

Clarifying the Issues

The Economic Context for Air Traffic Control Bargaining



Economic Submission
By CAW Local 5454 – CATCA
To Federal Minister of Labour Mediation Process
March 2003

Introducing the CAW

P Canada's largest private sector union

- ▶ 265,000 members

P Present in 16 different sectors

P Abundant experience with tough economic times and corporate restructuring

Introducing the CAW in Aviation

P 15,000 members in air transportation

- ▶ 3,000 at Navcan
- ▶ 9,000 at Air Canada
- ▶ 3,000 at other airlines & suppliers

P 10,000 members in aerospace

P We've been through numerous crises – some real, some not-so-real

P Solid understanding of airline economics and relationship to long-run labour relations

Overview

1. What is Navcan?
2. Navcan's Financial Strategy
3. The Current Airline Crisis
4. Implications of the Crisis for Navcan
5. Making Sensible Comparisons
6. Conclusion

1. What is Navcan?

- P Navcan is not an airline
- P Navcan employees are not airline employees
- P Navcan is a legislated monopoly mandated to provide a public utility on a cost-recovery basis
- P That service must be provided regardless of the state of the airline business
- P Safety and sustainability should be top priorities

ATCs Did Not “Invest” in the Airline Business

- P We invested in learning a challenging skill that is essential to safe air transportation
- P We did not ask for a share of airline profits when the business was booming
 - ▶ Nor did we receive a share
- P We are not willing or able to shoulder the economic risk of airlines

What is Relevant to Our Bargaining?

P Safety & sustainability of working conditions

P Skill, stress, & efforts of ATCs

P Labour market and macroeconomic trends and comparisons

▶ Including compensation for *other ATCs*

P Navcan's ability to pay

▶ Not the *airlines'* financial condition

Navcan's Unique Structure

P Legislated monopoly

P Commercial cost-recovery mandate

P No share capital (no financial “cushion”)

P 99% of assets financed by debt

- ▶ Worse debt-equity ratio than the airlines!

Understanding Navcan's Economics

P Most costs are fixed

- ▶ Units must be staffed regardless of traffic levels

P Revenue is completely variable

P To maintain cost recovery philosophy, unit fees must fluctuate immediately with traffic

