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UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Issued by the Department of Transportation
on the 14th day of August, 2000

INTRA-ALASKA MAINLINE
SERVICE MAIL RATES

Docket OST-95-429 - 120
(Docket 38961)

ORDER TO SHOW CAUSE ESTABLISHING
MAINLINE SERVICE MAIL RATES

Summary

By this order the Department proposes to establish new Intra-Alaska mainline mail rates for the terminal element for the year ending September 30, 2001, and non-fuel linehaul costs for the same period, which, when combined with fuel costs for the quarter ending June 30, 2000, will allow us to set linehaul rates as well. ¹ The rates that are currently in effect were established by Order 99-7-16, finalized by Order 99-9-13, for the year ending September 30, 2000, and updated for quarterly fuel adjustments by Order 2000-6-5. Those rates will remain in effect as final rates through September 30, 2000, or until a final order is issued with respect to the rates proposed here, whichever is later.

The order makes two significant adjustments to the rate calculation. We have included Tatonduk Outfitters, Ltd., d/b/a Air Cargo Express (ACE) for the first time to reflect its operations during the period. Also, for the first time we have adjusted our updating methodology by weighting terminal costs of each carrier by the amount of mail each carrier emplanes and linehaul costs by the amount transported by each aircraft type. We also direct Alaska Central Express to work with our staff and to begin reporting more detailed T-100 data, Schedule T-2 information consistent with its mainline carrier competitors.

Finally, Alaska Airlines and Northern Air Cargo have expressed concern about several difficult issues, including adding a bush carrier to the mainline update, equalization and

¹ Because of our earlier decision in Order 99-12-15 to use the most current quarterly fuel cost data, the Department cannot at this time establish new linehaul rates to be effective October 1, 2000. By Order 99-12-15, in response to dramatic fuel price increases, we began using the most recent quarter's fuel costs as the base for the following quarter's fuel rate, and second quarter data will not be available until mid-August. We can only update the terminal rate and non-fuel linehaul costs at this time because the time-frames of the two data are now different.

equitable tender, and the alleged conversion of freight shipments to mail shipments to the disadvantage of specific carriers. They indicate that these issues need not be resolved at this time. We anticipate discussing these issues fully with the parties before the next mail rate update on September 30, 2001.

Background

The structure for compensating mainline carriers for transportation of mail was established by Order 82-11-23 after a time-consuming two-year investigation. That order determined the average cost of moving the mail in Alaska, and broke it down into a terminal and linehaul element. For the terminal element, the Postal Service pays carriers based on the pounds of mail loaded (enplaned) onto the aircraft, since the cost of loading mail onto an aircraft does not vary with distance. For the linehaul element, which reflects the aircraft specific costs of pilot, fuel, maintenance, depreciation and lease, the Postal Service pays carriers based on the RTMs of mail which they transport, which reflects the amount of mail carried times the distance transported.

The Department conducts annual updates of the mail rate based on established unit cost changes to avoid going through another burdensome base-rate investigation to ensure that the rate reflects changes in these costs over time. Alaska Airlines and Wien Air Alaska were the two carriers that made up the pool of mainline carriers that comprised the 1982 base rate. Since that time, Wien has ceased operations and was deleted from the update mainline pool, while Northern Air Cargo (NAC) and MarkAir began operations and were added to the mainline pool. MarkAir was subsequently deleted from the update mainline pool when it ceased operations.

In order to determine the changes in unit costs over time, the Department has updated the linehaul element by dividing mainline pool carriers' linehaul costs by their available ton mile (ATMs), a traffic element that does not vary by amount of traffic nor distinguish between type of traffic carried, i.e., passenger, freight, or mail. This index is then compared to an index calculated in the same way for the base period to determine the change in costs. For the terminal element, the Department divides the mainline pool carriers' terminal costs by their Intra-Alaska enplaned tons of all traffic to arrive at a unit cost per ton enplaned.²

Order 99-9-13, the most recent of our annual updates, finalized mainline rates tentatively set by Order 99-7-16 through September 30, 2000.³ In that order we indicated that we intended to add Lynden Air Cargo (LAC) and ACE to the mainline pool in view of their

² For Alaska Airlines, that traffic consists of passengers, freight, and mail enplaned. For NAC and other all-cargo operators, traffic consists of freight and mail only.

³ Since that order issued, the department has modified its procedures to reflect the recent spike in fuel prices by applying a quarterly fuel cost adjustment. See Order 99-12-15 and most recently Order 2000-6-5.

transporting a significant portion of Alaska mainline mail for a number of years.⁴ Both carriers have worked with us to supply the data necessary to be included in the mainline pool, and no party has objected to their inclusion in this update.

Petition of Northern Air Cargo, March 10, 2000

On March 10, 2000, NAC petitioned the Department to adjust the mainline mail update methodology, specifically, by weighting carrier's costs by the amount of mail each carrier transports.⁵ NAC's contention is as follows. For the terminal element, each carrier's costs should be weighted by the amount of mail that carrier enplaned. For the linehaul, where greater cost detail is available, costs should be weighted by the amount of mail carried by each aircraft type.⁶ In other words, if an aircraft carries no mail, its costs would no longer affect the mail rate. The statute sets out a goal of making the rate reflect as closely as possible the cost of the "facilities used and useful" for mail carriage, and it is argued that applying such a weighting to the costs of specific carriers and their equipment should help accomplish that goal. Furthermore, the Department has made necessary *ad hoc* adjustments to the update methodology since the base rate was established almost 20 years ago, and this weighting issue is not a new one.⁷ This proposed weighting would be significant, because in prior updates when costs were not weighted by mail volumes, Alaska Airlines' linehaul costs made up 80.3% of total ATMs but it carried only 45.73% of the mail.⁸ NAC further contends that the Department should weight the linehaul not merely by the amount of mail each carrier transports but by the amount of mail carried on each aircraft type. This would reflect a significant further refinement to the Department's rate updates because Alaska Airlines' 737-200s are the most expensive aircraft in Alaska Airlines' fleet and historically have transported the bulk of the mail transported by Alaska Airlines. To not weight costs by amount of mail carried by aircraft type significantly understates the mail rate, according to NAC.⁹

⁴ The Postal Service reports that priority and nonpriority mainline mail for the YE 9/30/99 had a total value of \$61,784,315, and was transported as follows: Alaska Airlines, 29.2%; NAC, 21.2%; ACE, 17.8%; Alaska Central Express, 13.7%; LAC, 10.3%; and Reeve, 6.9%. The percentages total 99.1%. Another dozen carriers transported the remainder of the mail. Also, Alaska Airlines' totals include mail revenue transported by its code-share partners ERA Aviation and Peninsula Airways.

