



DETAILS AND PRINCIPLES REGARDING PROPOSED REVISED SERVICE CHARGES

OCTOBER 2, 2002

GENERAL

This document ("Details and Principles") provides additional details to expand upon the *Notice of Revised Service Charges* issued on October 2, 2002 (the "Notice"). Under Section 36 of the *Civil Air Navigation Services Commercialization Act*, S.C. 1996, c. 20 (the "ANS Act"), NAV CANADA is required to produce a document containing more details in relation to the proposed revised charges set forth in the Notice, including a justification in relation to the charging principles set out in Section 35 of the ANS Act.

Except for the revisions proposed in the Notice, all the existing charges and related terms and conditions, as set out in earlier Announcements pertaining to charges, remain in effect.

This document sets out the following: (1) a general overview of NAV CANADA, (2) supporting information for proposed revisions, (3) a justification of the proposal in relation to the charging principles, and (4) information regarding the Notice and on making representations to NAV CANADA.

Persons interested in making representations in writing to NAV CANADA with regard to the Notice may do so by forwarding their submissions to the address set out in the Notice. Submissions must be received by NAV CANADA not later than December 2, 2002.

1. GENERAL OVERVIEW OF NAV CANADA

NAV CANADA is a non-share capital, private corporation which is responsible for the provision of civil air navigation facilities and services for aircraft in Canadian airspace or any other airspace for which Canada is responsible for providing air navigation services.

The system of governance at NAV CANADA is the result of a unique corporate structure intended to make the company a self-sustaining commercial enterprise that is accountable to its stakeholders. The Corporation is governed by a 15-member Board of Directors consisting of 10 directors nominated by stakeholders representing aviation users, bargaining agents and the federal government, 4 independent directors and the President & CEO. NAV CANADA also has an Advisory Committee elected by associate members, empowered to analyze and make reports and recommendations to the Board of Directors on any matter affecting the air navigation system.

The fundamental elements governing the mandate conferred on NAV CANADA by the ANS Act include the exclusive right to provide certain air navigation services, the ability to set and collect charges for air navigation services provided or made available by NAV CANADA or a person acting under the authority of the Minister of National Defence, and the obligation of the Corporation to provide these services.

The financial statements, issued quarterly and annually, provide extensive information on the revenues and expenses of NAV CANADA.

2. SUPPORTING INFORMATION FOR PROPOSED REVISIONS

The fee proposals are set out in the Notice. The proposals include a 3% increase in service charges, several modifications with little or no revenue impact and charges for Aeronautical Publications. The Notice also provides information explaining the reasons for the proposals.

This section presents the traffic outlook underlying the revenue forecasting and a rate discussion.

2.1 Traffic Outlook For Fiscal Year 2002/03

In developing the outlook, consideration was given to results to-date, airline schedules (as reported in the Official Airline Guide) and available forecasts from the aviation industry and government institutions. Additionally, NAV CANADA has prepared the outlook presented below based on reasonable assumptions about general economic conditions. However, the outlook contains uncertainty given the current economic environment and the global issues facing the air transportation sector.

In general, traffic as measured in charging units is forecasted to be back to the pre-September 11th, 2001, level by the summer of 2003, and is then forecasted to grow at "normal" rates, assumed to be 4.5% annually for Overflights, NAT and Int'l Com, and 3% annually for charging units pertaining to enroute (other than overflights) and terminal air navigation services.

The following assumptions were made for the recovery of charging units to the pre-September 11th level:

- Charging units for Overflights, North Atlantic Enroute (NAT) and International Communications (Int'l Com) would be 8% below the pre-September 11th level for September and October 2002, improve to 5% below for the winter schedule (November 2002 - May 2003), and then reach the pre-September 11th level for the summer of 2003.
- Enroute (other than overflights) and terminal charging units would be 5% below the pre-September 11th level for September 2002 to May 2003, and then reach the pre-September 11th level for the summer of 2003.

The following table shows the traffic outlook for movement-based charging units as compared to fiscal year 2000/01, i.e., to the pre-September 11th level. It should be noted that the reductions indicated for fiscal year 2001/02 reflect three quarters of actual results and an estimate for the last quarter.

