



DETAILS AND PRINCIPLES REGARDING PROPOSED REVISED SERVICE CHARGES

JUNE 2013

GENERAL

This document ("Details and Principles") provides additional details to expand upon the *Notice of Revised Service Charges* dated June 2013 (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) Traffic Outlook, (3) Forecasted Costs for Fiscal 2014, (4) Financial Analysis, (5) Principles Governing NAV CANADA's Service Charges, and (6) 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 no later than August 30, 2013.

1. GENERAL OVERVIEW OF NAV CANADA

NAV CANADA is a non-share capital, private sector 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. The Corporation is governed by a 15-member Board of Directors consisting of 10 directors elected by stakeholders representing aviation users, bargaining agents and the federal government, four independent directors and the President & CEO. NAV CANADA also has an Advisory Committee elected by associates, 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 exclusive 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 and Management's Discussion and Analysis (MD&A), issued quarterly and annually, and the Annual Information Form provide extensive information on the revenues and expenses of NAV CANADA. These documents are available electronically at www.navcanada.ca.

2. TRAFFIC OUTLOOK

In developing the traffic outlook, the primary sources of information considered are airline schedules as reported in the Official Airline Guide, a time series analysis of historical weighted charging units (WCUs), and available passenger and/or aircraft movement forecasts, such as from IATA, Transport Canada, FAA and Eurocontrol.

Since the Company last modified its service charges at the beginning of fiscal 2009, we experienced a year-over-year traffic decrease of 6.0% in fiscal 2009 followed by a further modest decline in fiscal 2010. Since that time we have seen modest year-over-year traffic growth but traffic is still below fiscal 2008 levels. A year-over-year decline is forecast for fiscal 2013, followed by an expected modest growth in fiscal 2014.

The following table shows the traffic outlook for movement-based charging units expressed as a year-over-year percentage change.

FISCAL YEARS 2013 AND 2014 CHARGING UNIT OUTLOOK
EXPRESSED AS YEAR-OVER-YEAR % CHANGE

	<u>FY 2013</u>	<u>FY 2014</u>
Overflight	-2.5%	2.3%
Terminal	-0.7%	1.5%
Enroute	-1.8%	1.5%
NAT	-2.8%	2.3%
Int'l Com	-2.5%	2.3%
Weighted	-1.7%	1.8%

Overall, year-to-year traffic growth of -1.7% and +1.8% is forecast for fiscal years 2013 and 2014, respectively.

3. FORECASTED COSTS FOR FISCAL YEAR 2014

NAV CANADA's forecasted costs ("expenses and other (income) loss") for fiscal year 2014 are \$1,236 million. A breakdown of this is provided in the following table:

NAV CANADA FORECASTED EXPENSES AND OTHER (INCOME) LOSS
FISCAL YEAR 2014
(\$ MILLIONS)

Operating Expenses:	
Salaries, benefits, and allowances	778
Other operating	231
	<u>1,009</u>
Other Expenses and (Income) Loss:	
Interest expense	104
Depreciation and amortization	137
Other (income) loss	(5)
	<u>236</u>
Total Expenses and Other (Income) Loss before Fair Value Adjustment	1,245
Fair Value Adjustments	(9)
Total Expenses and Other (Income) Loss	<u>1,236</u>

4. FINANCIAL ANALYSIS

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), 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.

Fiscal 2014 Forecast

The total expenses and other (income) loss of the Company for fiscal year 2014 are forecasted to be \$1,236 million. As shown in the table below, the forecast revenue (\$1,190 million) including an anticipated \$4 million revenue increase from the proposed revision to the Enroute charges, and from the non-aeronautical sources such as technology sales (\$36 million), totals \$1,226 million.

FISCAL 2014 FORECAST **(\$ MILLIONS)**

Total expenses and other (income) loss	1,236
Revenue	
Overflight	403
Terminal	460
Enroute	212
North Atlantic and Int'l Com	46
Daily and Annual Charges	65
Total ANS Revenue <u>Before</u> Proposed Revision	1,186
Revenue from Proposed Enroute Charge Revision*	4
Total ANS Revenue <u>After</u> Proposed Revision	1,190
Revenue from Non-aeronautical Sources	36
Total Revenue	1,226
Excess (Shortfall)	(10)
<p>* These revenues relate to the proposed revision to the application of the Enroute Charge for flights which land or take off in Canada, as set out in the Notice.</p>	

Deficit for Rate Setting Purposes

When establishing customer service charges, the Company considers:

- a) the Company's overall financial requirements;
- b) the current and anticipated balance in the rate stabilization account, adjusted "notionally" for the non-credit related portion of the fair value variance from face value on investments; and
- c) the balance of the accrued pension benefit asset (net of its regulatory liability), which represents contributions previously made to the pension plan that have not yet been recovered through customer service charges.

The table below shows the forecasted "notional" liability balance of the rate stabilization account and the deficit for rate setting purposes at August 31, 2014. The Company intends to eliminate the deficit over time.

DEFICIT FOR RATE SETTING PURPOSES
FISCAL 2014 FORECAST
(\$ MILLIONS)

Forecast fiscal 2013 ending rate stabilization account (RSA) liability		41
Forecast excess (shortfall) for fiscal 2014		(10)
Forecast fiscal 2014 ending RSA liability		31
Fair value variances:		
Fair value adjustment on investments		32
Face value variance on A-2 notes		3
Credit loss provisions		(8)
Net non-credit related fair value variances from face value (1)		27
Forecast "notional" fiscal 2014 ending RSA liability (2)		58
Accrued pension benefit asset	(240)	
Regulatory liability related to pensions	151	(89)
Deficit for rate setting purposes		(31)

- (1) The estimated fair value variance from face value on investments expected to be held by the Company at August 31, 2014, of \$35 includes cumulative fair value adjustments on these investments of \$32 and \$3 realized fair value variance on A-2 notes when purchased in fiscal 2011. The \$35 in fair value adjustments will have reduced the amount in the rate stabilization account. Of the fair value variance from face value of \$35, the Company currently estimates that \$27 will be recovered over time, as the fair value of these investments should ultimately reflect the face value of the notes less credit losses, which are currently estimated at \$8. Accordingly, \$27 has been added to the rate stabilization account to arrive at the estimated “notional” balance of the rate stabilization account as at August 31, 2014.
- (2) The long-term target liability balance of the rate stabilization account is 7.5 per cent of total planned annual expenses net of other income, excluding non-recurring items. For fiscal 2014, the target balance is \$94.

5. 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 Company's cost allocation methodology is set out in the report entitled "Methodology to be Used in Attributing the Costs of Air Navigation Services". The costs are allocated annually in the report entitled "Compilation of Air Navigation Services Costs". The Company's auditors, KPMG, annually prepare a specified auditing procedures report on the compilation of the ANS cost information. The KPMG report states that the cost information has been properly compiled by NAV CANADA, in all material respects, in accordance with the Company's cost allocation methodology. A copy of this report 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 distance. The Terminal Services Charge is based on a unit rate multiplied by aircraft weight raised to the 0.8 power.

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 1, 2008 *Customer Guide to Charges*.

6. 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 and Commercial Services

by e-mail: service@navcanada.ca
by facsimile: 1-613-563-3426
by telephone: 1-800-876-4693

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: Vice-President,
Revenue and Pension Administration

by facsimile: 1-613-563-7994

Note: Representations must be received by NAV CANADA not later than the close of business on August 30, 2013.



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 June 17, 2013, 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.