Navcan's Strange Math

$$P_{REV} = COST_f$$

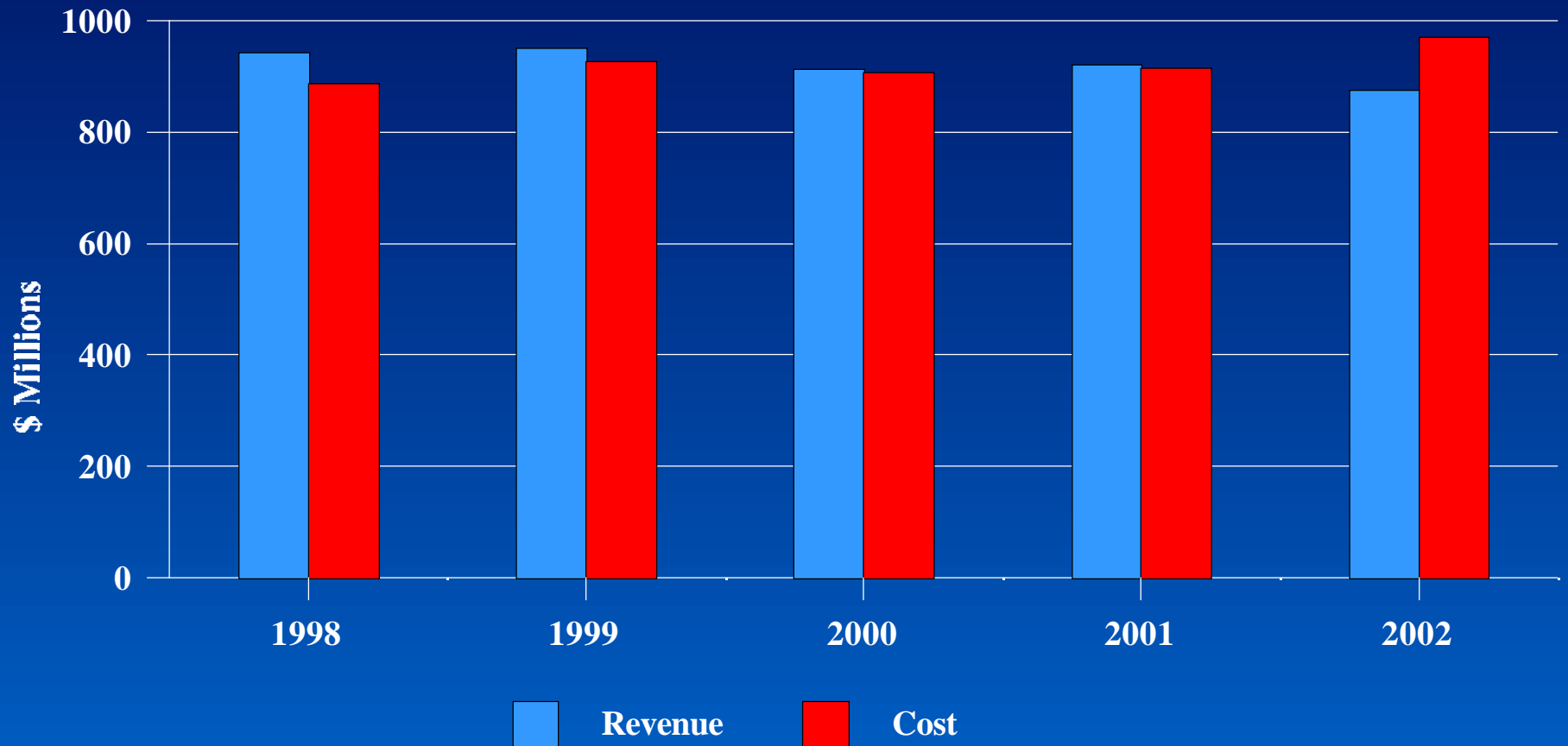
$$P_{REV} = TRAFFIC * UNIT\ CHARGE$$

$$P_{UNIT\ CHARGE} = COST_f / TRAFFIC$$

A Vicious Cycle

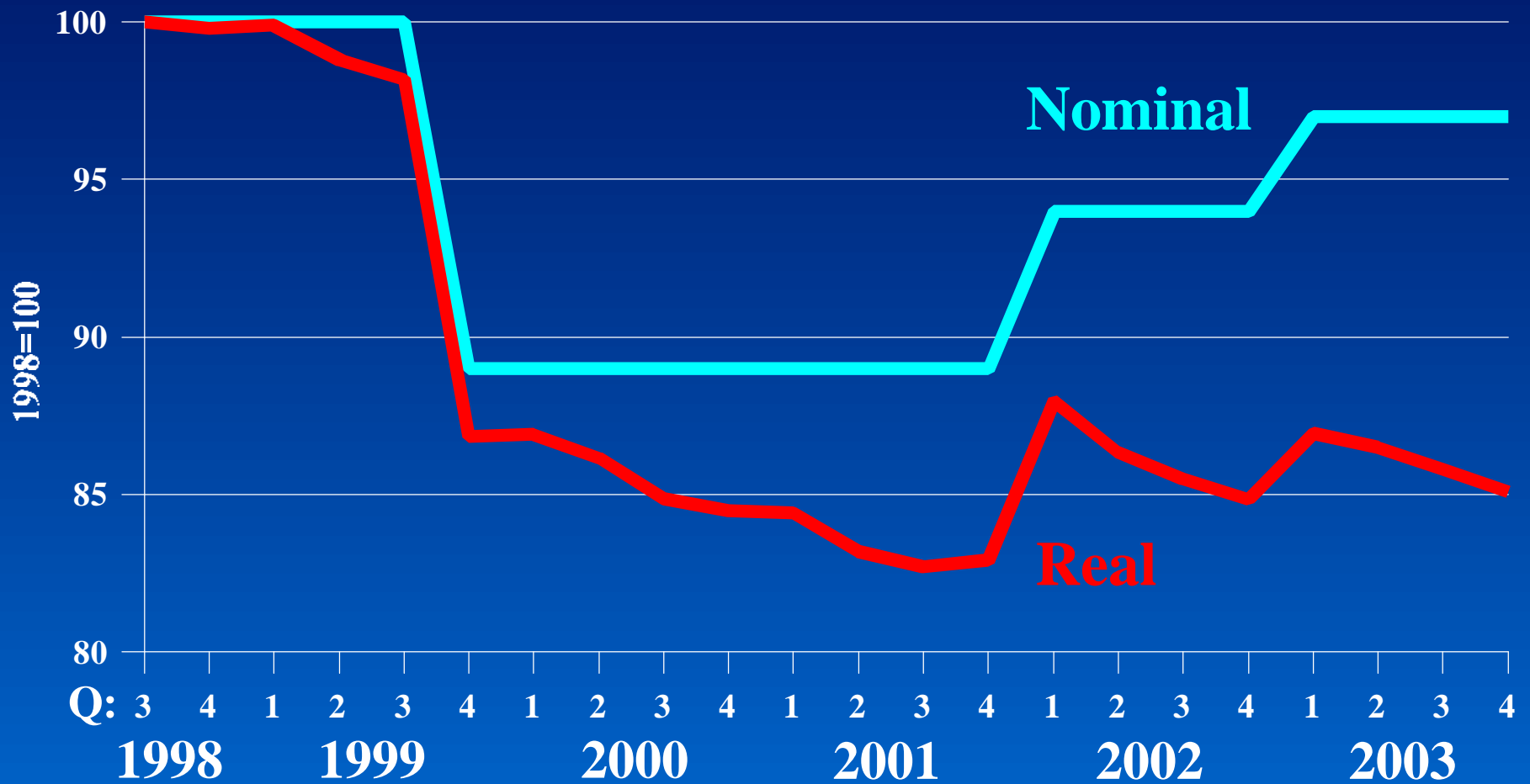
- P Good years: more traffic, unit charges can fall to meet costs
- P Bad years: less traffic, unit charges must rise to meet costs
- P Irrational result: for its customers Navcan makes good years better, bad years worse
 - ▶ contributes to boom-and-bust pattern of airline business

Navcan Total Revenues and Costs



Excludes rate stabilization drawdowns.

Navcan Unit Revenues



Implications of the Model

P Total costs and revenues are very stable

P Unit costs fluctuate:

- ▶ But this variability is inherent in the business model which airlines strongly supported
- ▶ And variability in the unit cost does not translate into variability in the total “burden”

P Example: In 2002, did airlines pay “more” or “less” for ANS?

- ▶ Unit fees up 3%
- ▶ Total costs down 5.5%

How Firm is the “Balanced Budget” Constraint?

P Legislative “requirement” justified reduced charges in good years

P Yet management had considerable discretion:

- ▶ Rate stabilization account
- ▶ Debt reduction

P Management is treating the constraint flexibly when increased charges are required

- ▶ Significant short-run deficits accepted
- ▶ “Cost recovery” now interpreted in a longer-run sense

The Legislative Obligation

P “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.”