Fiscal Year 2002/03 Charging Unit Outlook
Expressed as % reduction from Fiscal Year 2000/01 Level

	<u>FY 01/02</u>	<u>FY 02/03</u>
Overflight	-10.5%	-4.1%
Terminal	-10.5%	-3.6%
Enroute	-10.1%	-3.5%
North Atlantic Enroute	-12.2%	-4.1%
Int'l Com.	-12.0%	-4.1%
Weighted	-10.5%	-3.8%

2.2 Rate Discussion

Pursuant to the ANS Act, service charges are set at a level that, based on reasonable and prudent projections, will generate sufficient revenues to meet the Corporation's current and future financial requirements, i.e., to recover all costs (including debt servicing requirements and the repayment of principal), as determined in accordance with generally accepted accounting principles, and to maintain a contingency reserve for unforeseen events. In determining the rates, revenues from non-aeronautical sources must be taken into account.

Within this basic framework, and consistent with the other charging principles set out in the ANS Act, breakeven rates for enroute, terminal and oceanic air navigation services are developed to determine the required level of charges. As indicated in the Notice, at existing charges, a shortfall of approximately \$100 million for fiscal year 2002/03 is anticipated without increased revenues. The Rate Stabilization Account has been fully drawn down, and therefore cannot be used to alleviate this problem. For these reasons, an increase in service charges is regrettably necessary. However, the following considerations suggest that it should be kept as low as possible:

- The air transportation sector remains in a difficult financial situation.
- At this time, the level and stability of breakeven rates cannot be reliably assessed as traffic growth has not yet stabilized, the new non-aeronautical revenue initiatives - while promising - have not been concluded, and the evolution of costs - largely dependent on the outcome of ongoing labour negotiations - remains uncertain.

On this basis, a 3% increase in service charges is proposed, effective January 1, 2003. As this level of increase is more in the nature of an inflation adjustment, an across-the-board application seems reasonable. This initiative is expected to generate \$20 million in fiscal year 2002/03.

To balance revenues and expenses, including variances in traffic, costs and potential new non-aeronautical revenues from those anticipated, it is planned that approximately \$80 million of expenses will be recovered from customers over time.

3. PRINCIPLES GOVERNING NAV CANADA'S SERVICE CHARGES

The principles governing the establishment of new charges or the revision of existing charges by NAV CANADA are set out in Section 35 of the ANS Act. Each of the principles is presented below in italics, followed by an explanation of how the Notice complies with that particular principle.

- 35 (1) (a) *Charges must be in accordance with a methodology established and published by the Corporation that is explicit and that also includes the terms and conditions affecting charges;*

The Notice, required under Section 36 of the ANS Act, has been placed on the Internet and sent to aviation associations. On the basis of this information, any person subject to NAV CANADA's charges can calculate the amount that would be payable for a given flight.

- 35 (1) (b) *Charges must not be structured in such a way that a user would be encouraged to engage in practices that diminish safety for the purpose of avoiding a charge;*

For any given flight, NAV CANADA's charges are not structured in such a manner that safety may be affected. For example, any flight involving a jet aircraft of a given weight between two points (e.g., Ottawa and Québec City) is subject to the same Terminal Services Charge and Enroute Charge, regardless of whether the flight is IFR or VFR.

- 35 (1) (c) *Charges for the same services must not differentiate between domestic and international flights of air carriers;*

There is no differentiation in the proposed revised charges between domestic and international flights of air carriers.

- 35 (1) (d) *Charges for the same services must not differentiate among Canadian air carriers or among foreign air carriers;*

There is no differentiation in the proposed revised charges for a flight based on which domestic or foreign carrier provides the flight.

- 35 (1) (e) *Charges must differentiate between the provision of services in relation to the landing and take-off of aircraft and the provision of services in relation to aircraft in flight, and must reflect a reasonable allocation of the costs of providing the services in those circumstances;*

The charges are based on an allocation of costs among the enroute, terminal and oceanic services. The rules for the attribution of costs to the services were arrived at by considering work loads, statistics based on activity reports, management judgment and ICAO guidelines.

The accounting firm of KPMG has provided an opinion that the allocation methodology adopted by NAV CANADA reasonably reflects the way in which services are provided, is consistent with approaches used by other air navigation service providers, and is appropriate for use as a basis for establishing the costs of these services. A copy of this opinion is available upon request from NAV CANADA.

- 35 (1) (f) *Charges in respect of recreational and private aircraft must not be unreasonable or undue;*

The charges reflect the need for recreational and private aircraft to contribute, along with other users, to the costs of operating the Canadian civil air navigation system. NAV CANADA believes the charges are neither unreasonable nor undue.

- 35 (1) (g) *Charges for designated northern or remote services and for services directed to be provided under subsection 24(1) must not be higher than charges for similar services utilized to a similar extent elsewhere in Canada;*

Since NAV CANADA's charges are uniform throughout Canada, northern or remote services are subject to the same charges as services utilized elsewhere in Canada.

