held a debenture for the original face value of some $5,000 issued in 1962.

Since that time interest has accrued and has not been paid so that present indebtedness, including principal and interest amounts to some $8,853.15 as at September 30, 1975. The debenture is unsecured and ranks after banking indebtedness. There are other debenture holders and in fact Drummond's debenture claim is relatively small amongst the creditors of McGregor Travel.

Mr. Drummond was one of the original shareholders of McGregor Travel. In 1969 he transferred his shares to other shareholders and has since that time only been a debenture holder, in respect of which no payments have been made. We have examined the corporate records of the company and find that Mr. Drummond has not taken part in directors and shareholders meetings for at least ten years.

In summary he appears to have been an initial investor who has been unable to recover his money or realize on his original investment. We have interviewed Drummond and have examined under oath officers and employees, shareholders and debenture holders of McGregor Travel. We have examined personal banking records in some instances and have examined personnel in companies dealing with McGregor Travel, as well as the chartered banks with whom McGregor Travel does business. In the course of the accounting investigations mentioned above we have examined the files, records and working papers of the auditors of McGregor Travel and have examined the partner of the audit firm, in charge of the McGregor Travel audit, under oath in the hearings.

Mr. Drummond entered the Quebec National Assembly in April 1970, and was appointed to the cabinet shortly thereafter.

As a result of the foregoing investigations, studies and hearings we find no evidence of any kind which indicates that Mr. Drummond, either before or after he entered Provincial politics, has used his office in McGregor Travel or his position in the Government of the Province of Quebec to further the interests of McGregor Travel or to enhance his position as a debenture holder in McGregor Travel. We find no evidence of any attempt by Mr. McGregor or any one associated with McGregor Travel to take advantage of their association with Drummond to obtain any concessions from the Province of Quebec or specifically to cause any revision or amendment to be made to legislation of Quebec relating to travel agencies or the regulations thereunder.

All the facts described above were known to this Inquiry prior to the newspaper publication and we saw no reason to repeat in public that which had already been done in public or to repeat in public hearings that which had been done by Inquiry staff action through investigation. The conduct of hearings is expensive and there was no purpose in charging the public with the cost of reviewing this matter once again.

15. *Air Canada Pension Plan and Trust Fund*

(a) *Pension Plan*

The Company Plan is what is known as a "unit benefit plan" under which the benefit formula is set by reference to length of service and remune-

ration paid. The benefits are computed according to a set formula, and amount to approximately 2% per year of allowable service of the average annual earnings in the best successive sixty months of allowable service. Allowable service is limited to 35 years. The pension vests when the employee is over forty-five years of age and has accumulated ten years service. Employee contributions are set at 4½% of salary up to the ceiling set by the Government as "Year's Maximum Pensionable Earnings, (Y.M.P.E.)", which is $7,400.00 in 1975, and 6% of salary on the excess. Y.M.P.E. is the maximum level of annual earnings on which the employee is required to pay contributions to the Canada/Quebec Pension Plan in any one year. An actuarial computation is then made of the Company contribution to the fund based on various assumptions such as salary levels, inflation rates, and rate of return on investments. The current assumed rate of return on investments is 8%. This is the rate recommended by the Company's actuarial consultants, and approved by the Board of Directors and this rate is reviewed every three years. An actuarial report setting out the Company's contributions is forwarded for review to the Superintendent of Insurance in Ottawa at three-year intervals; the last report was dated as of December 31, 1972.

The Pension Plan is administered by a Pension Committee, made up from a cross-section of the Company. Four members of the Committee are appointed by the Board, and the other three are elected by the employees. The current members are the following:

Mr. F. C. Eyre, Chairman (Vice President European Region, Ex Director of Personnel, Ex President of Air Jamaica)
M. H. Cochrane (Vice President Finance)
D. G. Elrick (CALEA Representative)
J. R. Sylvestre (Director, Pension and Benefits Development)
D. R. Lovat (IAM and AW Representative)
Captain D. G. Richardson (CALPA Representative)
Captain C. B. Tinsley (Former pilot, now Manager of Flight Training in Toronto)

(b) *Trust Fund*

The trustees of the fund are the Air Canada Board of Directors. The Fund is administered by an Investment Policy Committee, which reports to the Board semi-annually, and presents an annual report. The Investment Policy Committee is currently made up of the following:

M. H. Cochrane, Vice President Finance, Chairman
W. Allen, Director
P. Desmarais, Director
R. Vaughan, President
H. Seath, Controller
T. J. Coburn, Committee Secretary

The Committee is responsible for all investment policies of the Trust Fund, including portfolio policies and investment strategies. They monitor

investments of the Fund to ensure compliance with the *Pension Benefits Standards Act*. The Committee approves all changes of cash flow and equity portfolio allocation between external managers and internal investment management. It approves real estate and mortgage proposals according to quantitative restrictions as decided upon from time to time, and it reviews quarterly reports of the Fund, financial statements and performance results.

The Trust Fund is administered on a day-to-day basis by the Investment Division, of whom the Director, Investments is T. DeWolf. The Investment Division follows a set of operating guidelines established by the Investment Policy Committee and has certain limits on its authority to make investments. For example, its authority to invest in uninsured mortgages is 2.5 million dollars, in insured mortgages 5 million dollars. There are no limitations on authority to invest in bonds. All investments in real estate require approval of the I.P.C. As for equities, there are no limitations except that I.P.C. approval is required for venture capital investments and "basket clause" investments. The Investment Division also recommends portfolio policies and investment strategies to the I.P.C. for approval.

Benefits under the Pension Plan are paid by Winnipeg and a monthly statement is sent to the Director of Investments supporting a net payment to him after contributions, expenses, benefits, etc., are netted out. Investment income on bonds and internally managed equities goes through Montreal Trust, which is the custodian for these internally managed assets. Investment income on mortgages is paid to the Fund on a monthly basis by the various servicing agents who hold and administer these assets in trust for the Fund. These servicing agents consist of the Bank of Montreal, Bank of Nova Scotia, Canada Life, C.I.B.C., Investors Trust, Montreal Trust, Morguard Trust, Royal Trust and the Toronto Dominion Bank. The income on some short-term investments of the Fund (primarily temporarily idle funds awaiting funding of mortgages) goes through the Bank of Nova Scotia. It might be noted that 40% of the equities fund, which totals about 140 million dollars, is managed by external managers, namely Canada Trust, National Trust and Royal Trust. It might be noted also that signing authority for disbursements from the fund are unlimited. Such authority is vested in the Vice President Finance, the Assistant Treasurer, the Director of Investments, the Manager of Fixed Income Investments, the Manager of Equity Investments, and the Senior Properties Investment Accountant.

The Fund presently has an unfunded liability of about 26 million dollars, which is being amortised over about twenty years at 2.5 million dollars per year. This payment to the Fund is properly made a note (Note 7) to the 1974 Air Canada annual report.

Actuarial consultants every three years compute any deficiencies in the Fund, as required by the *Pension Benefits Standards Act*. Unfunded liabilities may be amortised over a period of years.

The Fund showed an overall rate of return for 1974 of 5.9%. The actual yield would have been less because unrealised losses were not taken into account. It should be noted that the assumed rate of return from the

Fund was 8%, which is probably one of the highest rates assumed for such plans anywhere in Canada. Why this unusually high rate has been assumed is beyond the scope of this Inquiry. It should be noted, however, that this assumed rate is one of the factors which determines the company's contribution to the Plan. As the rate did not in fact meet the expectation the Fund would show a deficiency for 1974. Mr. DeWolf has indicated that the rate of 8% was realistic in 1971 and 1972, when the equity market was performing better. The next actuarial re-evaluation should take place at the end of this year.

The above review of the Air Canada Pension Plan has been superficial. However, it comes within the terms of reference of the Inquiry to report upon the elements of financial control of the company as they might apply to company pension plans. Hence this review is included in this Report.

16. *General Comments*

It is not surprising that no great accounting deficiencies in the corporate accounting procedures have been uncovered by this investigation. The corporation has had the benefit of a succession of the country's leading accountants as the corporate auditors over the past few years. Management has sought their guidance and implemented their recommendations. In this Inquiry we adopted the unusual practice of having the Vice President Finance, Mr. Cochrane, and the Commission auditor testify at the same time so as to discuss before the Commission proposals by Commission auditors and the response by the Vice President Finance. Mr. Cochrane showed a willingness to implement some of the technical proposals of Messrs. Clarkson, Gordon, the Commission auditors and others were not immediately adopted. The basis applied by Air Canada in assessing these proposals has been that of balancing the cost of the proposed control procedures or adjustment to procedures, against the risk or saving related thereto. The end result of this processing was eminently satisfactory to this Commission of Inquiry and Air Canada is to be commended for its cooperation and speedy acceptance of what are essentially technical proposals.

In assessing the foregoing lengthy and critical analysis of factual transactions and responses thereto, both by the accounting system and the executive personnel, it should be remembered that critics inevitably display a striving for perfection they themselves do not always attain.

The accomplishments of the Air Canada management team over the past decade must be kept in mind when assessing the cluster of problems which sprang up initially in the Marketing Branch and the executive response thereto in several branches. Despite these adversities and the attendant publicity, it must be said, to maintain one's perspective, that this large national undertaking ranks amongst the world's leading airlines.

Chapter 14

RECOMMENDATIONS AND CONCLUSIONS

From the discussion of the evidence and documents in Chapter 13 certain conclusions were reached. The following recommendations are made with reference to these conclusions relating to the financial controls, accounting procedures, fiscal management and corporate control of Air Canada.