⁵ Currently, the Department does not weight each carrier's or aircraft type's relative costs by the relative volumes of mail transported in setting mail rates.

⁶ Currently the terminal element is weighted by the amount of freight, mail, and passenger tons enplaned. For the linehaul, carrier costs are weighted by the number of freight, mail, and passenger ATMs flown by each carrier, regardless of whether the traffic transported is passenger, mail, or freight.

⁷ Three years ago the Department stated in its Final Report on the Review of the Alaska Mail Ratemaking Methodology, September 2, 1997, page 19, "We do plan to continue to explore, as the USPS had suggested earlier in this review, the desirability of weighting individual carriers' costs in proportion to the relative shares of total mail volume handled."

⁸ This apparent discrepancy arises because Alaska Airlines is a combination carrier transporting passengers, mail, and freight, whereas NAC is an all-cargo operator, carrying only mail and freight.

⁹ It appears that the Postal Service most strongly objects to this second level of weighting, i.e., by amount of mail carried by each aircraft type rather than by each carrier.

Response of United States Postal Service

In its response to NAC's proposal, dated April 19, 2000, the Postal Service makes the following assertions

[the Postal Service] has always expressed interest in promoting efficiency in the Alaska air industry and in this context has some concerns with the proposal. In particular, the...use of NAC's proposed mainline rate update methodology could lead to an inappropriate skewing of mainline mail costs in the direction of the least efficient (highest cost) carriers and carrier aircraft...[the Postal Service] has always contended that such a weighting scheme would have to be tempered by a mechanism to ensure that the Postal Service does not reward carriers for the use of inefficient high-cost aircraft for the carriage of mail. In fact, in the past the Postal Service has suggested that efficient carriers receive financial incentives for positive cost reductions.

The Postal Service's concern is understandable because under equitable tender rules, the Postal Service has no discretion to give more mail to the lowest cost or highest quality carrier as they would in the free market, and so the further entry of high cost carriers, perhaps encouraged by this new update methodology, would drive up the rate. Furthermore, under an extreme case, if linehaul costs were weighted by the amount of mail carried by each aircraft type, carriers "could funnel all mail to only their highest-cost planes, which would result in a significant increase in costs to the Postal Service on top of the aforementioned structural increase in costs that would be expected if only overall carrier costs were weighted by mail carried."

Regarding the addition of new carriers such as LAC and ACE, the Postal Service in general is in favor of it, but believes

"The Department should adhere to its past precedent and examine and verify that the new carriers share sufficient operational cost, aircraft type....and route characteristics with the mainline carriers currently being used in the update methodology."

Finally, the Postal Service contends that should "the Department accept NAC's recommendations or variants thereof, the Department would have to recalculate unit costs for the prior ten years using the new methodology and only then perform the appropriate regression analysis to determine the" long-term trend in inflation of carrier costs.

Answer of Alaska Airlines

On May 23, 2000, Alaska Airlines answered in support of NAC's petition. Alaska characterizes the Postal Service's position as favoring abandoning the class rate system in favor of individual carrier incentives or an individual rate approach. Alaska's "short answer" to the Postal Service's suggestion of incentives for less expensive carriers is that such individual rates were abandoned almost twenty years ago in favor of the average cost approach of the class rate system.

Alaska argues that, contrary to the Postal Service's contention, the class rate system provides a substantial incentive for less efficient carriers to achieve lower unit costs, since

the lowest cost operator is paid the same rate as the highest cost operator. This rate reflects average costs that exceed those of the most efficient operator but fall short of the highest cost operator's costs. Over time, inefficient carriers are encouraged to either become more efficient or retrench, and efficient carriers are encouraged to grow. Also, the Postal Service in its response produced "no demonstrable evidence that the Intra-Alaska carriers, either individually or as a group, would choose to ignore the continuous pressure to optimize their fleets for the sole purpose of inflating Intra-Alaska class mail rates." Also, while the Postal Service expresses nebulous concerns about weighting linehaul costs by the amount of mail carried on each aircraft type, no party has suggested that Alaska's combination aircraft are more expensive than similar class aircraft. Alaska Airlines in fact is using its more expensive B-737-200 aircraft to carry relatively more mail than its other Alaska aircraft, not because it is trying to increase the mail rate, but because the 737-200, unlike the other aircraft in its fleet, is better suited in general to carriage of mail in Alaska, because it has a large cargo door and a great deal more cargo capacity given its ability to load mail and freight on the main deck.¹⁰

Furthermore, Alaska asserts that the Postal Service's position involves a logical conflict. The Postal Service is concerned that the Department should not recognize the greater cost of the aircraft actually used to move the mail, because that might drive carriers to choose high-cost aircraft, merely to artificially jack-up the mail rate. However, Alaska asserts that when the base rate was constructed, mail costs were determined on a by-product basis. In other words, capacity costs were not fully allocated to mail, as they would be under joint-product costing. Rather, only the costs of the belly and cargo portion of the main-deck compartment were included. In brief, if mail determines whether or not the plane is flown as the Postal Service contends, then mail can no longer be treated as a by-product and its costs must be increased to reflect joint-product costing.

Finally, Alaska Airlines raises two new issues. First, it suggests that at some future point it might be appropriate for the Department to add other carriers to the mainline cost pool, especially Alaska Central Express (Express),¹¹ that transport a great deal of mainline mail. Second, the Department should consider calculating costs on the basis of RTMs instead of ATMs in order to account for Express's diversion of mail from the other mainline carriers. That diversion should work to increase the rate but does not, because costs are currently updated on ATMs. Costs should be updated on RTMs in order to reflect the diversion of mail from the true mainline carriers, which decreases overall load factors and thus increases costs per RTM.