- 35 (1) (h) *Charges must be consistent with the international obligations of the Government of Canada; and*

The most relevant international obligations are the Convention on International Civil Aviation of 1944 (the "Chicago Convention") and bilateral air services agreements between Canada and other states. Article 15 of the Chicago Convention deals with charges for air navigation facilities, and establishes the principle that fees charged for the use of airport and air navigation services not be higher for foreign compared to domestic users engaged in similar international air services. The charges comply with Article 15 because: (i) the charges in respect of international air services are not higher for foreign air carriers than they are for Canadian carriers engaged in similar international air services (i.e., the charges do not differentiate according to the flag of the carrier), and (ii) the charges relate to the availability or provision of air navigation services and are not imposed for the right of entry into Canadian airspace.

The charges are also consistent with bilateral air services agreements between Canada and other states.

- 35 (1) (i) *Charges must not be set at a level that, based on reasonable and prudent projections, would generate revenues exceeding the Corporation's current and future financial requirements in relation to the provision of civil air navigation services.*

NAV CANADA's charges are set to recover the corporation's costs, including expenses determined according to Generally Accepted Accounting Principles (GAAP) and the costs of complying with certain financial requirements, as described in detail in Subsection 35(5) of the ANS Act.

- 35 (2) *The charging methodology may recognize that the value of the services differs among users.*

NAV CANADA's charging methodology does recognize that the value of the services differs among users, e.g., charges that vary with aircraft weight.

- 35 (3) *Where the Corporation's charging methodology recognizes the value of the services and aircraft weight is used as a measure of the value of the services, the principle referred to in paragraph (1)(a) is deemed not to have been observed if aircraft weight is taken into account either directly proportionally or greater than directly proportionally.*

The International Communication Services Charges and the North Atlantic Enroute Facilities and Services Charge are levied on a per flight basis and do not take weight into account.

The Enroute and Terminal Services charges take weight into account, but less than proportionally. The Enroute Charge is based on a unit rate multiplied by the square root of aircraft weight multiplied by the distance in Canadian airspace. The Terminal Services Charge is based on a unit rate multiplied by aircraft weight raised to the 0.9 power. The Airport Surface Detection Equipment Charge is based on the same formula as that for the Terminal Services Charge (but with a different unit rate).

Pursuant to Subsection 35(7), Subsection 35(3) does not apply to flat fees. The Annual, Quarterly and Daily Charges represent flat fees.

- 35 (4) *For the purpose of subsection (3), "weight", in relation to an aircraft, means the maximum permissible take-off weight specified in the aircraft's certificate of airworthiness or in a document referred to in that certificate.*

Weight calculations are based on the maximum permissible take-off weight specified in the aircraft's certificate of airworthiness or in a document referred to in that certificate. For more information, please refer to the September 2000 *Customer Guide to Charges*.

4. INFORMATION REGARDING THE NOTICE AND ON MAKING REPRESENTATIONS TO NAV CANADA

The Notice and this document are available on-line and a copy may be downloaded from NAV CANADA's Internet site (www.navcanada.ca).

Information on the existing charges is provided in NAV CANADA's announcements on service charges and *Customer Guide to Charges*, which are also posted on the Internet site.

Additional copies of the Details and Principles document may be obtained by contacting NAV CANADA:

in writing: NAV CANADA
P.O. Box 3411, Station "D"
Ottawa, Ontario
CANADA K1P 5L6
Attention: Director, Customer Relations

by e-mail: service@navcanada.ca
by facsimile: 1 - 613 - 563 - 3426
by telephone: 1 - 800 - 876 - 46934 (within North America, disregard the last digit)

Pursuant to Section 36 of the ANS Act, persons interested in making representations in writing to NAV CANADA with regard to the Notice may do so in writing to the following address:

NAV CANADA
P.O. Box 3411, Station "D"
Ottawa, Ontario
CANADA K1P 5L6
Attention: Director, Rates and Revenues

By facsimile: 1 - 613 - 563 - 7994

Note: Representations must be received by NAV CANADA not later than the close of business on December 2, 2002.

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Caution Concerning Forward-looking information

Certain statements made in this document are of a forward-looking nature and are subject to risks and uncertainties. The results indicated in these statements may differ materially from actual results. The forward-looking information contained in this document represents NAV CANADA's expectations as of August 15, 2002, and are subject to change after such date. However, NAV CANADA disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.