1. The accounting measures proposed in Chapters 11 and 12 are recommended without repetition in this chapter. Specific and isolated recommendations made with reference to particular matters in other chapters are not repeated in this Chapter 14.

2. *The Board of Directors*

(a) Consideration is recommended of measures to improve the position of the Board of Directors as the ultimate authority in the corporation as discussed in Chapter 13. This should include the enlargement of the Board, the formation of an Executive Committee of the Board, statutory tenure and standards for appointment; all to the end of assuring the Director an independence and stature commensurate with the present importance of the position.

(b) The Board of Directors should prescribe a formal procedure to be followed when Board approval of expenditures and the incurring of obligations is sought. The Board should not be asked to approve, nor should it approve, matters with financial connotations unless, so far as possible, the cost of the project has been calculated. Doubt should be removed from present By-law provisions as to when leases and like transactions require Board approval.

(c) Consideration should be given to the redesign of the *Air Canada Act* to establish a channel whereby the Executive Branch of Government can issue to the Board of Directors of the corporation policy directives where the national interest from time to time requires, in the manner of other statutes as noted in Chapter 13.

3. *The Chief Executive Officer*

This office presently combines two classic functions: firstly to report and to maintain liaison with the complex ultimate owner of the corporation;

and secondly to operate the airline undertaking. The combination of the two in the circumstances of Air Canada represents a workload which must contribute to the executive congestion and lack of communications through and amongst senior management, as extensively commented upon in this Report. Therefore, serious consideration should be given to a fundamental reexamination and redefinition of the function of the offices of Chairman and that of the President as mentioned in number 4 below.

4. *The Presidential Sector*

(a) The Presidential sector, including the Office of the President, should be reappraised. The President should be a member of the Board and he should have a direct line of responsibility so as to accord some stature to the Office in the corporate organization; or alternatively the Office should be abolished. The misuse of the title leads to misunderstanding either of the need for Presidential approval, or the significance thereof, or both.

(b) The Law Department should be accorded a more precise and important role than presently provided in the By-laws and company procedures. Its approval of contracts and agreements should be required not only in matters of form but also as to corporate powers, signing authority, the establishment of subsidiary and affiliated corporations and to matters relating to the relationship between the airline and regulatory bodies.

(c) The Corporate Secretary is a member of the presidential staff. Corporate minutes should be so drawn as will allow persons receiving copies to understand the action taken without reference to outside materials not attached, except where confidentiality requires otherwise. All decisions taken by the Board, whether positive or negative in form and which relate to the business or undertaking of the organization, its assets, rights and liabilities should be recorded.

(d) The Directorate of Corporate Development should have concentrated in it all corporate acquisitions. This Directorate should be required to study or comment upon all such projects for the acquisition or establishment of new undertakings by the airline, its affiliates and subsidiaries.

5. *Other Officers*

It is recommended that the duties of the Vice Presidents be articulated in the By-laws which now define only the duties of the Chairman and the Secretary. This recommendation is intended to assist in the clarification of the relationship between the areas of authority of the various officers to avoid such matters as overlapping by the Marketing Branch into the areas of Public Affairs, Sales and Services, and Corporate Development, which the record of this Inquiry reveals has occurred with obvious results.

6. *The Finance Branch*

(a) The Branch should be accorded a paramount position in the approval and comment procedures relating to the expenditure of corporate funds and

this position should be articulated in the corporate By-laws and not, as presently, in executive directives, the latter being susceptible to executive waiver.

(b) In the procedure specifically relating to the AFE system, the duties of the Branch should expressly include, in addition to its present responsibilities, the duty in both prospective and retrospective reviews to report whether the corporation will receive full value for its expenditure. Where services are being purchased the Branch should be required to obtain suitable certification of value from the Branch acquiring such services. In this vital function the Finance Branch must maintain its paramount position of responsibility and not sub-contract it to the other branches and regions.

(c) In all authorization and approval procedures the Branch should have a clear directive to report a variance from corporate procedures, or a failure to protect the corporate assets or revenues, to the appropriate and designated officer or section of the corporation such as the Chief Executive, the Board of Directors or a committee thereof, or to a management committee such as the present Executive Committee.

(d) The discrepancies between the By-law provisions and the AFE regulations, as described in Chapter 5, should be eliminated; and the AFE regulations should be consolidated to include all executive directives with respect to the AFE system as well as proposals made for the extension of those regulations in the light of the McGregor experience.

(e) The AFE closing procedures have little meaning as presently constituted and should be reconstructed. The closing out of an AFE prior to the expiry of the contract period for performance should be expressly forbidden, unless appropriate and specified certification of receipt of goods or services is included in the documentation. In short there should be injected into the process some meaning where there is now largely motion.

(f) The regulations should require that an AFE be so drawn as to communicate the precise nature of the transaction being authorized, to the officials executing the AFE and to any person whose duties include the later scrutiny thereof.

(g) The functional role of the Controllers in the other branches and regions, and in subsidiary and affiliated companies, should be either formally discontinued or fully articulated in corporate regulations.

(h) In budget matters the Finance Branch should be more than a consultant to the line and operating divisions of the corporation, which is substantially the present situation. Budget procedure should be made the subject of detailed regulations whereunder the Finance Branch should be responsible for reviewing in detail all branch, regional and other sectors of the corporate budget. Budget variances within the branch and other sectors of the corporate budget should be reviewed by the Finance Branch, and the Vice President should report all significant variations to the Chief Executive, whether or not such variance will cause or probably cause the branch or sector in question to exceed its annual budget. These budget variance procedures might, for reasons of efficiency and speed, include a requirement of written approval

of the Finance Branch, within prescribed limits, and over such limits, the obligation to report the variance to the Chief Executive. There should be a scheduled periodic reporting by the Finance Branch to the Board of Directors or its Executive Committee, if one be established, on all variances approved by the Finance Branch and the Chief Executive.

7. *The Marketing Branch*

The Marketing Branch should not be classified as equivalent to a Group unless some logical expansion of its role in the corporate structure can be undertaken. If the Branch is to continue its role as a staff branch then it should be stripped of operating or line responsibilities and its status reduced to the level of other staff branches.

8. *Capital Budget Approval*

The capital budget approved under the *Financial Administration Act* should be approved prospectively and accordingly corporate and departmental procedures should be adopted to ensure this result.

9. *Internal Audit Section*

(a) The primary task of this section should be to establish, by independent inquiry, that the corporate authorizations and accounting procedures are adhered to by the branches, regions, and subsidiary and affiliated corporations.

(b) The duties of the Internal Audit section should be articulated in corporate By-laws approved by the Board of Directors. The proper performance of its duties requires an independence which should be assured by according to this service a position in the corporate structure where its personnel will be independent in theory and in fact. Its duties should be delineated precisely and the Audit service must be given sufficient authority to enable it to discharge those duties. Relocation outside the Finance Branch should be considered in view of the size of the corporation's operations and, if so, it should report directly to the President of the airline or the Chairman of the Board.

(c) The Internal Audit section should be required to report to the Audit Committee periodically throughout the year on the number and type of investigations being undertaken.

10. *Subsidiary and Affiliated Companies*

(a) The use of affiliated corporations to undertake actions not clearly within the corporate power should be reappraised. Where the present statute can be invoked for the establishment of subsidiary operations, such should be done. In the event affiliated corporations are continued to be used, the business of such affiliates should not include matters which should be properly

conducted by the airline itself or by a wholly owned subsidiary. The dangers of doing indirectly through CNR subsidiaries what Air Canada cannot do directly are manifest.

(b) Subsidiary and affiliated corporations should be integrated into the airline's financial and corporate control By-laws and regulations and treated for these purposes as divisions of the airline. The boards of subsidiary companies should include members of the Board of Air Canada and the general rule should be that the majority of the membership of each of such boards should be made up of members of the Air Canada Board, wherever ownership direct or indirect permits. Subsidiary and affiliated companies should have a designated officer at the corporate headquarters to whom the President of such company shall make periodic reports and who in turn will report to the Executive Committee of Management and the Committee of the Board on the affairs of the subsidiary. No subsidiary should have autonomy in the area of project authorization or the disbursement of funds or the undertaking of obligations except under the By-laws, the AFE regulation or other procedures of the airline itself.

11. *External Auditors*

The External Auditors should be expressly instructed to report upon the existence of all affiliate and subsidiary corporations in their annual report to Parliament and should advise whether such accounts were consolidated or are otherwise reported upon in the corporation's financial statements.

12. *Pensions*

(a) The appropriate accounting actions should be taken to reflect in financial statements the future unfunded obligations of the corporation in all pension or like arrangements.

(b) The Board of Directors should be given the calculated cost or market cost of all arrangements made with respect to the hiring or advancement of personnel who report directly to the Chairman, the President or Group Vice Presidents of the corporation at the time that Board approval of any such appoointment or advancement is sought.

13. *Communications*

(a) Recommendations with respect to specific items of communication deficiencies set out in this Chapter 14 are not repeated here.

(b) Officers should not, except in unusual and fully documented circumstances, be shared between two branches or other principal segments of the corporate structure.

(c) The Management Executive Committee should be utilized as a clearinghouse for all current business so as to be an important element of corporate communication.

14. *The Air Canada Act*

(a) Recommendations under specific headings already set forth in this Chapter 14 are recommended in this section 14 without specific repetition.

(b) The corporate powers and objects should be reconstituted in the statute so as to reflect the facts of a modern airline undertaking and consideration should be given to adding such powers and objects as in the competitive airline industry are properly and regularly invoked by airlines. However, it is not recommended that the corporation be given the general status of a commercial corporation so that the nature of the undertaking can change and expand without recourse to Parliament.