¹⁰ Although Alaska's other aircraft are significantly larger, the 737-200 combination aircraft has 1,605 cubic feet and 23,500 pounds available for cargo; the 737-400 has 1,364 cubic feet and 16,400 pounds, and the MD-80 only 1,253 cubic feet and 18,800 pounds.

¹¹ Express predominantly operates Beech 1900 aircraft that are well shy of the mainline threshold of 7,500 pounds. However, it operates its bush aircraft in mainline markets, in competition with much larger equipment.

Consolidated Reply of Northern Air Cargo, May 31, 2000

NAC asserts that the Postal Service's response does not actually reject NAC's analysis. Rather, the Postal Service seeks to prevent the implementation of mail-weighting by expressing "concerns" that such an approach would reward inefficient operators and thereby unduly drive up mail rates. NAC argues that such concerns are misplaced, because the class rate system inherently encourages efficiency.

NAC goes on to focus upon the status of Express. NAC asserts that by virtue of a distortion and abuse of the rate equalization procedures, Express is able to compete in numerous mainline markets against "true"¹² mainline carriers. NAC contends on page 8 of its reply that allowing Express to divert mail from true mainline carriers is contrary to the public interest because it "does not provide a service designed to meet the present and future needs of the commerce of the United States as one of the three essential objectives of the Nation's Air Transportation System, in addition to the Postal Service and National Defense. (49 U.S.C., §40101(a)(7))." NAC contends that Express is not a "legitimate" commercial carrier because it can only remain in business by manipulating artificial Postal Service procedures dictating that all carriers in a market receive an equal amount of mail. For example, during the most recent annual period 93.5% of Express's total traffic was mail. Furthermore, its service provides no real benefit even to the Postal Service because it typically operates in markets served by a number of other carriers. In addition, NAC argues that with recent revisions, Express's operation contravenes the Postal Service's own regulations as stated in its Handbook PO-508 2-3.5, Utilization of Equalized Service. According to the Handbook, equalized service (such as Express's) will be used by the Postal Service at its discretion when it needs to improve mail service to a community, taking into account the cost implications of that equalization.

NAC urges the Department to include Express in the pool of mainline mail carriers in the next mail update unless the Postal Service takes action to eliminate or reduce Express's diversion of mail. The Department and the Postal Service cannot continue to ignore Express's large-scale participation in the transportation of mainline mail.

NAC goes on to protest the present legal structure that encourages the conversion of freight traffic to mail. NAC states that it has been able to contend successfully with competition in the marketplace from other all-cargo operators because of the quality of its service and its marketing efficiency, but those characteristics do not give it any advantage in the mail market because of the Postal Service's policies on the equitable tender of mail. Moreover, because Postal customers are charged approximately a fifth of the price required for transporting a similar-size shipment of freight, the current system penalizes air-freight operators by encouraging shippers to transport anything possible as mail. In addition, the Postal Service pays carriers significantly less per pound to carry mail than shippers pay in corresponding freight rates. NAC contends that over 27,000 tons and several million dollars annually would have been moved by NAC as freight given its superior quality, had it not been artificially converted to mail and therefore allocated

¹² By definition, mainline equipment is equipment that exceeds 7,500 pounds payload. Express has no such equipment.

equally to all eligible operators with no recognition by the Postal Service of NAC's superior service.

Decisions:

Weighting by Amount of Mail Transported

We have reviewed carefully the parties' pleadings and have decided tentatively to modify our mainline update methodology by weighting our calculation of mail rates by the relative amounts of mail moved by each carrier for the terminal element and by each carrier and aircraft type for the linehaul. We already update mail rates by applying appropriate weights in most areas. For example, we weight Alaska Airlines' costs by the amount of its Intra-Alaska service. Though we use Alaska Airlines system average unit costs, we weight those costs by the amount of its Intra-Alaska ATMs, because using its system ATMs would dwarf the impact of NAC and any other Alaskan carrier's costs under the weight of Alaska Airlines' much greater size. Similarly, Order 85-7-28 refined our methodology for updating the terminal element. Until that time terminal rates were updated on the basis of changes in aircraft operating costs per ATM, a mileage related statistic. Terminal costs are not related to distance traveled and so we changed to using Tons Enplaned.

Against this background of making necessary refinements in update methodology the Postal Service has argued that such costing would provide the wrong incentives and possibly encourage carriers to operate inefficiently. We do share the Postal Service's concerns in this regard, as explained further below, but it should be noted that Alaska Airlines already uses its most expensive aircraft to transport mail in Alaska in the face of not having had those costs fully recognized in the mainline cost pool since Alaska Airlines added the 737-400 and MD-80 to its fleet. Weighting aircraft costs by the amount of mail each aircraft transports will more accurately reflect the true cost of providing that service.

Furthermore, it is logical that as more carriers enter the market and operate in Alaska or are added to the pool of mainline carriers to update the rate, the less possibility there will be for carriers to manipulate the rate. If a carrier purposely used its most expensive aircraft to increase the rate, the resulting increase would be shared by all operators but the costs of using the more expensive aircraft would be borne solely by the carrier attempting to manipulate the rate. Likewise, because for most carriers mail is only a portion of total traffic, any attempt by carriers to increase mail rates by using expensive aircraft would increase their own passenger and freight costs, and it is unlikely that competition would allow those costs to be passed on to their customers. If there was only one carrier in the rate or mainline pool and if only mail was being moved, the Postal Service's concerns would be very worrisome.

The Postal Service contends that to use the regression to determine long-term trends in costs we must recalculate unit costs prior to using the new methodology. While it would be preferable to do so, it is not possible because data on RTMs of mail by aircraft type

and Intra-Alaska mail tons enplaned are not available.¹³ However, we note that to do so would not be in the Postal Service's interest. The long-term trend in costs calculated in our regressions for the mainline has been reduced by Alaska Airlines' increasing use of new, less expensive aircraft. We will therefore continue to use the traditional method for calculating the long-term trends in costs. As soon as possible, we have tentatively decided to use the more refined costing methodology we are tentatively implementing here to determine long-term trends in costs as well.