- Civil Air Navigation Services Commercialization Act, 1996, Section 35 (1) (i).

Management's Discretion

P Contrary to superficial claims, Navcan's management had legislative authority during "good times" to:

- ▶ Accumulate a larger financial cushion
- ▶ Repay debt

P A different course of action was followed because of institutional allegiance to airlines

2. Navcan's Financial Strategy

P Combination of factors have contributed to the current situation:

- ▶ Risky & unproven business model
- ▶ Inherent volatility of pricing methodology
- ▶ Biased, asymmetric financial decisions

P To the extent that Navcan faces a financial crisis, the problem is of management's making

- ▶ No legitimate reason to avoid a fair settlement

Navcan's "Mandate Drift"

P What is the overriding objective of the company?

- ▶ To operate a financially sustainable ANS?
- ▶ Or to save its customers money?

P Pattern of behaviour reveals confusion over the primary goal:

- ▶ Management has acted to reduce cost burden to airlines, even at expense of Navcan's financial stability

It's Christmas Every Day

- P Initial ANS sale underpriced by \$1 billion+?
- P Initial total cost reduction of 30% from Air Transportation Tax
- P Early drive to quickly cut unit charges
 - ▶ Justified by claim that “budget must be balanced”
- P Subsequent reluctance to increase costs
 - ▶ Now the budget *doesn't* have to be balanced!
- P Flexible repayment terms
- P Acting as an all-purpose airline lobbyist?

Auditor-General 1997 Report

P “The Department agreed to transfer the air navigation system for a negotiated payment of \$1.5 billion. This amount was less than the entity’s going-concern value of \$2.4 billion estimated by the Department’s own financial advisors, and we considered even that to be a conservative estimate.”

– Auditor-General Denis Desautels, October 7 1997

Crichton Letter on ATSC

P “It is absolutely essential that we do everything possible to minimize additional financial burdens on the industry.”

– John Crichton letter to Paul Martin, February 12 2002

Adding up the Savings

P Move from ATT to Navcan charging system saves airlines \$300 million per year

- ▶ Problems with ATT; 1000 non-op staff reductions

P Subsequent reductions in Navcan unit charges saved airlines \$300 million 1999-2003

- ▶ Still saving \$30 million per year

P Freezing nominal charges saved airlines an additional \$300 million 1999-2003

- ▶ Still saving \$100 million per year & growing

P Total ongoing savings: \$450 million per year???

Prudent Financial Behaviour?

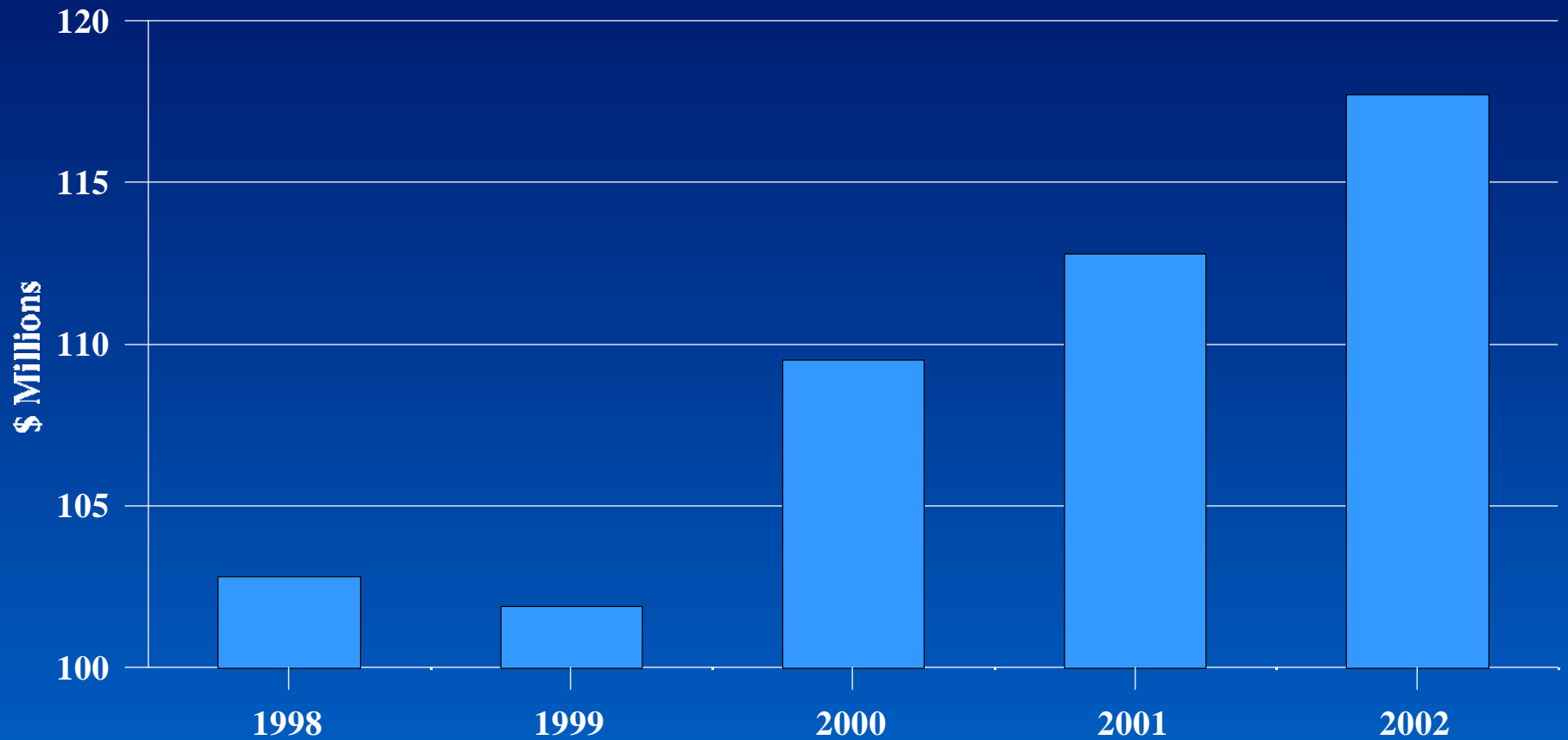
- P** Generate surpluses in good years, to offset deficits in bad years
 - ▶ Normal business practice in cyclical industries
 - ▶ Federal budget
 - ▶ Employment Insurance system
- P** Navcan followed a different tack:
 - ▶ 85% of “excess resources” 1999-2003 went into reducing nominal charges
- P** Allocation of surplus monies to lower charges dwarfed allocations to prudent stabilization