15. *Executive Response*

The instances of inadequate response by the senior management of the corporation to the knowledge of various irregularities, the departures from corporate procedures, failure to comply with regulations, and related matters are detailed in the appropriate chapters of this Report and therefore are not repeated here.

It may be well to end this Report as it began by stating that this Inquiry was to investigate and report upon financial controls, accounting procedures and fiscal management. It was not authorized to examine and did not examine any other areas of this large enterprise. Nothing contained in this Report should be read as indicating or inferring that Air Canada is not, as regards its actual airline operations, a sound business-like operation.

ALL OF WHICH IS RESPECTFULLY SUBMITTED
FOR YOUR EXCELLENCY'S CONSIDERATION.

Commissioner.

23rd October, 1975.

Appendix A

AIR CANADA INQUIRY—MISCELLANEOUS DATA

Order-in-Council No. P.C. 1975-963 (April 25, 1973)

Commissioner: THE HONOURABLE WILLARD Z. ESTEY

Staff:

Counsel

R. M. SEDGEWICK, Q.C.	*Commission Counsel*
L. YVES FORTIER	*Commission Counsel*
BERNARD ROY	
ARTHUR M. GANS	

Accounting Advisers

W. A. FARLINGER	*Clarkson, Gordon & Co.*
S. B. LOWDEN	" " "
P. O. GRATIAS	" " "
R. R. OKKER	" " "
T. E. SINTON	*Arthur Young & Co.*

Secretary

H. JORY KESTEN

Registrar

BEVERLEY ORAM

Registrar's Assistant

SUZANNE LAVIGNE

Hearings: Commenced: WEDNESDAY, APRIL 30, 1975

Closed: THURSDAY, JULY 24, 1975

Total No. of Days of Hearings: 47

Hearing Dates:

Week	1:	APRIL 30, MAY 1-2
"	2:	MAY 7-8
"	3:	MAY 12-16
"	4:	MAY 20-22
"	5:	MAY 26-30
"	6:	JUNE 2-5
"	7:	JUNE 9-12
"	8:	JUNE 23-27
"	9:	JULY 7-10
"	10:	JULY 14-18
"	11:	JULY 21-24

Hearings Held at: CHANCELLOR DAY HALL,
McGILL UNIVERSITY LAW SCHOOL,
3644 PEEL STREET,
MONTREAL, P.Q.

(Weeks 1 & 2 held at

FEDERAL COURT,
PALAIS DE JUSTICE,
MONTREAL, P.Q.)

Transcripts: 42 VOLUMES

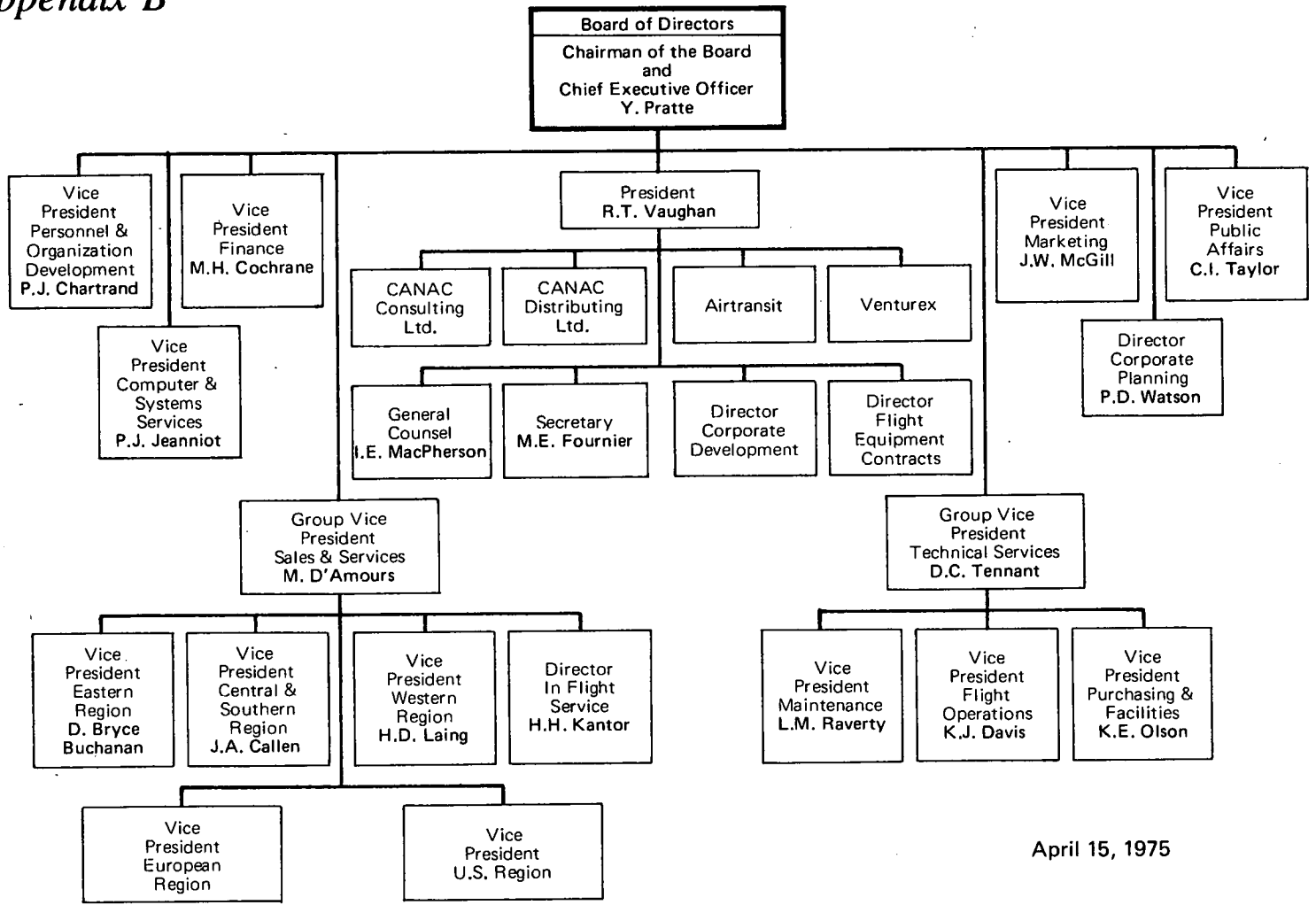
Approx. 8150 pages—public hearings

720 pages—in camera hearings

Exhibits: Total No. of Exhibits: 304 (plus numerous sub-exhibits)

Witnesses: Total No. of Witnesses: 55

Appendix B



April 15, 1975

Appendix C

Air Canada Act, R.S.C. 1970, c. A-11

MANAGEMENT

5. (1) The Corporation shall be under the management of a Board of Directors composed of nine persons, elected and appointed as hereinafter provided.

(2) It is not necessary that a director be a shareholder of the Corporation, but no person shall be elected or appointed as a director or shall continue to hold office as such who is not a British subject who has been continuously resident in Canada for not less than five years prior to the date of his election or appointment.

(3) Five directors shall be elected by the shareholders of the Corporation and four directors shall be appointed by the Governor in Council. R.S., c. 268, s. 5; 1952-53, c. 50, s. 11.

ADMINISTRATION

5. (1) La Corporation est gérée par un conseil d'administration composé de neuf personnes élues et nommées comme il est prescrit ci-dessous.

(2) Il n'est pas nécessaire qu'un administrateur soit actionnaire de la Corporation; mais nul ne doit être élu ou nommé administrateur ou continuer de remplir cette charge s'il n'est pas un sujet britannique qui a continuellement résidé au Canada durant au moins cinq ans avant la date de son élection ou de sa nomination.

(3) Cinq administrateurs sont élus par les actionnaires de la Corporation, et quatre sont nommés par le gouverneur en conseil. S.R., c. 268, art. 5; 1952-53, c. 50, art. 11.

AUDIT

12. The accounts and financial transactions of the Corporation shall be audited by the auditor appointed by Parliament to audit the account of Canadian National Railways. 1952-53, c. 50, s. 14.

VÉRIFICATION

12. Les comptes et opérations financières de la Corporation doivent être apurés par le vérificateur nommé par le Parlement pour examiner les comptes des Chemins de fer nationaux du Canada. 1952-53, c. 50, art. 14.

BUSINESS AND POWERS OF THE CORPORATION

13. (1) The Corporation is authorized
(*a*) to establish, operate and maintain air lines or regular services of aircraft of all kinds, to carry on the business of transporting mails, passengers and goods by air, and to enter into contracts for the transport of mails, passengers and goods by any means, and either by the

AFFAIRES ET POUVOIRS DE LA CORPORATION

13. (1) La Corporation est autorisée à
a) établir, exploiter et entretenir des lignes aériennes ou des services réguliers d'aéronefs de toutes sortes en vue de poursuivre le commerce de transport par air du courrier, des passagers et marchandises, et à conclure des contrats pour le transport de courrier, des passa-

Corporation's own aircraft and conveyances or by means of the aircraft and conveyances of others, and to enter into contracts with any person or company for the interchange of traffic and, in connection with any of the objects aforesaid, to carry on the business of warehousing goods, wares and merchandise of every kind and description whatever;

(*e*) to purchase, hold and, subject to this Act, sell and dispose of shares in any company incorporated under section 18 or in any company or corporation incorporated for the operation and maintenance of air lines or services of aircraft of any kind;

(*g*) to deposit money with or lend money to the Canadian National Railway Company at such rate of interest as may be agreed upon between the Corporation and the Canadian National Railway Company;

(*i*) to buy, sell, lease and operate motor vehicles of all kinds for the purpose of transporting mails, passengers and goods in connection with the Corporation's air services and the air services of other air carriers and to enter into contracts with any other person respecting the provision of motor vehicle services of all kinds;

(*j*) to purchase, lease, or otherwise acquire or provide, hold, use, enjoy and operate such hotels in Canada as are deemed expedient for the purposes of the Corporation; and

17. (1) The provisions of Part IV of the *Canada Corporations Act*, except sections 161, 174, 175, 179, 196 and 197, in so far as the said provisions are not inconsistent with this Act, apply to the Corporation, and this Act shall for the purposes of Part IV of the *Canada Corporations Act*, be deemed to be a special Act and the Corporation shall be deemed to be a company for the purposes of that Part.