New Issues Raised by Carriers

Northern Air Cargo and Alaska Airlines have raised issues that we do not need to settle with this update. We will deal with those issues outside this annual update in discussions with the parties. In the meantime, because Alaska Central Express transports more mainline mail than any mainline carrier except Alaska Airlines and NAC, we have tentatively decided to require it to begin reporting T-100 information. This requirement does not imply any predisposition on our part as to the legal or policy merits of including Express in the next mail update.

Addition of New Carriers

In this Order we have tentatively decided to add Tatonduk Outfitters Ltd., d/b/a Air Cargo Express (ACE) to the pool of mainline carriers. Our decision as to which carriers to include involves several tradeoffs. Preferably all carriers moving mail in the class would be included in the mainline pool. However, including carriers that transport only a small portion of the total mail may not justify the administrative burden of adding another entity. Also, carriers costs and traffic must be reliable, and their costs reflective of Intra-Alaska service. For this reason we are not adding Lynden Air Cargo (LAC) at this time. LAC's system terminal unit costs are less than half of the class rate average. After discussing this matter with the carrier, it is apparent that its system average is not representative of its Intra-Alaska costs. The majority of LAC's traffic is outside of Alaska, and on those operations its customers frequently load and off-load the aircraft themselves, and LAC thereby incurs virtually no terminal costs. This is not typical of its Intra-Alaska operations. In the coming year we will explore with LAC the possibility of determining its Intra-Alaska terminal expenses by using a more sophisticated costing methodology designed to isolate its Intra-Alaska costs, similar to our current treatment of Alaska Airlines.

Alaska Airlines has argued that Alaska Central Express (Express) should be included in the calculation of the mainline mail rate. Including Express's operation presents several issues, because it operates primarily Beech 1900 aircraft whose payload is well within the 7,500 pound bush-payload boundary, but it primarily transports mainline mail. As earlier indicated, NAC and Alaska believe Express should be added to the mainline pool. Though it was not directly addressing the issue of adding Alaska Central Express at the time, the Postal Service contends that new carriers added to the mainline pool should share "sufficient operational cost, aircraft type....and route characteristics with the

¹³ While Postal Service reports go back a number of years, they do not show what aircraft type moved the mail, and they do not break out how much mail was moved by Alaska Airlines' code-share partners, ERA Aviation and Peninsula Airways.

mainline carriers currently being used in the update methodology.” We will examine the issue of adding Express to the mainline pool in the future. In the meantime, because it does carry a great deal of mainline mail, we direct it to report T-100 and Schedule T-2 information consistent with that of the mainline carriers, so that we may be able to evaluate its impact on the other carriers.

New Rates

The proposed final rates, contained in Appendix A, reflect the application of cost adjustment factors, developed in Appendix B, to the basic mail rate structure established by the Civil Aeronautics Board in Order 82-11-23. We have used the carriers’ reported operating expenses for the YE 3/31/00, except for fuel costs that are now updated quarterly. Regarding fuel costs, the carriers’ quarterly fuel data is not due to be reported until mid-August. We have elected to issue this order now, rather than wait until those fuel costs are submitted, to afford the parties time to comment so that the rates set by Orders 99-9-13 and 2000-6-5 can be updated in a timely fashion. For comparison purposes, we have included first quarter 2000 fuel expenses in the linehaul portion. As usual, we have not inflated fuel costs, but have increased non-fuel linehaul and terminal unit costs to the mid-point of the new rate period, based on the long-term (ten-year) average annual changes in unit costs. For determining the long-term trend we have used the results of NAC and Alaska Airlines computed in the prior fashion, i.e., unweighted by amount of mail transported.

The proposed final rates differ from the final rates currently in effect by Orders 99-9-13 (annual update) and 2000-6-5 (latest quarterly fuel surcharge) by the amounts shown in the following table:

	Order 2000-6-5	Appendix A of this Order	Percent Change ¹⁴
Linehaul Charge per Priority	\$1.6706	\$1.8673	11.77%
Billing Ton-Mile: ¹⁵ Non-Priority	\$1.0114	\$1.1304	11.77%
Terminal Charge per Priority	\$.2519	\$.2612	3.69%
Pound Originated: Non-Priority	\$.2165	\$.2244	3.65%

The combination of the proposed linehaul and terminal charges above produces proposed rates for the QE 12/31/00 that are 8.59 percent higher than those in effect for the current period for a 463-mile average length of haul. As quarterly fuel costs change, the linehaul charge will change accordingly. Again, the values in above from Appendix A are pro-forma—they assume fuel costs for the quarter ended June 2000 will be the same as those used in Order 2000-6-5.

¹⁴ Difference in percentage change between priority and non-priority is due to rounding.

¹⁵ The proposed linehaul rates above for the year ending 9/30/00 are the sum of YE 3/31/99 non-fuel linehaul expense, with an inflation factor applied, plus uninflated fuel expense.

General Matters

In this order we are continuing to use the methodology first implemented in Order 98-7-3 to calculate a long-term moving average for changes in the mail rate, rather than the more volatile year-over-year determinations. The calculation of the long term moving average is shown in the regression in Appendix D. The results indicate that, on average over the last ten years, unit costs have increased annually by 2.28% for the non-fuel linehaul and 1.53% for the terminal element.

As shown above, the projected linehaul rate is 11.77% higher and the terminal is 3.69% higher than the current rates. We must focus on the non-fuel linehaul and terminal expenses, because fuel costs are not yet reported. As can be seen from Appendix C page 1, last column, had we not weighted ATMs by transported mail and excluded ACE, the non-fuel linehaul would have been \$.410992, rather than \$.419435. In other words, the addition of ACE and the weighting of costs by RTMs of mail transported by each aircraft type produces only 13.84% of the total non-fuel linehaul unit cost increase.¹⁶ For the terminal element, had we not weighted total tons enplaned by mail tons enplaned and excluded ACE, the terminal would have been \$300.22 (Appendix C, Page 1, last column). Including ACE and weighting by tons of mail therefore decreased the terminal unit cost to \$288.11.