A One-Sided Approach



A Deepening Hole

Navcan Interest Expenses



What If?

P If Navcan management had frozen unit charges at their *nominal* 1999 levels and paid off debt with the surpluses:

- ▶ 2003 revenues would be \$40 million higher
- ▶ 2003 interest payments would be \$20 million lower
- ▶ \$50 m stabilization fund would more than cover deficit

P If Navcan had indexed unit charges to inflation from 1999:

- ▶ 2003 revenues would be \$150 million higher

A Fundamental Asymmetry

P When airline times were good, Navcan cut unit charges aggressively

- ▶ Imprudent, unsustainable strategy

P When airline times are bad, Navcan is reluctant to raise fees sufficiently

P Legacy is an underfunded, precarious ANS provider

- ▶ Growing debt burden, long-term cost
- ▶ Asset sell-offs?

Explaining the Asymmetry

P Navcan governance structure

- ▶ 10 “representative” directors
- ▶ Controlling block (5) from Navcan customers
- ▶ Those 10 appoint the 4 “independent” directors + CEO

P This structure has influenced Navcan’s financial strategy, with negative impact on the company’s long-term financial stability

P CAW reform proposal: restructure board so no single group has a controlling block

An Unnecessary “Crisis”

- P To the extent that Navcan faces a financial “crisis,” it is an unnecessary legacy of previous management priority on reducing airline costs
- P Navcan management chose to operate with an inadequate financial cushion
- P This provides no legitimate reason for Navcan employees to forego normal and reasonable improvements in compensation and working conditions

Proposals for Long-Run Reform

P Inherent instability of Navcan business model needs to be addressed:

- ▶ Authority to establish a much larger reserve fund
- ▶ Authority to normally generate surpluses during strong years, deficits in weak

P Other changes to charging formula could further strengthen Navcan's financial base:

- ▶ Charge on passengers, not just aircraft
- ▶ Larger contribution from small craft

3. The Current Airline Crisis

P Global industry faces a major challenge

P Canada better off than U.S.

P War in Iraq could make it much worse

P Implications for Navcan are not obvious

- ▶ Contrary to rumours, Navcan is not an airline

Dimensions of the Crisis

P Modest decline in overall traffic

- ▶ 5% decline in movements in 2002

P Financial crisis of airlines exacerbated by other, earlier problems

- ▶ Cutthroat competition
- ▶ Shift in market toward no-frill segment
- ▶ Rising costs (fuel, airports, security)

P Traffic will gradually recover, but airline restructuring will be dramatic and painful

Federal Forecasts

P February 2003 budget:

02	03	04	05	06	
-5.4%	3.9%	5.9%	4.6%	4.3%	(passengers)

P Transport Canada Nov. 6 forecast

02	03	04	05	06	
-3.8%	3.6%	5.2%	4.0%	3.8%	(passengers)
-8.2%	2.2%	4.5%	3.2%	2.5%	(movements)

Looking for the Rebound

P “The level of air passenger traffic in 2002 was stronger than originally estimated. Moreover, positive growth in air passenger traffic for 2003 to 2006 may now be factored into ATSC revenue projections with greater confidence.”

▶ Federal Budget Plan, Annex 3, February 2003

Not Unprecedented

P Transport Canada, Historical Aviation Statistics

P 1980-83 downturn:

- ▶ Passenger traffic declined 17%
- ▶ Movements at towered airports declined 25%

P 1990-93 downturn:

- ▶ Passenger traffic declined 14%
- ▶ Movements at towered airports declined 19%

P Financial challenges facing airlines are unique, but the downturn in Navcan's business is not

Two Problems

P General airline overcapacity

- ▶ Less passenger traffic requires reduction in capacity
- ▶ This affects Navcan's charging base, but will be alleviated over time

P Restructuring of air travel demand

- ▶ Shift to no-frill travel hurts some airlines, helps others
- ▶ This longer-run trend does not hurt Navcan's charging base, and may help it
 - Lower fares stimulate demand
 - No-frill aircraft are smaller, shorter-haul, resulting in more Navcan revenue per RPM

Growth of No-Frill Segment

P WestJet will increase capacity 50% this year

- ▶ 9 new aircraft
- ▶ 26 destinations in total
- ▶ Flew more domestic RPMs in January than CAI did in 1999

P JetsGo growing quickly

- ▶ 8 aircraft in fleet
- ▶ New destinations in Alta., B.C., Nfld., NB.