(2) The fiscal year of the Corporation is the calendar year. R.S., c. 268, s. 18.

gers et marchandises de toutes manières, soit par des aéronefs ou d'autres moyens de transport appartenant à la Corporation, soit par des aéronefs ou d'autres moyens de transport appartenant à d'autres, et à conclure des contrats avec toute personne ou compagnie pour l'échange du trafic et, relativement à l'un quelconque des objets susdits, à faire le commerce d'emmagasinage des articles, denrées et marchandises de toutes sortes;

e) acheter, détenir et, sous réserve de la présente loi, vendre et aliéner les actions de toute compagnie constituée en corporation sous le régime de l'article 18, ou de toute compagnie ou corporation constituée pour l'exploitation et l'entretien de lignes aériennes ou de services d'aéronefs de toute sorte;

g) déposer de l'argent auprès de la Compagnie des chemins de fer nationaux du Canada ou lui prêter de l'argent au taux d'intérêt convenu entre la Corporation et la Compagnie des chemins de fer nationaux du Canada;

i) acheter, vendre, louer et exploiter des véhicules automobiles de toutes sortes en vue du transport des envois postaux, des voyageurs et des marchandises à l'égard des services aériens de la Corporation et de ceux d'autres transporteurs par air, de même que conclure avec toute autre personne des contrats pour la fourniture de services de toutes sortes par véhicules automobiles;

j) acheter, louer ou autrement acquérir ou fournir, détenir, employer, posséder et exploiter au Canada les hôtels jugés utiles aux buts de la Corporation; et

17. (1) Les dispositions de la Partie IV de la *Loi sur les corporations canadiennes*, sauf les articles 161, 174, 175, 179, 196 et 197, s'appliquent à la Corporation en tant qu'elles ne sont pas incompatibles avec la présente loi, et la présente loi est censée, pour les objets de la Partie IV de la *Loi sur les corporations canadiennes*, être une loi spéciale, et la Corporation est censée une compagnie pour les fins de ladite Partie.

(2) L'exercice financier de la Corporation est l'année civile. S.R., c. 268, art. 18.

SUBSIDIARIES

18. The Governor in Council may on the petition of the Corporation declare that any number of persons named in the petition, not exceeding nine in number, shall be a body corporate and upon such declaration being made those persons are a body corporate and politic. 1952-53, c. 50, s. 17.

25. All the provisions of this Act relating to Air Canada, except sections 3, 4, 6, 11, 14 and 15, apply *mutais mutandis* to every corporation incorporated under section 18. R.S., c. 268, s. 26; 1964-65, c. 2, s. 1.

27. The Board of Directors shall make a report annually to Parliament setting forth in a summary manner the results of their operations and such other information as appears to them to be of public interest or necessary for the information of Parliament with relation to any situation existing at the time of such report, or as may be required from time to time by the Governor in Council. R.S., c. 268, s. 28.

28. The annual reports of the Board of Directors and the auditor, respectively, shall be submitted to Parliament through the Minister. R.S., c. 268, s. 29.

FILIALES

18. Le gouverneur en conseil peut, à la requête de la Corporation, déclarer qu'un nombre quelconque de personnes mentionnées dans la requête, d'au plus neuf, composent un corps constitué et, après une telle déclaration, ces personnes deviennent un corps constitué et politique. 1952-53, c. 50, art. 17.

25. Toutes les dispositions de la présente loi se rapportant à Air Canada, sauf les articles 3, 4, 6, 11, 14 et 15, s'appliquent *mutatis mutandis* à toute corporation constituée sous le régime de l'article 18. S.R. c. 268, art. 26; 1964-65, c. 2, art. 1.

27. Le conseil d'administration doit présenter chaque année au Parlement un rapport indiquant de façon sommaire les résultats de ses opérations et tel autre renseignement qu'il juge d'intérêt public ou nécessaire pour faire connaître au Parlement la situation existant à l'époque d'un tel rapport, ou que le gouverneur en conseil peut requérir à discrétion. S.R., c. 268, art. 28.

28. Les rapports annuels du conseil d'administration et du vérificateur doivent être respectivement présentés au Parlement par l'intermédiaire du Ministre. S.R., c. 268, art. 29.

PART VIII

CROWN CORPORATIONS

66. (1) In this Part

"agency corporation" means a Crown corporation named in Schedule C;

"auditor" means, in relation to a corporation, the person authorized by Parliament to audit the accounts and financial transactions of the corporation;

"Crown corporation" means a corporation that is ultimately accountable, through a Minister, to Parliament for the conduct of its affairs, and includes the corporations named in Schedule B, Schedule C and Schedule D;

"departmental corporation" means a Crown R.S., c. 116, s. 70.

70. (1) Each agency corporation shall annually submit to the appropriate Minister an operating budget for the next following financial year of the corporation for the approval of the appropriate Minister and the President of the Treasury Board.

(2) For each corporation the appropriate Minister shall annually lay before Parliament the capital budget for its financial year approved by the Governor in Council on the recommendation of the appropriate Minister, the President of the Treasury Board and the Minister of Finance.

74. Subject to any order or direction of the Treasury Board, a corporation may make provision for reserves for depreciation of assets, for uncollectable accounts and for other purposes. 1966-67, c. 74, s. 15.

PARTIE VIII

CORPORATIONS DE LA COURONNE

66. (1) Dans la présente Partie

«corporation de département» signifie une corporation de la Couronne nommée à l'annexe B;

«corporation de la Couronne» signifie une corporation qui, en dernier lieu, doit rendre compte au Parlement, par l'intermédiaire d'un ministre, de la conduite de ses affaires, et comprend les corporations nommées aux annexes B, C et D;

«corporation de mandataire» signifie une corporation nommée à l'annexe C;

«corporation de propriétaire» signifie une corporation de la Couronne nommée à l'annexe D;

70. (1) Chaque corporation de mandataire doit soumettre tous les ans, au ministre compétent, un budget d'exploitation pour l'année financière suivante de la corporation en vue de l'approbation du ministre compétent et du président du conseil du Trésor.

(2) Le ministre compétent doit tous les ans, à l'égard de chaque corporation, soumettre au Parlement le budget d'établissement pour son année financière, approuvé par le gouverneur en conseil, sur la recommandation du ministre compétent, du président du conseil du Trésor et du ministre des Finances.

74. Sauf tout arrêté ou directive du conseil du Trésor, une corporation peut pourvoir à des réserves pour dépréciation d'élément d'actif, pour comptes irrécouvrables et pour d'autres objets. 1966-67, c. 74, art. 15.

75. (1) A corporation shall keep proper books of account and proper records in relation thereto.

(2) Subject to such directions as to form as the Treasury Board may give, a corporation shall prepare in respect of each financial year statements of accounts which shall include

(*a*) a balance sheet, a statement of income and expense and a statement of surplus, containing such information as, in the case of a company incorporated under the *Canada Corporations Act*, is required to be laid before the company by the directors at an annual meeting; and

(*b*) such other information in respect of the financial affairs of the corporation as the appropriate Minister, the Treasury Board or the Minister of Finance may require.

(3) A corporation shall, as soon as possible, but within three months after the termination of each financial year submit an annual report to the appropriate Minister in such form as he may prescribe, which shall include the statement of accounts specified in subsection (2), and the appropriate Minister shall lay the report before Parliament within fifteen days after he receives it or, if Parliament is not then in session, within fifteen days after the commencement of the next ensuing session.

(4) A corporation shall make to the appropriate Minister such reports of its financial affairs as he requires. R.S., c. 116, s. 85; 1966-67, c. 74, s. 16.

76. The auditor is entitled to have access at all convenient times to all records, documents, books, accounts and vouchers of a corporation, and is entitled to require from the directors and officers of the corporation such information and explanations as he deems necessary. R.S., c. 116, s. 86.

77. (1) The auditor shall report annually to the appropriate Minister the result of his examination of the accounts and finan-

75. (1) Une corporation doit tenir des livres de comptabilité appropriés, ainsi que des archives pertinentes.

(2) Sous réserve des instructions que le conseil du Trésor peut donner quant à la forme, une corporation doit, à l'égard de chaque année financière, préparer des états de comptes qui comprennent

a) un bilan, un relevé de revenus et des dépenses et un état du surplus, avec les renseignements qui, dans le cas d'une compagnie constituée selon la *Loi sur les corporations canadiennes*, doivent être présentés à la compagnie par les administrateurs à une assemblée annuelle; et

b) les autres renseignements sur les affaires financières de la corporation que le ministre compétent, le conseil du Trésor ou le ministre des Finances peut exiger.

