



**BACKGROUND INFORMATION
ON
ANNOUNCEMENT OF NEW AND REVISED
SERVICE CHARGES – APRIL 2006
RESULTING FROM SERVICE CHARGES REVIEW**

April 13, 2006

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INTRODUCTION

In January 2005 NAV CANADA released a discussion paper on the Company's service charge methodology in order to facilitate dialogue with customers and stakeholders on a comprehensive review of this methodology, which had been in place since 1999. Several months of consultation followed with customers and stakeholders and written submissions were received.

Following a review of the input received, the Company developed specific proposals which were set out in the Notice of New and Revised Service Charges dated December 2005. The proposals for changes to the charging methodology are not designed to increase the Company's total revenue but are intended to be revenue neutral.

The Notice was released for consultation on December 2, 2005. Approximately 200 written submissions were received by the Company before the consultation period ended on February 10, 2006. This paper provides a summary of those submissions and outlines the Company's final assessment and decisions with respect to changes in charges.

1. Terminal Services Charge and the Daily Charge for Aircraft Weighing over Three Tonnes

Proposal

In the December 2005 Notice, the Company proposed reducing the exponent in the Terminal Charge formula from 0.9 to 0.8 in two phases: from 0.9 to 0.85 in 2006 (Phase 1), and then from 0.85 to 0.8 on September 1, 2008 (Phase 2). Related phased increases to the terminal component of the Daily charge were also proposed.

The result of this change is to decrease Terminal charges for larger aircraft and increase Terminal charges for smaller aircraft. The Daily charge would also go up to reflect an increase in the terminal component of that charge. For Phase 1, the increase for smaller aircraft would be in the 17 to 54 cents range per passenger per flight, while the decrease would be up to approximately \$1 per passenger for larger aircraft, if air carriers passed on the changes to the travelling public. The impact of Phase 2 would be similar.

Summary of Representations

Operators of larger aircraft support reducing the exponent and many feel that NAV CANADA should not wait until September 2008 to implement the second phase. Some stated that the exponent should be reduced even lower than 0.8 or alternatively, that the weight factor should be removed altogether.

Operators of smaller aircraft generally do not support the proposal and some suggested that the increase in charges on small aircraft operators could negatively impact air transportation services provided to remote communities, including those in the North.

Assessment

The impact of the proposal on the passengers of smaller air carriers would be a fraction of one per cent of the total price of a trip, assuming that the air carriers passed the increased cost on to passengers. With respect to the aircraft serving Northern Canada, the overall impact would also be modest. For example, in Phase 1, there would be a decrease of up to approximately 1.3 per cent for B727 aircraft and an increase of approximately the same percentage for B737. Smaller aircraft would be subject to the same modest increases in terms of cost per passenger described above.

The role of weight in the calculation of NAV CANADA's Terminal charges is higher than in most other countries, making Terminal charges in Canada among the highest for larger aircraft and the lowest for smaller aircraft. The *Canada Transportation Act Review Panel* noted in its report "Vision and Balance" (2001) that "a review of the pricing structure is desirable, to determine whether the higher charges imposed on larger aircraft are excessive". In terms of developments internationally, it is noted that Europe will gradually harmonize terminal charges to an exponent of 0.7.

Although the concerns of smaller aircraft operators are recognized, the proposed changes seem to provide an appropriate rebalancing of the charges.

Outcome

The exponent in the Terminal Services Charge formula will be reduced from 0.9 to 0.85, effective May 1, 2006, and then to 0.8, effective September 1, 2008. The terminal component of the Daily Charge will be increased on the same dates by a percentage that is similar to the increase in the Terminal Services Charge for smaller aircraft.

Phase 1 of these changes is set out in the Announcement of New and Revised Service Charges dated April 2006. With respect to the Phase 2 changes, a Notice will be issued in advance of September 1, 2008, setting out the proposed unit rate for the Terminal charge with an exponent of 0.8 and the specific rates for the Daily charge.