P No-frill carriers pay just as much to Navcan as Air Canada

Example

P Air Canada

- ▶ Direct flight, Ottawa – Vancouver, A320
- ▶ Navcan fees = \$1620

P WestJet

- ▶ “Milk run”, Ottawa – Vancouver, Boeing 737 (3 stops)
- ▶ Navcan fees = \$3420

– Source: Navcan on-line fee calculator

Conclusion

P Financial crisis facing airlines is formidable

P But the scale of the downturn in airline operations is not unprecedented

P Shift in composition of airline industry is a “wash” for Navcan

P Overall impact on Navcan finances is serious, but temporary

- ▶ Is it really a “crisis”?
- ▶ Only for a company with razor-thin finances

4. Implications of the Crisis for Navcan

P Declining traffic necessitates higher unit fees

P Overall cost of ANS, however, is stable

P Are airlines paying more...?

- ▶ Or are they paying less?

P ANS fees per unit increase

- ▶ But the scale is negligible in overall economics of airline travel

“Our Customers Can’t Afford Any More”

- P Navcan goes out of its way to help the airlines during tough times
- P Navcan uses airlines’ alleged inability to pay as an excuse in collective bargaining
- P Yet Navcan recognizes that unit fee increases are inevitable, and knows the airlines will pay them

Can Airlines Pay?

P ANS fees constitute a very small share of total airline costs (2-3 %)

P 10% increase in Navcan fees = 0.2-0.3% increase in total airline costs

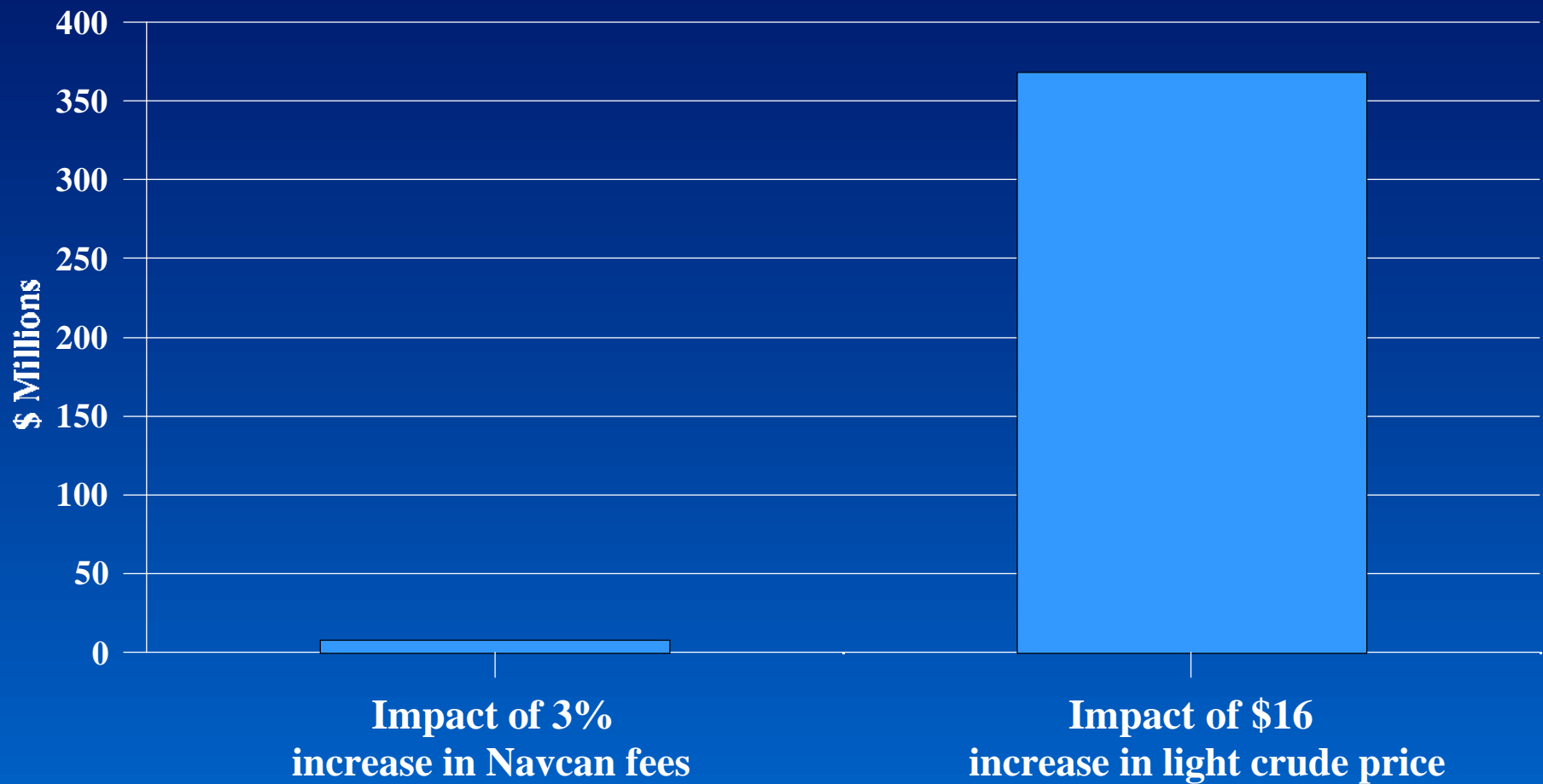
P Is this the straw that breaks the camel's back?