(3) Une corporation doit, aussitôt que possible, mais dans les trois mois qui suivent la fin de chaque année financière, soumettre au ministre compétent un rapport annuel en la forme que ce dernier peut prescrire, lequel rapport doit comprendre l'état de comptes spécifié au paragraphe (2). Le ministre compétent doit présenter ce rapport au Parlement dans les quinze jours après qu'il l'a reçu ou, si le Parlement n'est pas alors en session, dans les quinze jours de l'ouverture de la session suivante.

(4) Une corporation doit adresser au ministre compétent tels rapports que ce dernier peut exiger en ce qui regarde les affaires financières de la corporation. S.R., c. 116, art. 85; 1966-67, c. 74, art. 16.

76. Le vérificateur a droit d'accès, en tout temps convenable, aux registres, documents, livres, comptes et pièces justificatives d'une corporation, et il a le droit d'exiger des administrateurs et fonctionnaires de la corporation les renseignements et explications qu'il juge nécessaires. S.R., c. 116, art. 86.

77. (1) Le vérificateur doit faire connaître, tous les ans, au ministre compétent, le résultat de son examen des comptes ainsi

cial statements of a corporation, and the report shall state whether in his opinion

(*a*) proper books of account have been kept by the corporation;

(*b*) the financial statements of the corporation

(i) were prepared on a basis consistent with that of the preceding year and are in agreement with the books of account,

(ii) in the case of the balance sheet, give a true and fair view of the state of the corporation's affairs as at the end of the financial year, and

(iii) in the case of the statement of income and expense, give a true and fair view of the income and expense of the corporation for the financial year; and

(*c*) the transactions of the corporation that have come under his notice have been within the powers of the corporation under this Act and any other Act applicable to the corporation;

and the auditor shall call attention to any other matter falling within the scope of his examination that in his opinion should be brought to the attention of Parliament.

(2) The auditor shall from time to time make to the corporation or to the appropriate Minister such other reports as he may deem necessary or as the appropriate Minister may require.

(3) The annual report of the auditor shall be included in the annual report of the corporation.

(4) Notwithstanding section 68, this section operates in lieu of section 132 of the *Canada Corporations Act*. R.C., c. 116, s. 87.

78. In any case where the auditor is of the opinion that any matter in respect of a corporation should be brought to the attention of the Governor in Council, the Treasury Board or the Minister of Finance, such report shall be made forthwith through the appropriate Minister. R.S., c. 116, s. 88.

que des états financiers d'une corporation, et le rapport doit indiquer si, à son avis,

a) la corporation a tenu des livres de comptabilité appropriés;

b) les états financiers de la corporation

(i) ont été préparés sur une base compatible avec celle de l'année précédente et sont en accord avec les livres de comptabilité,

(ii) dans le cas du bilan, donnent un aperçu juste et fidèle de l'état des affaires de la corporation à la fin de l'année financière, et

(iii) dans le cas du relevé des revenus et des dépenses, donnent un aperçu juste et fidèle du revenu et des dépenses de la corporation pour l'année financière; et si, à son avis,

c) les opérations de la corporation venues à sa connaissance étaient de la compétence de la corporation aux termes de la présente loi et de toute autre loi y applicable;

et il doit signaler toute autre matière qui rentre dans le cadre de son examen et qui, d'après lui, devrait être portée à l'attention du Parlement.

(2) Le vérificateur doit, de temps à autre, adresser à la corporation ou au ministre compétent les autres rapports qu'il estime nécessaires ou que le ministre compétent peut exiger.

(3) Le rapport annuel du vérificateur doit être inclus dans le rapport annuel de la corporation.

(4) Nonobstant l'article 68, le présent article produit son effet au lieu de l'article 132 de la *Loi sur les corporations canadiennes*. S.R., c. 116, art. 87.

78. Lorsque le vérificateur estime qu'une question concernant une corporation devrait être signalée au gouverneur en conseil, au conseil du Trésor ou au ministre des Finances, ce rapport doit être fait immédiatement par l'intermédiaire du ministre compétent. S.R., c. 116, art. 88.

PART IV

General Powers

163. (1) Every company incorporated under any Special Act shall be a body corporate under the name declared in the Special Act, and may acquire, hold, alienate and convey any real property necessary or requisite for the carrying on of the undertaking of such company, and shall be invested with all the powers, privileges and immunities necessary to carry into effect the intention and objects of this Part and of the Special Act, and which are incident to such corporation, or are expressed or included in the *Interpretation Act*.

171. The directors of the company may, in all things, administer the affairs of the company, and may make or cause to be made for the company, any description of contract which the company may, by law, enter into. R.S., c. 53, s. 159.

By-laws

172. The directors may make by-laws not contrary to law or to the Special Act or to this Part, for

(*a*) regulating the allotment of shares, the making of calls thereon, the payment thereof, the issue and registration of certificates for shares, the forfeiture of shares for non-payment, the disposal of forfeited shares and of the proceeds thereof, and the transfer of shares;

(*b*) the declaration and payment of dividends;

(*c*) the number of the directors, their term of service, the amount of their share qualification and their remuneration, if any;

(*d*) the appointment, functions, duties and removal of all agents, officers and servants of the company, the security to be given by them to the company and their remuneration;

(*e*) the time and place for the holding of the annual meeting of the company.

PARTIE IV

Pouvoirs généraux

163. (1) Toute compagnie constituée par une loi spéciale forme une corporation sous le nom indiqué dans la loi spéciale et peut acquérir, posséder, aliéner et transmettre les immeubles nécessaires ou requis pour l'exercice de l'entreprise de cette compagnie; et elle jouit de tous les pouvoirs, privilèges et immunités nécessaires pour réaliser l'intention et les objets de la présente Partie et de la loi spéciale, et qui sont inhérents à une telle corporation, ou qui sont exprimés ou compris dans la *Loi d'interprétation*.

171. Les administrateurs de la compagnie ont plein pouvoir pour gérer les affaires de la compagnie, et peuvent passer ou faire passer, au nom de la compagnie, toute espèce de contrat que la loi lui permet de conclure. S.R., c. 53, art. 159.

Statuts

172. Il est loisible aux administrateurs d'établir des statuts non contraires à la loi, non plus qu'à la loi spéciale, ni à la présente Partie, pour régler

a) la répartition des actions, les appels de versements, les versements, l'émission et l'enregistrement des certificats d'actions, la confiscation des actions à défaut de paiement, la disposition des actions frappées de déchéance et de leur produit, et le transfert des actions;

b) la déclaration et le paiement de dividendes;

c) le nombre des administrateurs, la durée de leur service, le montant de leurs actions statutaires, et leur rémunération, s'il en est;

d) la nomination, les fonctions, les devoirs et la révocation de tous les agents, fonctionnaires et serviteurs de la compagnie, la garantie qu'ils doivent donner à la compagnie et leur rémunération;

e) l'époque et le lieu de la tenue de l'assemblée annuelle de la compagnie, la

the calling of meetings, regular and special, of the board of directors and of the company, the quorum at meetings of the directors and of the company, the requirements as to proxies, and the procedure in all things at such meetings;

(*f*) the imposition and recovery of all penalties and forfeitures admitting of regulation by by-law; and

(*g*) the conduct, in all other particulars, of the affairs of the company. R.S., c. 53, s. 160.

convocation des assemblées régulières et extraordinaires du conseil d'administration et de la compagnie, le quorum aux assemblées des administrateurs et de la compagnie, les conditions exigées quant aux fondés de pouvoir, et la procédure à suivre à ces assemblées;

f) l'imposition et le recouvrement des amendes et confiscations qui peuvent être déterminées par règlement; et

g) la conduite des affaires de la compagnie à tous autres égards. S.R., c. 53, art. 160.

173. The directors may repeal, amend or re-enact any such by-law, but every such by-law, repeal, amendment or re-enactment unless in the meantime confirmed at a general meeting of the company duly called for that purpose shall only have force until the next annual meeting of the company and in default of confirmation thereat ceases from the time of such default to have force or effect. R.S., c. 53, s. 161.

creation of preference shares and no by-law authorizing the creation of such shares and nothing done under or in pursuance of any such provision or by-law, affects or impairs the rights of creditors of the company. R.S., c. 53, s. 185.

173. Les administrateurs peuvent révoquer, modifier ou remettre en vigueur tout semblable règlement; mais ce règlement, et toute révocation, modification ou remise en vigueur d'un règlement, à moins d'être ratifiée dans l'intervalle par une assemblée générale de la compagnie régulièrement convoquée pour en délibérer, ne sont exécutoires que jusqu'à la prochaine assemblée annuelle de la compagnie; et, à défaut de ratification par l'assemblée, ils cessent de recevoir leur application à compter de ce défaut. S.R., c.

relative à la création d'actions privilégiées, et nul règlement qui autorise la création de ces actions, et rien de ce qui peut se faire sous l'autorité ou en exécution de cette disposition ou de ce règlement, ne porte atteinte ni préjudice aux droits des créanciers de la compagnie. S.R., c. 53, art. 185.

Contracts

198. (1) Every contract, agreement, engagement or bargain made, and every bill of exchange drawn, accepted or endorsed, and every promissory note and cheque made, drawn or endorsed on behalf of the company, by any agent, officer or servant of the company, within the apparent scope of his authority as such agent, officer or servant, is binding upon the company.

(2) In no case is it necessary to have the seal of the company affixed to any such contract, agreement, engagement, bargain, bill of exchange, promissory note or cheque, or to prove that the same was made, drawn, accepted or endorsed, as

Contrats

198. (1) Les contrats, conventions, engagements ou marchés conclus, les lettres de change tirées, acceptées ou endossées, et les billets à ordre et chèques faits, tirés ou endossés, au nom de la compagnie, par ses agents, fonctionnaires ou serviteurs, dans les limites apparentes de leur autorité comme agents, fonctionnaires ou serviteurs, lient la compagnie.