2. New Daily Charge at Major International Airports for Aircraft Weighing Three Tonnes or Less

Proposal

A new Daily charge for aircraft weighing three tonnes or less that depart from Vancouver, including the water aerodrome, Calgary, Edmonton, Winnipeg, Toronto (Pearson), Ottawa, Montreal (Trudeau), or Halifax international airports was proposed to be phased in as follows:

- (1) \$5 per day effective September 1, 2006 with a maximum limit of \$300 per aircraft for the period up to February 28, 2007;
- (2) an increase in the maximum to an annual amount of \$600 effective March 1, 2007;
and
- (3) the charge would be increased to \$10 per day effective March 1, 2008 with an annual maximum limit of \$1,200 per aircraft.

Summary of Representations

The Company received a significant number of submissions from general aviation pilots, their representative associations, smaller commercial operators and others opposed to this proposal.

Many of these submissions argued that the new charge would violate the Civil Air Navigation Services Commercialization Act (ANS) charging principle related to safety, as pilots would avoid the airports with daily charges in order to avoid a charge. Others felt that the amount of the charge was unreasonable and could be constituted as violating the ANS Act charging principle which requires that charges to the general aviation

community not be unreasonable or undue. Some expressed concern that the charge would be a first step toward future service charge increases for smaller aircraft operators and/or an expansion of the application of the charge to other airports.

Commercial operators using small aircraft based at one of the eight airports felt the new charge would create a competitive disadvantage for them.

Some submissions noted that transborder flights are often required to land at one of the major airports because Customs Services are only available at these airports.

Many of the submissions stated that ANS charges should not be structured in such a way as to influence traffic.

Considerable representation was made regarding the lack of a suitable reliever airport near Halifax. Comments were also received from those who consider the North Field at the Ottawa airport as separate from the main airport.

It has been a longstanding position of the general aviation community that the federal excise tax on fuel represents their contribution to the air navigation services. Some submissions suggested that NAV CANADA should make representation to the government requesting that a portion of the excise tax be transferred to NAV CANADA.

Larger commercial carriers support the proposal. The small amount that the general aviation community contributes toward ANS costs has long been an issue for them. Many indicated that the proposed charge should be higher. They also supported the proposed charge as an incentive for smaller aircraft to use other airports as this would help reduce problems between faster and slower aircraft, thereby improving system efficiency and avoiding costly delays for major commercial operators.

Assessment

As safety must remain NAV CANADA's first priority, representations suggesting that safety would be impacted by the new charge have been carefully assessed.

The main safety concern raised with the new Daily charge is that aircraft operators would not use the international airports in emergencies or as a weather alternate in order to avoid the charge. An exemption for flights using an international airport in an emergency or as a weather alternate would ensure compliance with the charging principle and address this concern.

Since the closure of Shearwater as a base for general aviation aircraft, Halifax no longer has a suitable alternative reliever airport. In view of this, it would seem reasonable to exclude Halifax from the charge.

With respect to the North Field at Ottawa airport, the North Field is part of the main airport with the same air traffic control services as operations on the two main runways.

Under certain wind conditions, the general aviation aircraft must use one of the main runways. There are three other publicly licensed airports in the area available for smaller aircraft. For these reasons, Ottawa would not be excluded from the charge.

With respect to the requirement for transborder aircraft to land at an airport with Customs Services, it should be noted that some of the available reliever airports are airports of entry and do have Customs, at least part-time. Nevertheless, consideration of Customs availability in NAV CANADA's application of charges would not be appropriate.

NAV CANADA supported the aviation industry and made representation to the government at the time the ANS charges were first developed, seeking recognition of the federal excise tax on fuel as a contribution to air navigation services. The Company continues to share the industry view with respect to the fuel tax. Considering the comments received, NAV CANADA should make a renewed representation to the government, requesting a reduction in the fuel tax on the basis that with the commercialization of ANS, the government no longer incurs any costs related to the provision of these services.

Recognizing that there are costs to implementing and administering the new daily charge, it would make sense to eliminate the first phase of the proposal and implement the full charge (\$10 with an annual maximum of \$1,200) on March 1, 2008.

The amount of the proposed daily charge seems very reasonable and would have the added benefit of encouraging small aircraft operators to use other airports thereby improving the efficiency of operations at the major airports.

On balance, having considered the concerns raised, the proposed daily charge at the major international airports, with the exception of Halifax, would be justified. An additional exemption for emergency flights, flights using the major airport as an alternate in the event of poor weather and Civil Air Search and Rescue Association (CASARA) training flights also seems warranted.