It is clear that the addition of ACE works to reduce the rate. ACE's non-fuel linehaul costs per ATM of \$.297040 for its DC-6 aircraft, the bulk of its fleet, is significantly less than that for NAC's DC-6s. We note, however, that this effect of adding ACE will be diminished in the final result because ACE's fuel cost per ATM, at least for prior periods, were significantly higher than NACs, and the same can be said for the terminal.

It is not clear what has caused this large increase in NAC's and Alaska Airline's unit costs. It is clearly not just the new weighting of costs by amount of mail that has produced this increase, because Alaska Airlines' and NAC's non-fuel linehaul unit costs per ATM have increased by 10.9% and 31.8% respectively when calculated in the prior manner. Alaska Airlines has also indicated that it expects its linehaul costs to increase in the future due to increases in maintenance. For terminal expenses, Alaska's unit costs per ton enplaned have increased by 7.5% from the prior period and NAC's by 6.5%. With respect to the most recent large linehaul unit cost increases of 10.9% for Alaska and 31.8% for NAC, we would note that reasonably they should be juxtaposed with the small decrease in the prior year's mail rate. In other words, part of this year's large increase may reflect rebound from prior depressed levels. For the terminal element, the increase reflects a continued surge in terminal expenses experienced last year. We would finally note that the timely addition of ACE into the mainline cost pool works to constrain these cost increases of Alaska Airlines and NAC.

¹⁶ Non-fuel linehaul unit costs: \$.358447, 1999; \$.410992, 2000 costs for NAC and Alaska, unweighted by RTMs; \$.419435, 2000 costs for NAC, ACE, and Alaska, weighted by RTMs of mail. $$.419435 - $.358447 = $.060988$; $$.410992 - $.358447 = $.052545$; $$.052545 / $.060988 = 86.16\%$.

In addition, some of the issues discussed here in the context of the mainline may come under discussion later in the context of the bush update. We will therefore now afford parties to the bush proceeding the opportunity to comment as to how these issues would be applied to them. We wish to make it clear that our tentative decisions here do not indicate we are prejudging similar issues that may arise for the bush proceeding.

The Department tentatively finds and concludes that:

The fair and reasonable final non-fuel rates of compensation to be paid in their entirety by the Postmaster General pursuant to the provisions of 49 U.S.C. 41901 for the transportation of mail by aircraft having a payload exceeding 7,500 pounds, the facilities used and useful therefore, and the services connected therewith, by each holder of a certificate authorizing the transportation of mail by aircraft within the State of Alaska, for the period beginning October 1, 2000, or on the date of issue of a final Department order with respect to the rates proposed here, whichever occurs later, through September 30, 2000, or until further order of the Department, whichever occurs later, are those specified in the attached Appendix A, except as noted for fuel expense in Appendix B and C; and

ACCORDINGLY,

1. We direct all interested persons to show cause why the Department should not adopt the foregoing tentative findings and conclusions and fix, determine and publish the proposed final rates specified in Appendix A, except as noted for the fuel expense portion of the linehaul, for the period beginning either October 1, 2000, or on the date of issue of the final order pertaining to the rates proposed in Appendix A, whichever occurs later, through September 30, 2001, or until further order of the Department, whichever occurs later;
2. We direct all interested persons having objections to the tentative findings and conclusions or to the rates proposed here to file an objection along with all supporting documents within forty-five (45) days after the date of service of this order. Objections shall be served on all parties in Dockets 405 and 429. Vague or unsupported objections that do not include all proposed adjustments and backup data will not be accepted;
3. If no objection is filed within the designated time, or if a timely filed objection raises no material issue of fact, we will deem all further procedural steps waived. We then will enter a final order incorporating the tentative findings and conclusions set forth here and establishing the final rates specified in the attached Appendix A;
4. We direct Alaska Central Express to begin reporting T-100 information, i.e., Schedule T-2 traffic;

5. These dockets shall remain open until further order of the Department; and
6. We will serve this order upon all parties on the Service List for this Docket and in Docket 405.

By:

Francisco J. Sanchez
Assistant Secretary for Aviation
and International Affairs

(SEAL)

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The electronic version may not include all of the appendices

INTRA-ALASKA MAINLINE CLASS SERVICE MAIL RATES

Effective: October 1, 2000, through September 30, 2001, or until further Department action, whichever comes later.

	Base Year Rates <u>1/</u>	Adjustment Factors <u>2/</u>	Proposed		Change from Prior Rate
			Final Rates <u>3/</u>	Orders 2000-8-5 and 99-9-13	
			Linehaul Charge per Billing Ton-Mile		
Priority	\$1.1969	56.01%	\$1.8673	\$1.6708	11.77%
Non-priority	\$.7248	56.01%	\$1.1304	\$1.0114	11.77%
			Terminal Charge per Pound Originated		
Priority	\$.1697	53.89%	\$.2612	\$.2519	3.69% <u>4/</u>
Non-priority	\$.1458	53.89%	\$.2244	\$.2185	3.65% <u>4/</u>

1/ Per Order 82-11-23

2/ See Appendix B

3/ Column (1) increase by Column (2).

4/ Differences due to rounding.

Note: The numbers in bold are included for comparison purposes only. Linehaul costs, composed of both fuel and non-fuel elements, can not be computed until second quarter fuel costs are submitted.

INTRA-ALASKA CLASS SERVICE MAIL RATES COST ADJUSTMENT FACTORS
(Expenses in Thousands of Dollars)

Unit Cost per Available Ton-Mile	Base Year Ended	Year Ended	Average Annual Change	Midpoint to Midpoint Change	Estimated Unit Cost at	Percent Change 1980 Base Year to
Fuel		\$ 189296 7/	Inflation Not Applicable to Fuel		\$ 189296	
Nonfuel		\$ 419435 8/	2.28%	3.45%	\$ 433906	
Total		\$ 608731 9/			\$ 623202	56.01%
Unit Cost per Ton Explained (App. C)	\$191.54	\$288.11	1.53%	2.31%	\$294.77	53.89%

1/ Per Order 82-11-23, updated most recently in Order 97-12-24.

2/ See Appendix C.