P Unit fee increases will be dwarfed by:

- ▶ Higher fuel prices
- ▶ Impact of a war on consumer confidence
- ▶ Macroeconomic conditions
- ▶ Airline restructuring

Navcan Fees in Perspective

Air Canada's Increased Annual Costs Due To:



U.S. light crude price is up \$16 from Nov 2002; cost assumes increase sustained full year.

Applying the Pressure

P “Let’s work together to keep a lid on rising navigation fees at a time when carriers can least afford it.”

– Robert Milton, Air Canada CEO, February 21 2003

P Would he say this to OPEC?

P “Let’s work together to keep a lid on rising oil prices at a time when carriers can least afford it.”

P Airline CEOs have no influence with OPEC, but a lot of influence with Navcan

P NB: AirCanada Navcan fees *fell* 8% in 2002

International Cost Comparisons

- P Canada's ANS is relatively inexpensive, given its size
- P ANS expenses are declining relative to economic aggregates

The Canadian Advantage (2001)

P Cost of Canada's ANS (Navcan): \$600 million (U.S.); 5400 employees

P Cost of U.S. ANS (FAA): \$7.1 billion (U.S.); 35,000 employees

P Cost of U.K. ANS (NATS): \$750 million (U.S.); 5600 employees

P U.S. system: 6.5 times as many employees, but costs 12 times as much

P U.K. system: less traffic and airspace, but more employees; 25% higher costs than Canada's

A Bargain by Any Measure (I)

P Overflight costs per 100 km (\$US):

	737	767
Canada	\$16.99	\$30.08
Australia	\$22.69	\$40.18
U.S. (Oceanic)	\$31.66	\$31.88
U.S. (Continental)	\$67.44	\$67.44
France	\$67.28	\$119.14
U.K.	\$97.63	\$172.87
Germany	\$108.09	\$191.40

– Source: IATA

A Bargain by Any Measure (II)

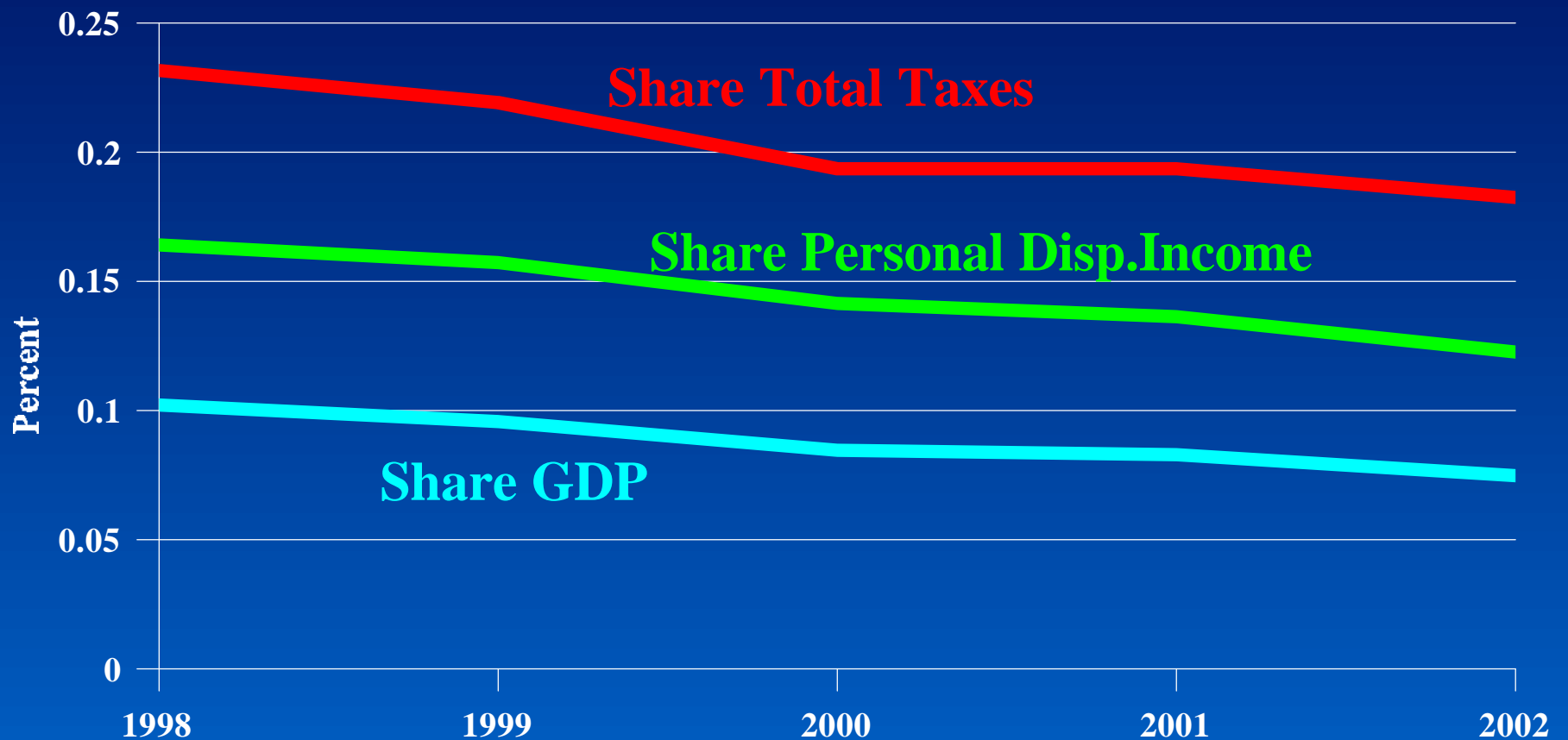
Recent ANS fee increases:

	EnRoute	Terminal
Canada	9%	9%
Australia	Average 5%	
France	14%	7%
U.K.	Regulatory approval underway	
Germany	14%	0%
Netherlands	13%	0%
Spain	26%	10%
Sweden	21%	0%
Switzerland	10%	4%

– Source: Navcan, company financial statements

A Bargain by Any Measure (III)

ANS Fees as Proportion Relevant Canadian Aggregates



The Airlines *Will* Pay

P “Any revenue shortfall will be recovered through additional rate increases, net of revenues from non-aeronautical sources.... The Company plans to further adjust rates in fiscal year 2002/03 as is necessary to achieve break-even revenues in the following fiscal year.”