Outcome

A new charge of \$10 per day (annual maximum of \$1,200) will be implemented on March 1, 2008, without any phase-in of the charge.

Halifax International Airport will be excluded from the list of airports where the charge will apply.

The following exemptions will be provided:

- A departure that follows a landing by a flight where an emergency was declared and where the airport had not been the intended destination;
- A departure that follows a landing by a flight using the airport as a weather alternate; and

- Operational training flights related to search and rescue operations under the direction of the Department of National Defence.

Additionally, NAV CANADA will write to the Minister of Finance requesting a reduction in the federal excise tax on fuel.

3. International Communication Services Charge

Proposal

In the December 2005 Notice the Company proposed to further differentiate the Voice and Data Link rates for the International Communication Services charge. The voice rate would be increased from \$52.33 to \$61.00 per flight, and the Data Link rate would be decreased from \$26.44 to \$22.96 per flight.

Summary of Representations

There was wide support for the proposal amongst those who commented on this issue.

Assessment

The further differentiation in the International Communications Services charge for operators using data link communication for position reporting is warranted and supported as a tool to encourage the use of data link.

Outcome

New International Communication rates will be implemented effective May 1, 2006. The voice communication charge will be increased from \$52.33 to \$61.00 and the data link communications charge will be reduced from \$26.44 to \$22.96.

4. Accommodation of Multiple Weights for Same Aircraft in Calculation of Service Charges

Proposal

The Company proposed that customers be given the option of applying different Maximum Permissible Take-off Weights (MTOWs) for the same aircraft for the purpose of calculating NAV CANADA service charges based on the following stage length ranges:

- 0 up to 805 km (0 to 500 statute miles);
- over 805 up to 2,414 km (over 500 up to 1,500 statute miles); and

- over 2,414 km (over 1,500 statute miles).

Summary of Representations

Those customers and associations who feel that aircraft weight should not be included in the ANS charging methodology see the proposal as further entrenching weight as a charging parameter and therefore opposed this proposal.

Some operators who feel they will not be able to utilize this option expressed concern that NAV CANADA will have to make up the lost revenue through rates that would be higher than they would be otherwise. This is particularly the case for foreign carriers as many foreign civil aviation authorities do not authorize multiple MTOWs. Some other stakeholders expressed support for the concept of multiple MTOWs but disagreed with the proposed methodology.

Assessment

Given that NAV CANADA's existing charges allow for variation in MTOWs for the same aircraft type and model, and for the same aircraft by season, it seems reasonable to accommodate an option under which a customer could also vary the MTOW by stage length. This would also be more equitable for air carriers operating larger aircraft on shorter routes, where they cannot operate with the highest MTOW.

An aircraft operating between Europe and North America could use a lower MTOW when flying to eastern seaboard destination than when flying to the west coast. However, the proposed stage lengths would prevent some carriers from benefiting without an additional distance range. This could be accommodated by splitting the longest distance range in the current proposal (over 2,414 km) into two ranges. However, this would result in lower revenues to the Company, necessitating a rate increase in order to keep the proposal revenue neutral. This would require a new Notice and consultation.

While some carriers support the concept of multiple MTOWs, they have serious concerns about the formulation proposed.

In view of these considerations, further discussions with customers are necessary.

Outcome

The proposed multiple MTOW option will not be implemented. However, further discussions will be held with customers to determine whether to continue to pursue a multiple MTOW option, and if so, what form it would take.

5. Increase in the Rate Stabilization Account

Proposal

It was proposed to increase the target balance of the Rate Stabilization Account (RSA) to \$75 million from the current target of \$50 million and, once that target has been achieved, set the RSA target balance at 7.5 per cent of total annual expenses, excluding one-time non-recurring items, on an ongoing basis.

The Company intends to achieve this initial increase of \$25 million only through positive variances in operating results rather than through any increase in charges.

Summary of Representations

Most representations received were opposed to the proposed increase.

Assessment

When NAV CANADA increased service charges as a result of the reduction in traffic post 9/11, many customers and associations stressed that a way must be found to prevent the need for increases in charges at times when the industry can least afford it.