3/ See the regression results in Appendix D. As indicated in Order 97-9-37, we will rely on the most recent fuel costs, and apply no inflation factor to those costs. Also, these are trends for Alaska and NAC, and exclude ACE.

4/ Reflects the fact that from the mid point of the reporting period to the midpoint of the prospective rate is 1 and 1/2 years.

1.0228 x 1.0114; where 1.0114 is the average annual unit cost increase projected for a 6-month period.

1.0153 x 1.00765; where 1.00765 is the average annual unit cost increase projected for a 6-month period.

5/ Fuel, most recent unit costs of \$ 189296; Non-fuel linehaul \$ 419435 x 1.0345; Terminal, \$288.11 x 1.0231.

6/ \$ 623202 in preceding column divided by \$ 399469 in the base period, and \$294.77 in the preceding column divided by \$191.54 in the base period.

7/ Fuel cost per available ton-mile is the same as in Order 2000-6-5. This number is included for comparison purposes only.

8/ Per Appendix C.

9/ Includes first quarter fuel, and the total is therefore for comparison purposes only, while we await the second quarter fuel submission.

Note: Numbers in bold are for comparison purposes only, since second quarter fuel has not been submitted yet.

Intra-Alaska Class Service Mail Rates--Year Ended March 31, 1999
Aircraft Operating Expenses in Scheduled Service

	Alaska Airlines (AS)		Northern Air Cargo (NAC)		(L-T Trend) Alaska and NAC Total
	#621_B-737-2C	#655_MD-80	#111_B-727	#216_DC-6 Hercules	
Domestic Non Fuel Linehaul	\$56,718,000	\$251,551,000	\$8,719,047	\$522,688.41	\$546,665,488
Intra-Alaska Skd. Block Hours	18,911	9,113	2,311	191	39,006
Domestic Total	26,886	166,594	2,440	191	355,662
Intra-Alaska Non-Fuel Linehaul Expense	\$39,894,149	\$13,760,305	\$8,258,081	\$522,688	\$72,587,702
Intra-Alaska Skd. Available Ton-Miles	89,330,589	45,713,885	14,758,995	1,191,734	176,615,995
Unit Cost per ATM, Non-Fuel Linehaul	\$446590	\$301009	\$559529	\$438595	\$410992
As-flown, Intra-Alaska KTMs of Mail	6,827,754	1,214,475	3,238,605	156,313	15,338,139
ATM Percent of Total	33.62%	5.98%	15.95%	0.77%	75.52%
Wtd. Cost per ATM, Non-Fuel Linehaul	\$0.150144	\$0.018000	\$0.089245	\$0.080371	

LINEHAUL COSTS

TERMINAL COSTS

A/C & Traffic Svc., #6900
System Tons Expended

\$47,844,438
158,235
\$302.36

Intra-Alaska Skd. Svc., Expenses
Intra-Alaska Skd. Svc., Tons Exp.
Unit Cost per Ton Expended

Alaska Tons of Mail Expended
Mail Tons Expended, % of Total
Wtd. Cost per Ton Expended

\$10,551,697
36,294

\$10,415,345
35,825
\$290.73

14,535
31.62%
\$91.93

\$58,259,783
194,060
\$300.22

34,804
75.71%

1/ Of \$631,800 of NAC's Hercules total directs (wet-lease), \$522,688 is allocated to Non-Fuel Line Haul on the basis of Lynden's ratio of fuel to total linehaul expense.

Intra-Alaska Class Service Mail Rates - Year Ended March 31, 2000
Aircraft Operating Expenses in Scheduled Service

	Talonduk (ACE)		Grand Total
	150, C-46	216, DC-6	
LINEHAUL COSTS			
Domestic Non-Fuel Linehaul	\$207,497	\$4,200,053	\$4,407,550
Intra-Alaska Skd. Block Hours	592	6,763	7,355
Domestic Total	592	6,763	7,355
Intra-Alaska Non-Fuel Linehaul Expense	\$207,497	\$4,200,053	\$4,407,550
Intra-Alaska Skd. Available Ton-Miles	485,718	14,139,674	14,625,392
Unit Cost per ATM, Non-Fuel Linehaul	\$,427196	\$,297040	(\$,301363)
As-Flown, Intra-Alaska RTMs of Mail	162,178	4,810,411	4,972,589
RTM Percent of Total	0.80%	23.68%	24.48%
Wtd. Cost per ATM, Non-Fuel Linehaul	\$0.003418	\$0.070319	
			\$76,995,252
			\$553,073,038
			\$46,361
			\$363,017
			\$191,241,387
			\$,402608
			\$20,310,728
			100.00%
			\$0.419435

TERMINAL COSTS

A/C & Traffic Svc., #6900	\$5,034,396		\$63,294,179
System Tons Explained	19,450		213,510
Intra-Alaska Skd. Svc., Expenses	\$5,034,396		\$296.45
Intra-Alaska Skd. Svc., Tons Exp.	19,450		
Unit Cost per Ton Explained	\$258.84		
Alaska Tons of Mail Explained	11,165	21	45,969
Mail Tons Explained, % of Total	24.29%		100.00%
Wtd. Cost per Ton Explained	\$62.87		\$288.11

If 11,982 reported scheduled tons of mail explained. We have reduced AC's weighting by a factor of 93.18%, to reflect that 6.82% of scheduled weighted departures were conducted with bush aircraft.