(2) Il n'est jamais nécessaire d'apposer le sceau de la compagnie sur ces contrats, conventions, engagements, marchés, lettres de change, billets à ordre ou chèques, ni de prouver qu'ils ont été conclus, tirés, faits, acceptés ou endossés, selon le cas,

the case may be, in pursuance of any by-law or special vote or order.

(3) The person so acting as agent, officer or servant of the company, shall not be thereby subjected individually to any liability whatever to any third person therefor. R.S., c. 53, s. 186.

206. No company shall use any of its funds in the purchase of shares in any other corporation except to the extent that such purchase is specially authorized by the Special Act. R.S., c. 53, s. 194.

conformément à quelque règlement ou vote ou ordre spécial.

(3) La personne qui agit ainsi comme agent, fonctionnaire ou serviteur de la compagnie n'est à ce titre personnellement assujettie à aucune responsabilité envers les tiers. S.R., c. 53, art. 186.

206. Une compagnie ne peut employer quelque partie de ses fonds à l'achat d'actions d'une autre corporation, sauf dans la mesure où cet achat est formellement autorisé par la loi spéciale. S.R., c. 53, art. 194.

Air Carrier Regulations, S.O.R./72-145 (promulgated under the Aeronautics Act)

PART IV

INTERNATIONAL CHARTERS

Interpretation

21. In this Part,

"accommodation" means a hotel or other commercial establishment offering sleeping facilities to the general public that are available each night of a tour and includes at least one meal each day of the tour at such establishment or elsewhere;

"basic entitlement" means the number of fourth freedom charter flights that a foreign air carrier is entitled to operate out of Canada during a calendar year without application of the criteria set out in Schedule A;

"destination" means the point to which the passengers or goods to be transported on a charter flight are bound;

"eligible list" means a list maintained by the Secretary of air carriers that are eligible to apply to the Committee for permits to operate international charter flights comprising

(*a*) international air carriers holding Class 8 licences;

(*b*) Canadian air carriers holding Class 9-4 licences using Group D, E, F, G, or H aircraft; and

(*c*) foreign air carriers operating aircraft having a maximum gross take-off weight on wheels in excess of 18,000 pounds whose applications under section 24 have been approved by the Committee and who continue to meet the Committee's requirements under that section;

"entity charter" means a charter in which the cost of transportation of passengers or goods is paid by one person, company or organization without any contribution, direct or indirect, from any other person;

PARTIE IV

AFFRÈTEMENTS INTERNATIONAUX

Interprétation

21. Dans la présente partie,

«affrètement avec participation» désigne un affrètement aux termes duquel les personnes transportées paient chacune une part du coût du transport;

«affrètement sans participation» désigne un affrètement aux termes duquel le coût du transport des passagers ou des marchandises est payé par une seule personne, une seule corporation ou un seul organisme et n'est partagé, ni directement ni indirectement, par aucune autre personne;

«affrètement pour voyage tout compris» désigne un affrètement aux termes duquel un transporteur aérien passe un contrat de location de tout ou partie d'un aéronef avec un ou plusieurs organisateurs de voyages, en vue de la revente, par l'organisateur, des places à un prix de voyage tout compris;

«année d'exploitation» désigne la période comprise entre le 1er octobre et le 30 septembre de l'année suivante;

«autorisation» signifie une autorisation écrite délivrée par le Comité qui autorise un transporteur aérien inscrit sur la liste d'admissibilité à effectuer un vol d'affrètement international;

«autres services et facilités» désigne les services supplémentaires compris dans le programme et le prix du voyage et dont la valeur ne doit pas dépasser en moyenne $1.50 pour chaque jour de voyage. Ils peuvent comprendre, en sus du logement prévu, les promenades-visites, les excursions locales sur terre ou sur l'eau, effectuées aux points de destination ou des repas en sus de ceux qui doivent être prévus en vertu du présent article;

"fifth freedom" means the privilege to take on or put down in Canada passengers, mail and cargo destined to, or coming from the territory of a country other than that of the air carrier operating the air service;

"fourth freedom" means privilege to take on in Canada passengers, mail and cargo destined to the territory of the country of the air carrier operating the air service;

"inclusive tour" or "tour" means a round or circle trip performed in whole or in part by air for an inclusive tour price for the period the participants are away from the starting point of the journey;

"inclusive tour charter" means a charter under which an air carrier contracts with one or more tour operators to charter an aircraft, in whole or in part, for resale by the tour operator at a per seat inclusive tour price;

"inclusive tour group" means a group of persons assembled at a point by a tour operator for the purpose of participating as a unit in an inclusive tour;

"inclusive tour price" includes, for an inclusive tour group, the cost of

(*a*) transportation,

(*b*) accommodation, and

(*c*) all other services and facilities in the tour program;

"off route trans-border flight" means a pro rata or entity charter flight between Canada and the Continental United States of America, including Alaska, other than between points on a route authorized to be served under licences issued by the Committee pursuant to the Air Transport Agreement between the Government of Canada and the Government of the United States of America;

"on route transborder flight" means a pro rata or entity charter flight between Canada and the Continental United States of America, including Alaska, between points on a route authorized to be served under licences issued by the Committee pursuant to the Air Trans-

«cinquième liberté» désigne le privilège d'embarquer ou de débarquer au Canada des passagers, du courrier et des marchandises à destination ou en provenance du territoire d'un pays autre que celui du transporteur aérien qui exploite le service;

«destination» désigne le point auquel doivent être transportés les passagers ou les marchandises qui font l'objet du vol d'affrètement;

«groupe affréteur avec participation» désigne un groupe de personnes inclus dans l'une ou l'autre des catégories suivantes exclusivement:

a) «groupe affréteur avec participation ayant une affinité» formé de personnes qui, à la date du départ du vol d'affrètement dont ils font partie, sont, depuis au moins six mois, membres en règle d'un organisme qui poursuit en pratique un but et des objectifs principaux autres que des voyages; ou

b) «groupe affréteur avec participation à but commun» formé de personnes dont le voyage en groupe a été organisé pour leur permettre d'assister à une manifestation ou à des manifestations déterminées et dont le but principal est uniquement de se rendre au lieu de cette manifestation ou de ces manifestations, ou d'en revenir;

et comprend un conjoint, un enfant à charge ou un parent qui cohabite avec une personne comprise dans l'une ou l'autre catégorie;

«groupe effectuant un voyage tout compris» désigne un groupe de personnes réunies à un même point par un organisateur de voyage pour faire, en tant que groupe, un voyage tout compris;

«liste d'admissibilité» désigne une liste, tenue par le Comité, de tous les transporteurs aériens qui ont le droit de faire une demande au Comité pour obtenir l'autorisation d'effectuer des vols d'affrètement internationaux et qui comprennent

port Agreement between the Government of Canada and the Government of the United States of America;

"operating year" means the period from October 1 in any year to September 30 of the year immediately following;

"origin" means the point from which a charter flight commences with the passengers or goods to be transported;

"other services and facilities" means additional features that are included in the tour program and price, the cost of which shall not be less than an average sum of $1.50 for each day of the tour, and that may consist of such services as sightseeing, local ground or water tours at destination points, or meals, in addition to accommodation;

"permit" means a written authority issued by the Committee authorizing an air carrier on the eligible list to operate an international charter flight;

"pro rata charter" means a charter in which the passengers to be transported share in the cost of transportation;

"pro rata charter group" means a group of persons falling exclusively in either of the following categories:

(*a*) "pro rata charter affinity group" formed exclusively of persons who, on the date of departure of a charter flight on which they are passengers, are and have been continuously for a period of at least six months immediately preceding such departure date, members in good standing of an organization whose principal aim, purpose and objectives are other than travel; or

(*b*) "pro rata charter common purpose group" formed exclusively of persons who have been organized to travel together to attend a specific event or events and whose principal purpose is only to get to or from such event or events

and includes a spouse, a dependent child or a parent living in the same household as a person falling in either category;

a) les transporteurs aériens internationaux titulaires de permis de la classe 8,

b) les transporteurs aériens canadiens titulaires de permis de la classe 9-4 et utilisant des aéronefs des groupes D, E, F, G ou H, et

c) les transporteurs aériens étrangers qui exploitent des aéronefs ayant un poids brut maximal au décollage, sur roues, de plus de 18,000 livres, dont la demande présentée conformément aux dispositions de l'article 24 a été agréée par le Comité et qui continuent à satisfaire aux exigences du Comité énoncées dans ledit article;

«logement» signifie une chambre dans un hôtel ou tout autre établissement ouvert au public pour chaque nuit du voyage et comprend un repas par jour, pris dans cet établissement ou ailleurs;

«organisateur de voyages» désigne

a) une personne dont l'entreprise au Canada consiste en grande partie à organiser des voyages pour des groupes de personnes, ou

b) une personne qui est membre d'une association d'agents de voyages en règle,

et avec qui un transporteur aérien peut passer un contrat d'affrètement de tout ou partie d'un aéronef, aux fins d'un voyage tout compris ayant son point de départ au Canada;

«origine» désigne le point de départ du vol d'affrètement, où sont pris les passagers ou chargées les marchandises à transporter;

«privilège de base» signifie le nombre de vols d'affrètement qu'un transporteur aérien étranger est autorisé à effectuer hors du Canada au titre de la quatrième liberté au cours d'une année civile sans que s'appliquent à son cas les critères énoncés dans l'annexe A;