The RSA has proven its importance to the Company and its customers and will continue to be retained as a key element of NAV CANADA's financial management to ensure the provision of an essential service on a long-term sustainable basis and to provide a mechanism for rate smoothing.

With respect to the level of the RSA, an increase in the target balance seems necessary because the current target balance has decreased in real terms since it was established as a result of inflation, and the risk of downturns in traffic has increased materially in the post 9/11 global environment of terrorist activities and related fears, health scares and natural disasters.

While it is recognized that most of the representations received were not supportive, the above considerations suggest that the proposed increase is a measured and reasonable approach which is warranted.

Outcome

Effective September 1, 2006, the target balance of the RSA will be increased from \$50 million to \$75 million and, once that target has been achieved, set at 7.5 per cent of total annual expenses, excluding one-time non-recurring items, on an ongoing basis. This initial increase of \$25 million will be achieved only through positive variances in operating results if and when they occur rather than through any increase in charges.

6. Requirement for Aircraft Registration Marks to be Included in Flight Plans

Proposal

In order to facilitate the efficient and accurate invoicing of the Daily charge, the Company proposed that inclusion of aircraft registration marks in flight plans would be required.

Summary of Representations

Smaller commercial airlines objected to the increased workload that would be required if they were forced to file each flight plan separately. They requested that more analysis be done to identify a solution that would not increase workload and would allow the continuation of efficient center-stored and master flight planning procedures.

Assessment

Larger air carriers file a flight plan for each individual flight and typically include the aircraft registration mark. However, many smaller air carriers file centre-stored or master flight plans. Under this approach, a single flight plan is filed for recurring flights. Since the flight plan often represents a flight that occurs daily at a specific time, this procedure saves the air carrier from having to file a flight plan for each occurrence of the flight.

Registration marks are typically not included in these types of flight plans as operators do not know which specific aircraft will be used from one day to another. For this reason, NAV CANADA developed procedures for obtaining the registration marks for the individual flights, or information on how many days an individual aircraft had been flown in a month, from the air carriers after the fact.

At this time, more discussions with customers are necessary to see if an approach for obtaining the aircraft registration marks for flights can be found that would alleviate the concerns expressed.

Outcome

Further discussions will be undertaken with customers in order to identify alternative methods of obtaining registration marks necessary to ensure timely and accurate invoicing, to be implemented by September 1, 2006.

7. Proposed Changes in Credit Terms and Conditions

Proposal

The Company proposed a new section in its credit terms and conditions in order to further reduce its exposure to bad debts by requiring payment earlier from customers that are believed to be a credit risk.

Summary of Representations

Generally, customers and stakeholders supported the tightening of credit terms. However, several customers felt that the specific proposal was too restrictive.

Assessment

The reduction of collection risk benefits all customers as any bad debt must be paid for by all customers through our service charges.

In managing collection matters NAV CANADA always acts in good faith. With respect to the customer concern, a minor wording change seems warranted to demonstrate that the conditions would not be applied without due care and consideration of all relevant facts.

Outcome

The new section in NAV CANADA's credit terms will be implemented effective May 1, 2006 as follows:

“A customer shall be required to pay for the provision or availability of air navigation services in advance or provide satisfactory security for such payment on the basis of an estimate of charges to be incurred, in the following circumstances:

- A customer fails to make a payment or any part of a payment in accordance with NAV CANADA's payment terms and conditions on three occasions or more;
- The customer's Dun & Bradstreet Financial Stress Score Risk Class is a 3, 4 or 5, or Dun & Bradstreet equivalent failure score as amended from time to time;
- A customer's credit is rated and its credit rating is below or falls to below B as determined by Standard & Poor's and/or B2 as determined by Moody's;
- If a customer is under creditor protection (e.g., Companies' Creditors Arrangement Act (CCAA) in Canada or Chapter 11 in the United States) or any other form of financial restructuring in accordance with applicable insolvency legislation or the customer has publicly announced that it may file for creditor protection or bankruptcy; or

- The customer has not provided NAV CANADA, upon request, with financial information such as credit ratings, credit reports, analyst reports, current audited financial statements, etc. which NAV CANADA deems sufficient to enable it to assess and conclude that the credit worthiness of the customer is satisfactory.”

The text in the existing terms and conditions that will become redundant with this new section will be removed.