▶ Navcan Business Plan 2002-05, p. 18.

Talking From Two Sides of the Mouth

- P Why claim the airlines can't afford fee increases, when Navcan has already announced it will impose them?
- P Current deficit reflects a conscious effort to postpone higher charges to the airlines, but everyone knows fee increases are inevitable.
- P Artificial atmosphere of financial crisis is convenient during collective bargaining

“Technically We Are Bankrupt”

- P Navcan has \$1 billion undrawn credit facility
- P Navcan has high investment-grade debt ratings (Aa3 to AA+)
- P Navcan had \$60 m cash as of Nov. 30 2002
- P Navcan has since raised \$460 m new debt
- P No question of Navcan’s ability to meet obligations for foreseeable future
- P Incredible and irresponsible assertion of “bankruptcy”

Navcan Capital Markets Platform

P “All indebtedness is incurred under a Capital Markets Platform and is secured under a Master Trust Indenture which provides the company with a total drawn and undrawn borrowing capacity of \$2,943 million.”

▶ Navcan Quarterly Financial Statements, 1st Quarter 2002-03, note 6.

P Drawn indebtedness as of November 30, 2002:
\$1,950 million

P Undrawn borrowing capacity: \$993 million

Not So Gloomy After All

P “The quality of all Navcan’s staff combined with the Company’s business model and *legislated monopoly in the provision of an essential service* have allowed it to receive among the highest corporate credit ratings in North America. These strong credit ratings facilitate ready access to capital markets and lower the Company’s costs of borrowing.”

▶ Navcan Business Plan, 2002-05, p. 18.

Navcan's True Financial Strategy

P Tolerate a sizeable deficit in short-term (\$84 million or more this year)

- ▶ sudden “flexibility” on cost recovery mandate

P Increase fees in medium-term

P Company argues that “fees cannot rise” or “deficit cannot grow”

- ▶ But this is explicitly contradicted *by their own strategy*

“We Cannot Afford Any More”

P What justifies do-or-die commitment to 2.5% salary increment?

P What justifies do-or-die commitment to \$84 million deficit?

P Management has been flexible for its clients

- ▶ cutting fees
- ▶ tolerating deficits
- ▶ restructuring payment terms

P Management can show flexibility for workers, too

5. Making Sensible Comparisons

- P Navcan economic submission had 15 slides (out of 60) detailing layoffs and wage concessions in North American airlines
- P Navcan submission provided no information on employment and wage trends for ATCs
- P Is Navcan an airline, or an ANS providers?
- P Which are the sensible comparisons to make?

International Comparisons: Levels

P U.S. ATCs earn 55-100% more than controllers in Canada (major airports)

▶ 40-90% more after adjusting for Canadian working hours

P Canadian ATCs earn less than controllers in other G7 economies

P Canadian ATC salaries were suppressed during era of federal wage freeze

P Conclusion: significant catch-up is required

A Debt Owed

P “Even with an average increase of approximately 30%, the salaries paid to Canadian air traffic controllers will continue to lag behind the air traffic controllers in other jurisdictions.... It is my expectation that additional catch-up will be required in the next round of bargaining.”

▶ Conciliation Commissioner Kevin Burkett, May 1999

International Comparisons: Recent Settlements

P FAA/NATCA employees (U.S.) get federal cost-of-living increase (4.1% as of January 1, 2003) *plus* a 1.6% annual movement within pay grids

P Average U.K. NATS employee wages and salaries grew 7.7% in 2001

P These airline systems are suffering worse financial crises than Canada's

- ▶ U.S. airline industry has been hardest hit
- ▶ U.K. NATS sought regulatory approval to raise fees

ATC: A Uniquely Challenging Job

- P Annual re-certification
- P Medical fitness requirement (equivalent to pilots)
- P Must relocate to assigned airport on graduation
- P Constant instability in working hours
- P Monopsony employer: no transferability, no “exit voice”
- P Personal responsibility as ATC license-holder
- P Unique level of stress and responsibility

Catching Up or Falling Behind?