«prix du voyage tout compris» pour un groupe effectuant un tel voyage, comprend le coût

a) du transport,

b) du logement, et

"third freedom" means the privilege to put down in Canada passengers, mail and cargo taken on in the territory of the country of the air carrier operating the air service;

"tour operator" means

(*a*) a person, a substantial part of whose business in Canada is the organization of travel arrangements for groups of persons, or

(*b*) a person who holds membership in a *bona fide* travel agent's association

with whom an air carrier may contract to charter an aircraft in whole or in part for the purposes of an inclusive tour originating in Canada;

"trans-border flight" means a pro rata or entity charter flight between Canada and the Continental United States of America, including Alaska;

"transportation" includes air transportation between all points in the tour itinerary and ground transportation between airports or surface terminals and hotels used at all such points other than the point of origin.

c) de tous les autres services et facilités inclus dans le programme du voyage;

«quatrième liberté» désigne le privilège d'embarquer au Canada des passagers, du courrier et des marchandises à destination du territoire du pays du transporteur aérien qui exploite le service;

«transport» comprend le transport aérien entre tous les points de l'itinéraire ainsi que le transport au sol entre les aéroports ou les gares des transports en surface et les hôtels utilisés ailleurs qu'au point d'origine;

«troisième liberté» désigne le privilège de débarquer au Canada des passagers, du courrier et des marchandises embarqués sur le territoire du pays du transporteur aérien qui exploite le service;

«vol transfrontière» désigne un vol d'affrètement avec ou sans participation entre le Canada et le territoire continental des États-Unis d'Amérique, y compris l'Alaska;

«vol transfrontière hors route» désigne tout vol d'affrètement avec ou sans participation effectué entre le Canada et la partie continentale des États-Unis d'Amérique, y compris l'Alaska, sauf entre les points situés sur une route desservie en vertu d'un permis délivré par le Comité aux termes de l'Accord relatif aux transports aériens entre le gouvernement canadien et le gouvernement des États-Unis d'Amérique;

«vol transfrontière sur route» désigne tout vol d'affrètement avec ou sans participation effectué entre le Canada et la partie continentale des États-Unis d'Amérique, y compris l'Alaska, entre les points situés sur une route desservie en vertu d'un permis délivré par le Comité aux termes de l'Accord relatif aux transports aériens entre le gouvernement canadien et le gouvernement des États-Unis d'Amérique;

«voyage tout compris» désigne un voyage aller-retour ou un voyage circulaire dont la totalité ou une partie est effectuée par air, offert pour un prix global et pour la période comprise entre la date de départ et celle du retour au point de départ.

25. Every air carrier shall, before applying for a permit or a licence, as the case may be, to perform an international air charter service,

(*a*) file a tariff covering such service; and

(*b*) satisfy the Committee that it has a valid and subsisting operating certificate issued by the Minister certifying that the holder is adequately equipped and able to conduct a safe operation as an air carrier.

25. Avant de demander une autorisation ou un permis en vue d'exploiter un service d'affrètement international, un transporteur aérien doit

a) déposer un tarif applicable à un tel service; et

b) établir, à la satisfaction du Comité, qu'il possède un certificat dit d'exploitation, valable et en vigueur, délivré par le Ministre et attestant que le titulaire possède l'équipement nécessaire et est en mesure d'assurer en toute sécurité les opérations d'un transporteur aérien.

DIVISION E

Inclusive Tour Charters

39. No air carrier other than an air carrier described in section 38, shall operate an inclusive tour charter without first obtaining a permit from the Committee.

DIVISION E

Affrètements pour voyages tout compris

39. Il est interdit à un transporteur aérien autre que celui qui est visé à l'article 38 d'exploiter par vol d'affrètement un voyage tout compris sans avoir au préalable obtenu une autorisation du Comité.

40. The issue of a permit by the Committee to an air carrier to operate an inclusive tour charter shall be subject to the following terms and conditions:

(*j*) the air carrier shall not pay directly or indirectly any commission to, or confer any benefit upon, a tour operator or any other person;

(*q*) the air carrier shall not act directly or indirectly as a tour operator and shall not advertise or participate in any way in the promotion of any inclusive tour;

40. La délivrance par le Comité d'une autorisation à un transporteur aérien en vue d'exploiter par vol d'affrètement un voyage tout compris est faite sous réserve des dispositions et conditions suivantes:

j) les transporteurs aériens ne sont pas autorisés à payer directement ou indirectement une commission ni à conférer aucun autre avantage à un organisateur de voyages ou à toute autre personne;

q) le transporteur aérien ne doit, ni directement ni indirectement, remplir les fonctions d'organisateur de voyages, et il ne doit faire aucune publicité ni ne chercher d'aucune façon à faire de la réclame pour un voyage tout compris;

DIVISION F—ADVANCE BOOKING CHARTERS (A.B.C.)

Air Carriers Performing Outgoing Portion of ABC's

43.15(1) Every air carrier that is to perform the outgoing portion of an ABC shall, upon executing the contract for that ABC,

(*a*) notify the Committee in writing of the proposed operation;

DIVISION F—

Transporteurs aériens chargés d'éxécuter le vol d'aller d'un ABC

43.15 (1) Le transporteur aérien chargé d'exécuter le vol d'aller d'un ABC doit, au moment d'exécuter le contrat d'affrètement,

a) notifier au Comité, par écrit, l'opération projetée;

(*b*) provide the Committee with an executed copy of the contract including an undertaking by the air carrier and the charterer to comply with this Division;

(*c*) where applicable, provide the Committee with evidence that the air carrier has complied with subsection 43.13(2);

(*d*) provide the Committee with a statement by each charterer, verified by his statutory declaration or, where the charterer is a company, by the statutory declaration of a duly authorized officer of the company setting out

(i) the name, address, nationality and nature of business of the charterer,

(ii) where the charterer is a company, the name, address and nationality of each director of the company,

(iii) a summary of the charterer's business experience relating to transportation activities including, where applicable, particulars of his membership in travel organizations, and

(iv) evidence of the financial responsibility of the charterer, consisting of

(A) audited statements including the auditor's report, and a balance sheet prepared as of a date not more than three months prior to the date of the receipt by the Committee pursuant to paragraph (*b*) of the executed copy of the contract,

(B) a letter from the charterer's bank stating the charterer's line of credit and the extent thereof,

(C) a description of the arrangements made by the charterer to ensure the protection of moneys paid to him in respect of ABC's during the period in which those moneys remain in his possession, and

(D) such other information as the Committee may from time to time require; and

(*e*) in addition to complying with paragraph (*d*), satisfy the Committee as to

b) fournir au Comité un exemplaire signé du contrat qui doit comporter l'engagement pris par le transporteur aérien et par l'affréteur de se conformer aux dispositions de la présente division;

c) s'il y a lieu, fournir au Comité un document établissant que le transporteur aérien s'est conformé aux dispositions du paragraphe 43.13(2);

d) fournir au Comité, de la part de chaque affréteur, une déclaration, attestée sous serment pas l'affréteur lui-même ou, si l'affréteur est une compagnie, par un agent autorisé de la compagnie, énonçant:

(i) le nom, l'adresse, la nationalité et le genre d'entreprise de l'affréteur,

(ii) s'il s'agit d'une compagnie, le nom, l'adresse et la nationalité de chacun de ses administrateurs,

(iii) un résumé de l'expérience des affaires que possède l'affréteur dans le domaine des transports, précisant, s'il y a lieu, les organisations de voyage dont il fait partie, et

(iv) des preuves de solvabilité de l'affréteur, soit

(A) des comptes vérifiés y compris le rapport du vérificateur comptable et un bilan arrêté à une date qui ne doit pas précéder de plus de trois mois celle de la réception par le Comité de l'exemplaire signé du contrat exigé par l'alinéa *b*),

(B) une lettre par laquelle le banquier de l'affréteur énonce la forme et la marge de crédit ouvert au nom de ce dernier,

(C) la description des mesures prises par l'affréteur pour assurer la sécurité des sommes qui lui seront versées pour les voyages d'ABC pendant qu'il les aura en sa possession, et

(D) tous autres renseignements que le Comité peut exiger, à l'occasion; et

e) en plus de satisfaire aux exigences de l'alinéa *d*), convaincre le Comité

(i) the financial responsibility of the charterer,

(ii) the business experience of the charterer relating to transportation activities,

(iii) the adequacy of the arrangements referred to in clause (*d*) (iv) (C), and

(iv) the ability of the charterer to successfully fulfil the contract.

(2) Where the Committee is satisfied that subsection (1) has been complied with, the Committee may assign an identification number to the contract.

43.16 Every air carrier performing the outgoing portion of an ABC shall, within six months after the end of each fiscal year of a charterer, provide the Committee with the audited statements described in clause 43.15(1)(*d*)(iv)(A) in respect of that charterer.

43.17 Every air carrier shall forthwith notify the Committee of any change of any information provided by it to the Committee pursuant to subsection 43.15 (1).

Payment of Benefits and Advertisements of ABC's Prohibited

43.31 air carrier shall

(*a*) pay or offer to pay any commission, gratuity or other benefit to any person in respect of any ABC; or

(*b*) advertise or cause to be advertised any ABC.

PART V—TARIFFS AND TOLLS

44. (10) No air carrier, or any officer or agent thereof, shall offer, grant, give, solicit, accept or receive any rebate, concession or discrimination in respect of the transportation of any traffic by the air carrier whereby such traffic is, by any device whatever, transported at a toll that

(i) de la solvabilité de l'affréteur,

(ii) de l'expérience des affaires que possède l'affréteur dans le domaine des transports,

(iii) de l'utilité des mesures dont il est fait mention dans la disposition *d*) (iv) (C), et

(iv) de l'aptitude de l'affréteur à assurer la bonne exécution du contrat.