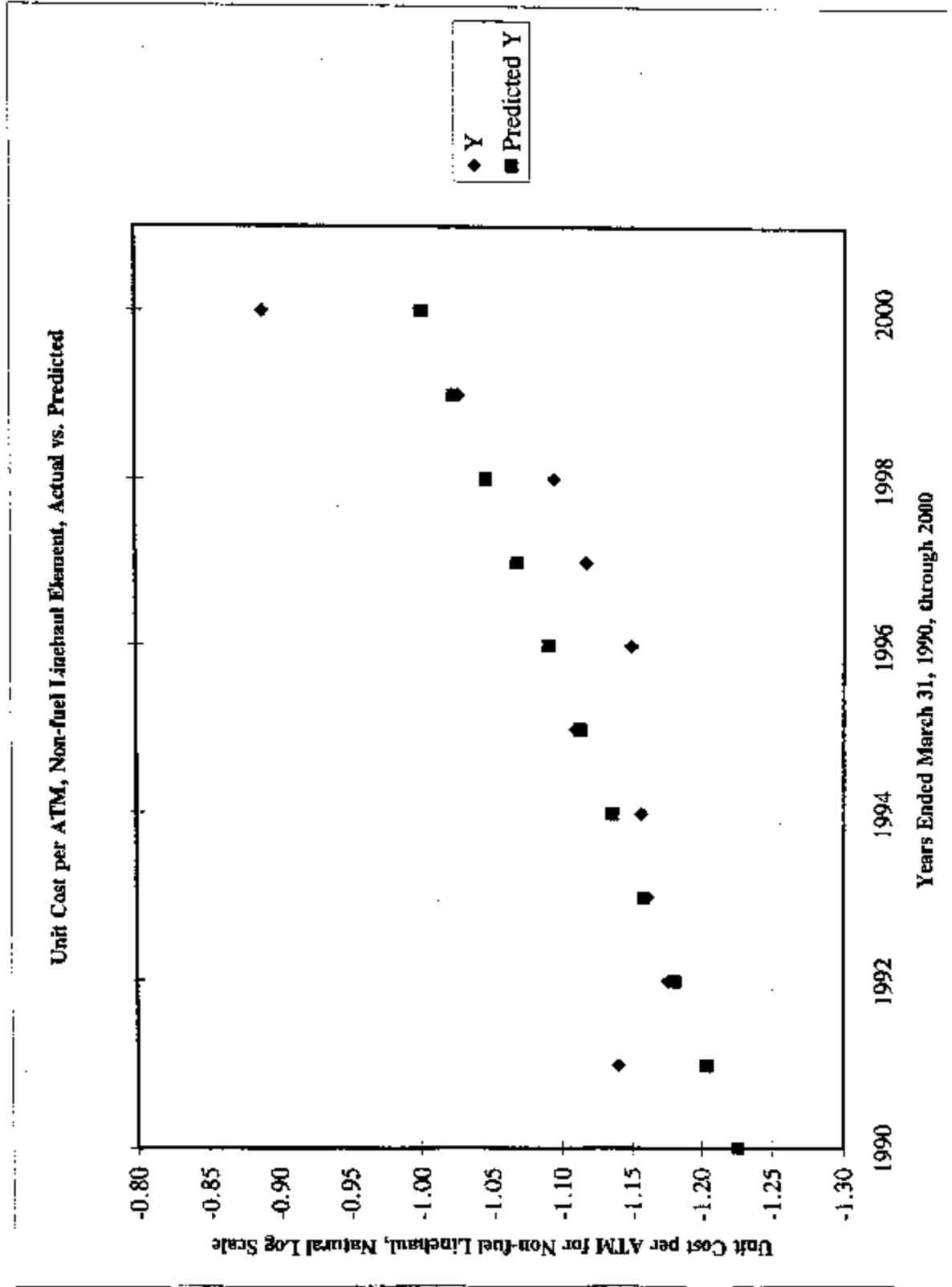
Calculation of Linehaul Portion of the Ten Year Trend

YE 3/31/	Order Number	Actual Y		Predicted Y		Residuals	Y_(EXP)	Annual % Increase
		\$/ATM	Non-Fuel Linehaul	\$/ATM	Non-Fuel Linehaul			
1990	93-1-19	\$0.293476	-1.225959	-1.22584664	-0.0001124	\$0.293509	2.28%	
1991	93-2-26	\$0.319788	-1.140097	-1.20330969	0.06321269	\$0.300199		
1992	94-12-25	\$0.308645	-1.175564	-1.18077275	0.00520875	\$0.307041		
1993	95-6-17	\$0.313231	-1.160814	-1.1582358	-0.0025782	\$0.314040		
1994	95-8-8	\$0.314536	-1.156657	-1.13569885	-0.0209581	\$0.321198		
1995	96-7-8	\$0.329670	-1.109663	-1.11316191	0.00349891	\$0.328519		
1996	97-6-27	\$0.316760	-1.149611	-1.09062496	-0.058986	\$0.336006		
1997	97-6-27	\$0.327227	-1.117101	-1.06808802	-0.049013	\$0.343665		
1998	98-7-3	\$0.334821	-1.094159	-1.04555107	-0.0486079	\$0.351498		
1999	99-7-16	\$0.358447	-1.025974	-1.02301413	-0.0029599	\$0.359510		
2000	App. C	\$0.410992	-.889182	-1.00047718	0.11129518	\$0.367704		
	I/	2/	3/	4/	5/	6/	7/	

Regression Statistics
Multiple R 0.8305619
R Square 0.689833
Adj. R Squar 0.65537
Std. Error 0.0528319
Observations 11

ANOVA	df	SS	MS	F	Significance		
						P-value	Lower 95%
Regression	1	0.0558705	0.0558705	20.0166264	0.00154574		
Residual	9	0.0251209	0.0027912				
Total	10	0.0809914					
	Coefficients	Std. Error	t Stat	P-value	Lower 95%	Upper 95%	
	Intercept	-46.074368	10.049468	-4.5847571	0.00131884	-68.807861	-23.340875
	X Variable	0.0225369	0.0050373	4.4739945	0.00154574	0.01114173	0.0339322

- 1/ Order number from which data is drawn.
- 2/ Non-fuel linehaul expense per the orders and Appendix C of this order.
- 3/ The natural log of the preceding column.
- 4/ The Y value, in natural log form, produced by the regression.
- 5/ The difference between predicted and actual, in the two preceding columns.
- 6/ The predicted Y value in the preceding column, converted back from natural log form.
- 7/ From the preceding column, any lower value divided by the above value.