- P Navcan proposal matches CPI April 01–August 02, but it's a *lump sum*
- P 2.5% annual increment for 02-03 will not match CPI inflation
 - ▶ Jan. 2003 CPI up 4.5% year over year
- P Subsequent 2.5% annual increments not likely to match CPI inflation
- P Conclusion: Navcan is proposing a real salary cut, when last conciliation report indicated need for substantial real wage growth

Continuing, Sensible Progress

P 1998-2001 agreement provided for real wage increase of approx. 25%

▶ Conciliator recognized more was needed

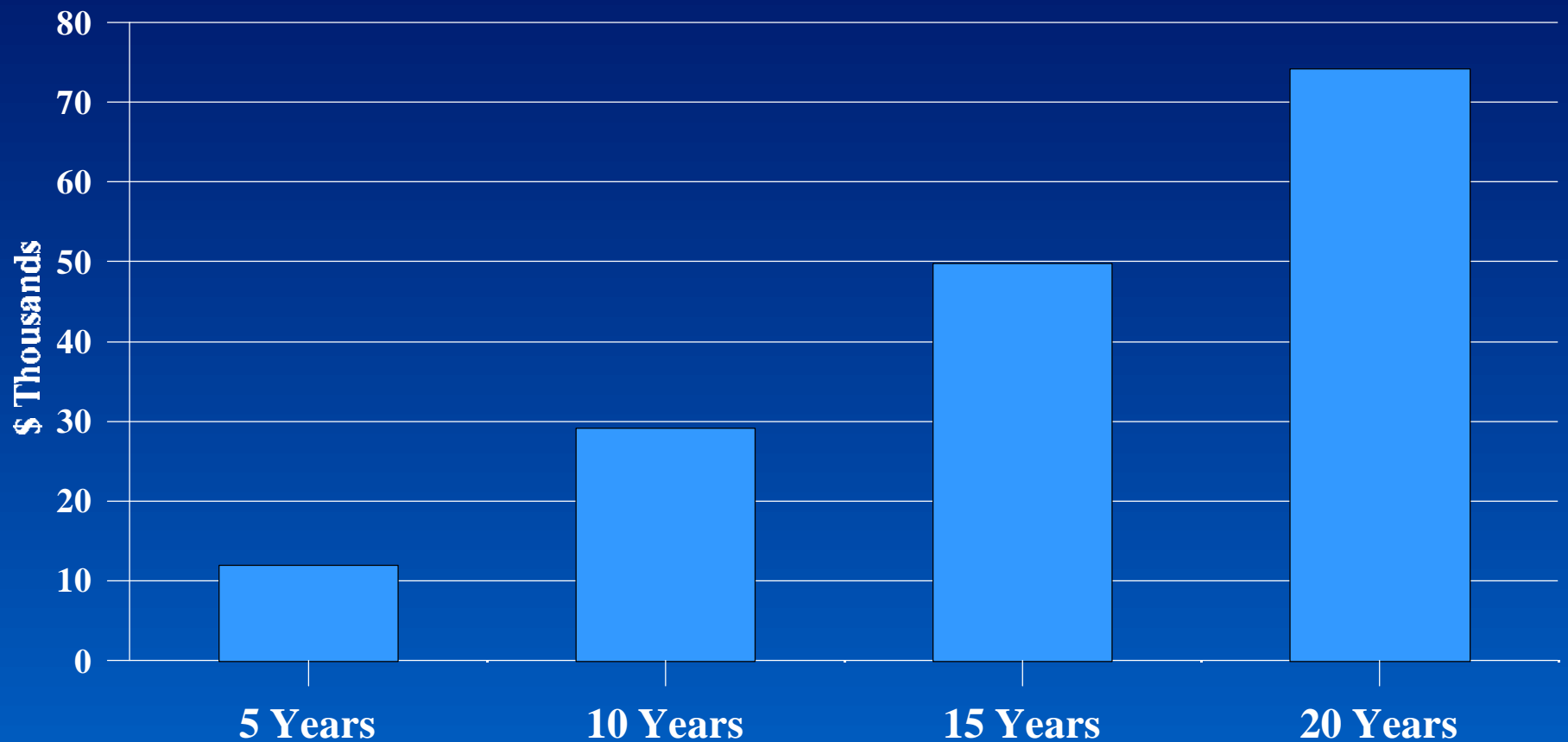
P Local 5454-CATCA proposal would provide for half that much real wage catch-up in this contract

A Lump of Coal

- P 3.4% lump-sum proposal April 1, 2001 through August 31, 2002
- P Cash payout reneges on long-term compensation progress
- P Cost to Local 5454-CATCA members is substantial
- P Over long-run, lump-sum payout is worth less than 4% of an equivalent increase in base rates

The Long-Run Cost of Lump-Sum

Cumulative Lost Income from One-Time 3.4% Lump-Sum



Assumes \$80,000 starting base, one-time 3.4% lump sum, 3.5% annual base increases afterward.

What's A Reasonable Proposal?

- P Make ongoing modest progress to long-run goal of catch-up
- P Move to sustainable working hours & conditions
 - ▶ Occupational safety and health
 - ▶ Quality of life for ATCs
- P These are reasonable and justifiable costs of providing a safe, sustainable ANS
- P Navcan is legally and economically capable of recovering these costs

Our Place in the Big Picture

P There is a broad recognition that Canadian ATCs are underpaid

- ▶ Historical real wage losses
- ▶ International comparisons
- ▶ Relative to other high-stress life-and-death occupations

P Equally strong recognition that ATC working conditions are unsustainable

P We can't "save" the airline industry by tightening our belts, nor should we be asked to

6. Conclusion

- P Navcan's arguments about an "inability to pay" (either its own, or its clients') are not convincing
- P We are not arguing Navcan can "charge anything it wants"
- P But Navcan is obligated to recover the normal, reasonable costs of providing its service
- P This includes a reasonable, sustainable labour agreement for its ATCs

Machiavelli Lives?

- P Navcan cuts fees to reduce costs for airlines
- P Seeds are planted for later financial problems
- P Navcan invokes these problems in refusing improvements in compensation and shifts
- P Navcan pushes federal government to restrict our bargaining rights (right-to-strike, binding arb.)
- P Conclusion: ATCs are unwilling pawns in Navcan management's effort to subsidize airlines