(2) Lorsque le Comité est convaincu que le transporteur aérien a satisfait aux prescriptions du paragraphe (1), il peut attribuer au contrat un numéro d'identification.

43.16 Le transporteur aérien chargé d'effectuer le vol d'aller d'un ABC doit, dans les six mois qui suivent la fin de chaque année financière d'un affréteur, fournir au Comité les comptes vérifiés dont il est question dans la disposition 43.15(1)*d*)(iv)(A), à l'égard de cet affréteur.

43.17 Le transporteur aérien doit notifier immédiatement au Comité tout changement dans les renseignements qu'il a fournis au Comité en application du paragraphe 43.15(1).

Interdiction visant le paiement de commissions, etc., et la publicité pour les ABC

43.31 Il est interdit à un transporteur aérien

a) de payer ou d'offrir de payer une commission, une gratification ou quelque autre avantage à une personne à l'égard d'un ABC; ou

b) d'annoncer ou de faire annoncer un ABC.

PARTIE V—

44. (10) Il est interdit à un transporteur aérien, ou à l'un quelconque de ses fonctionnaires ou de ses agents ou représentants d'offrir, de concéder, de donner, de solliciter, d'accepter ou de recevoir un rabais, une concession ou un privilège, qui permettrait le transport, par quelque

differs from that named in the tariffs then in force or under terms or conditions of carriage other than those set out in such tariffs, unless with the prior approval of the Committee.

45. (1) All tolls and terms or conditions of carriage established by an air carrier shall be just and reasonable and shall always, under substantially similar circumstances and conditions, with respect to all traffic of the same description, be charged equally to all persons at the same rate.

(2) No air carrier in respect of tolls

(*a*) make any unjust discrimination against any person or other air carrier;

(*b*) make or give any undue or unreasonable preference or advantage to or in favour of any person or other air carrier in any respect whatever; or

(*c*) subject any person or other air carrier or any description of traffic to any undue or unreasonable prejudice or disadvantage in any respect whatever.

moyen que ce soit, à un taux différent de celui des tarifs en vigueur, ou selon des modalités ou des conditions différentes de celles qui sont énoncées dans ces mêmes tarifs, sauf s'il a obtenu au préalable l'autorisation du Comité.

45. (1) Tous les taux, les modalités et les conditions de transport établis par un transporteur aérien doivent être justes et raisonnables et doivent toujours, dans des circonstances et conditions sensiblement analogues et à l'égard de tout le transport du même genre, être imposés de la même façon à toutes personnes au même taux.

(2) Il est interdit à un transporteur aérien, en ce qui concerne les taux,

a) d'établir une distinction injuste au détriment d'une personne ou d'une compagnie;

b) d'accorder une préférence ou un avantage indu ou déraisonnable à l'égard ou en faveur d'une personne ou d'un autre transporteur aérien, à quelque point de vue que ce soit; ou

c) de faire subir à une personne, à un autre transporteur aérien ou à un certain genre de transport un désavantage ou préjudice indu ou déraisonnable, à quelque point de vue que ce soit.

Appendix D

P.C. 1975-963

Certified to be a true copy of a Minute of a Meeting of the Committee of the Privy Council, approved by His Excellency the Governor General on the 25 April, 1975

WHEREAS Air Canada is a Crown Corporation named in Schedule "D" to the Financial Administration Act and is ultimately accountable through the Minister of Transport to Parliament for the conduct of its affairs;

AND WHEREAS there has recently come to the attention of the public indication of inadequate financial administration in respect of the operations of the Corporation;

AND WHEREAS there is evidence the public is concerned about the circumstances surrounding the payment of $100,000.00 to McGregor Travel Co. Ltd.;

AND WHEREAS there may be other matters necessarily related to the financial administration of the Corporation in respect of which it is desired that there be an inquiry.

THEREFORE, THE COMMITTEE OF THE PRIVY COUNCIL advise that, pursuant to Part I of the Inquiries Act, the Honourable Mr. Justice Willard Zebedee Estey, a Judge of the Supreme Court of Ontario and a member of the Court of Appeal for Ontario, be appointed a Commissioner under Part I of the Inquiries Act to inquire into and report upon the system of financial controls, accounting procedures and other matters related to the fiscal management and control of the Corporation and, without limiting the generality of the foregoing, to determine whether

(a) Air Canada follows a system of financial controls that is appropriate for a corporation of its size and undertaking having regard to the fact that it is a Crown corporation ultimately accountable through the Minister of Transport to Parliament for the conduct of its affairs;

(b) there has been any misapplication, improper handling or misuse of the funds of Air Canada in contravention of its existing financial control policies and procedures as approved by the Board of Directors, or in violation of any applicable legislation; and

(c) if such incidents did occur to determine whether they were brought to the attention of the senior management and in such event were

they handled effectively and promptly and, in particular, did senior management take appropriate action within a reasonable time to secure redress.

THE COMMITTEE further advise that

A. the Commissioner be authorized to prescribe and adopt such practices and procedures for all purposes of the Commission as he may from time to time deem expedient for the proper conduct of the inquiry and to vary those practices and procedures from time to time;

B. the Commissioner be authorized to sit at such times and at such places as the Commissioner may from time to time decide;

C. the Commissioner be authorized to engage the services of such accountants, engineers, technical advisers or other experts, clerks, reporters and assistants as he deems necessary or advisable, and also the services of counsel to aid and assist the Commissioner in the inquiry, at such rates of remuneration and reimbursement as may be approved by the Treasury Board;

D. the Commissioner be authorized to rent such space for office and hearing rooms as he deems necessary or advisable at such rental rates as may be approved by the Treasury Board; and

E. the Commissioner be authorized to submit interim reports to the Governor-in-Council from time to time and be requested to submit a final report to the Governor-in-Council with all reasonable despatch, if possible within two months.

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Clerk of the Privy Council—Le Greffier du Conseil Privé

C.P. 1975-963

Copie certifiée conforme au procès-verbal d'une réunion du Comité du Conseil privé, approuvé par Son Excellence le Gouverneur général le 25 avril 1975

VU QUE Air Canada est une société de la Couronne mentionnée à l'annexe D de la Loi sur l'administration financière qui, en dernier ressort, est comptable envers le Parlement de la conduite de ses affaires par l'intermédiaire du ministre des Transports;

VU QUE, récemment, l'attention du public a été attirée sur un fait qui semble indiquer que l'administration financière de l'activité de la Corporation laisserait à désirer;

VU QU'IL appert que le public se préoccupe des circonstances ayant entouré le paiement de 100,000 dollars à McGregor Travel Co. Ltd.;

ET VU QU'IL peut y avoir d'autres matières nécessairement reliées à l'administration financière de la Corporation à l'égard desquelles on souhaite qu'une enquête soit instituée:

A CES CAUSES, LE COMITÉ DU CONSEIL PRIVÉ recommande que, en vertu de la Partie I de la Loi sur les enquêtes, l'honorable juge Willard Zebedee Estey, juge de la Cour suprême de l'Ontario et membre de la Cour d'appel de l'Ontario, soit nommé commissaire en vertu de la Partie I de la Loi sur les enquêtes, afin de faire enquête et rapport sur le système de contrôle financier, les méthodes de comptabilité et autres matières reliées à la gestion financière et au contrôle de la Corporation et, sans limiter la généralité de ce qui précède, de déterminer

a) si Air Canada observe un système de contrôle financier qui convient à une société qui a autant d'envergure et de responsabilités, compte tenu du fait qu'elle est une société de la Couronne comptable en dernier ressort de la conduite de ses affaires envers le Parlement par l'intermédiaire du ministre des Transports;

b) s'il y a eu détournement, manipulation inconvenante ou mauvais emploi des fonds d'Air Canada en contravention de ses principes et méthodes actuels de contrôle financier approuvés par son conseil d'administration ou à l'encontre de toute loi applicable; et

c) à supposer que ces incidents se soient produits, s'ils ont été signalés à la haute direction, et, le cas échéant, si l'on s'en est occupé avec

efficacité et diligence et, en particulier, si la haute direction a pris des mesures appropriées dans un délai raisonnable afin de redresser la situation.

LE COMITÉ recommande en outre

A. que le commissaire soit autorisé à prescrire et adopter à toutes les fins de la commission, les pratiques et méthodes qu'il pourra de temps à autre juger utiles à la conduite de l'enquête, et à les modifier de temps à autre;

B. que le commissaire soit autorisé à siéger aux moments et aux lieux qu'il pourra déterminer de temps à autre;

C. que le commissaire soit autorisé à retenir les services des comptables, ingénieurs, conseillers techniques, ou autres experts, commis, rapporteurs et aides qu'il juge nécessaires ou opportuns, et aussi les services d'avocats pour l'aider et l'assister dans l'enquête, et à leur verser la rémunération et les indemnités que pourra approuver le Conseil du Trésor;

D. que le commissaire soit autorisé à louer les bureaux et les salles d'audiences qu'il juge nécessaires ou souhaitables, aux taux de location que pourra approuver le Conseil du Trésor; et

E. que le commissaire soit autorisé à présenter de temps à autre des rapports intérimaires au Gouverneur en conseil et qu'il soit tenu de présenter un rapport définitif à Son Excellence dans les meilleurs délais, si possible d'ici deux mois.

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