Calculation of the Terminal Portion of the 10-Year Trend

YE 3/31	Actual Y		Natural Log		Terminal Predicted Y	Residuals	EXP(Y)	Annual Increase
	Order Number	\$/Ton Emp.	Terminal	Terminal				
1990	93-1-19	\$224.13	5.412226	5.4782762	-0.066050182	\$239.433611	0.583767	
1991	93-2-26	\$244.68	5.499951	5.4934615	0.006489527	\$243.097227	0.3407839	
1992	94-12-25	\$254.70	5.540086	5.5086468	0.031439236	\$246.816899	0.2675376	
1993	95-6-17	\$275.00	5.616771	5.5238321	0.092938945	\$250.593488	0.0738368	
1994	95-8-8	\$278.97	5.631104	5.5390173	0.092086655	\$254.427862	11	
1995	96-7-8	\$252.48	5.531332	5.5542026	-0.022870636	\$258.320907		
1996	97-6-27	\$235.13	5.460139	5.5693879	-0.109248927	\$262.273520		
1997	97-6-27	\$244.69	5.499992	5.5845732	-0.084581218	\$266.286612		
1998	98-7-3	\$261.63	5.566931	5.5997585	-0.032827509	\$270.361110		
1999	99-7-16	\$279.55	5.633181	5.6149438	0.0182372	\$274.497952		
2000	App. C	\$300.22	5.704516	5.6301291	0.074386909	\$278.698093		
	1/	2/	3/	4/	5/	6/	7/	

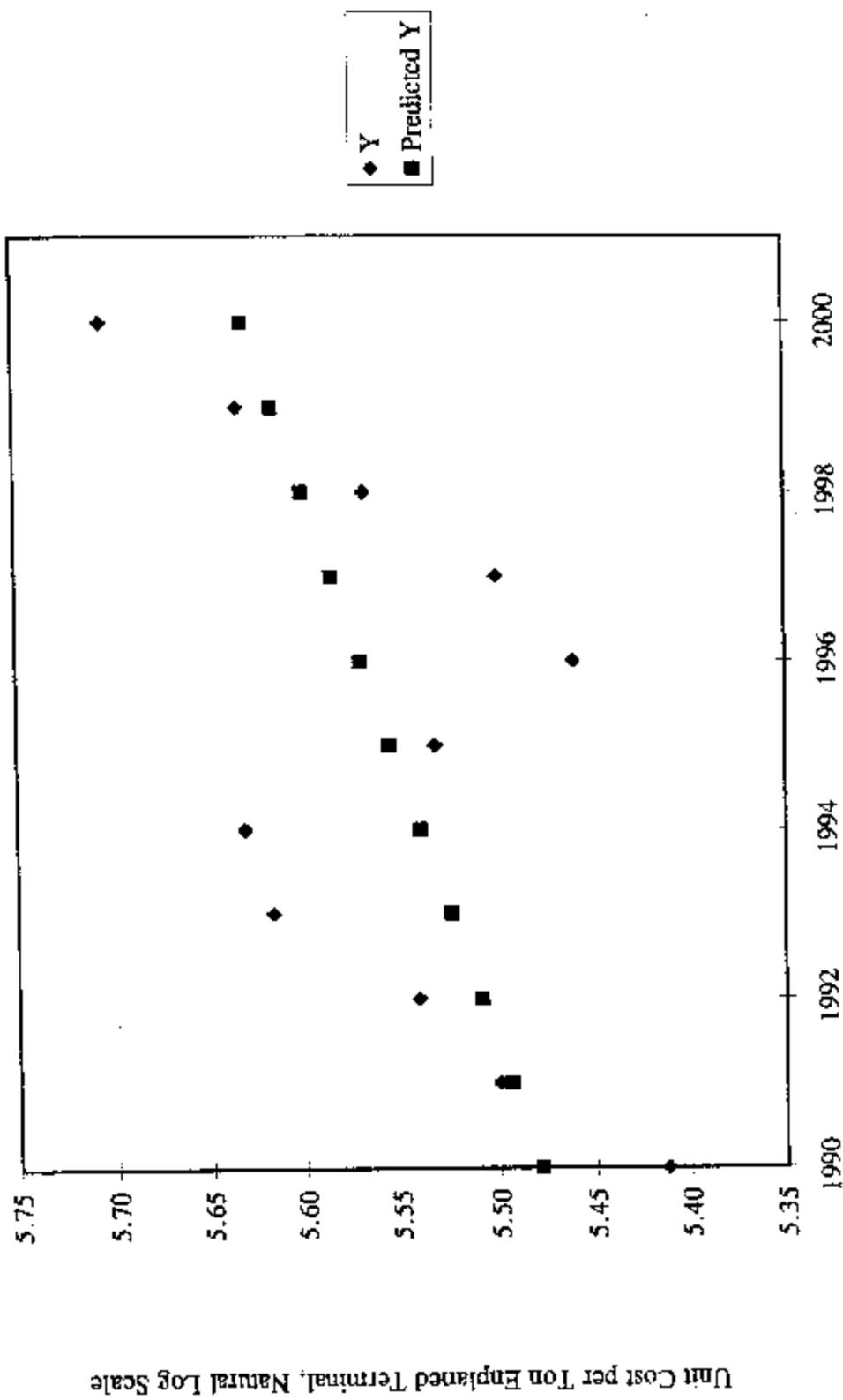
ANOVA	df	SS	MS	F	Significance F
Regression	1	0.0253652	0.0253652	4.6525788	0.059358188
Residual	9	0.0490668	0.0054519		
Total	10	0.074432			

Coefficients	Std. Error	t Stat	P-value	Lower 95%	Upper 95%	
Intercept	-24.7404527	14.044934	-1.7615215	0.1119935	-56.51232443	7.03141897
X Variable 1	0.015185291	0.0070401	2.1569837	0.0593582	-0.000740439	0.031111021

1/ Order number from which data is drawn.
2/ Terminal expense per the orders and Appendix C of this order.
3/ The natural log of the preceding column.
4/ The Y value, in natural log form, produced by the regression.
5/ The difference between predicted and actual, in the two preceding columns.
6/ The predicted Y value in the preceding column, converted back from natural log form.
7/ From the preceding column, any lower value divided by the above value.

Calculation of the Terminal Portion of the 10-Year Trend

Unit Cost per Ton Explained, Terminal Element, Actual vs. Predicted



Year Ended March 31, 1990 through 2000