

116069

ORDER 2000-11-9



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

Issued by the Department of Transportation  
on the 13<sup>th</sup> day of November, 2000

Served: November 16, 2000

INTRA-ALASKA MAINLINE  
SERVICE MAIL RATES

Docket OST-95-429 -126  
(Docket 38961)

**ORDER ESTABLISHING FINAL MAINLINE SERVICE MAIL RATES**

**Summary**

By this order the Department is setting new final intra-Alaska mainline mail rates effective October 1, 2000, through September 30, 2001. The rate is based on traffic and costs for the year ended March 31, 2000, except for fuel, where consistent with Order 99-12-15, in response to dramatic fuel price increases, we decided to update the fuel portion of the linehaul quarterly. The rates currently in effect were extended as interim rates by Order 2000-9-27, effective October 1.

The order adopts the costing methodology tentatively established by Order 2000-8-14, but makes several significant adjustments. First, because the quarter ended June 30, 2000, fuel costs have now been reported, we will incorporate them in this order.<sup>1</sup> Next, we are incorporating Northern Air Cargo's (NAC) revised financial numbers. We are also excluding Air Cargo Express's (ACE) linehaul costs from the cost pool because we have now found them to be unreliable. Finally, we will include Lynden Air Cargo's (LAC) linehaul costs.

**Background**

By Order 2000-8-14 the Department tentatively proposed a methodological change to our annual mainline mail update by weighting linehaul costs by the amount of mail transported by each carrier's aircraft type and terminal costs by the amount of mail each carrier enplanes. In addition, for the first time we tentatively included ACE's costs, terminal and linehaul, because it carries a significant amount of mainline mail. That order tentatively excluded LAC from the cost pool because it found their terminal costs

<sup>1</sup> When the show-cause order issued, we used the quarter ended 3/31/00 fuel costs for illustrative purposes because the June quarter had not yet been reported. Also, those fuel costs were not weighted by amount of

(though not their linehaul costs) did not properly reflect their intra-Alaska operations. That order also required Alaska Central Express (Express) to begin reporting T-100 information so the Department could examine the appropriateness of including them in future mainline mail rates, in view of the large amount of mainline mail this carrier operating bush-size aircraft transported. On September 22 the Postal Service answered Order 2000-8-14. On September 29, the carriers filed a motion for permission to reply to the Postal Service. In view of the importance of the matter and the promptness of their response, we will accept their reply. A number of issues have been raised, and we will address them below.

### **The Department Should Have Held Informal Meetings Among the Parties to Reach Consensus**

The Postal Service stated that the Department failed to meet with the parties to arrive at a consensus:

“In the past, the Department has attempted to base policy decisions on a relative consensus....With respect to the current Order (2000-8-14), the Department has provided notice and opportunity for comment, but has not allowed for an open forum to discuss the methodological change in the update procedure prior to the implementation of the Order.

The Postal Service asserts that when introducing a major change in the update methodology that clearly prejudices either party, it is the responsibility of the Department to bring the parties together to discuss such a change prior to issuing temporary mail rates.”<sup>2</sup>

Disposition This issue is now moot. The Postal Service by correspondence dated October 3 indicated that it did not wish to meet with the carriers to try to reach a consensus on this issue.

### **Weighting by Amount of Mail Carried is Inconsistent with the Statutory Requirement That Facilities Useful For Carriage of Mail be Included**<sup>3</sup>

In their initial March 10 petition, the carriers had argued that statutory language for including the cost of facilities “used and useful for” the transportation of mail favored the weighting of costs by mail transported. The carriers remained largely silent on this issue in their most recent joint reply on September 29.

The Postal Service contends that weighting linehaul costs by mail Revenue Ton Miles (RTMs) of each aircraft type conflicts with the statutory requirement that rates reflect the costs of the “facilities used in **and useful for**”<sup>4</sup> the transportation of mail. It contends that by definition, facilities useful for are available for use even if not specifically put to use at any particular time. Weighting of costs by mail RTMs is not permitted because it

---

<sup>2</sup> Answer of Postal Service, September 22, 2000, page 2.

<sup>3</sup> 49 U.S.C Sec. 41901, *et seq.*

<sup>4</sup> Answer of Postal Service, September 22, 2000, page 2.

captures the facilities used in but not necessarily the additional facilities useful for transportation of mail.

Disposition We believe that if assets or facilities are not used for the transportation of mail, there is a presumption against recognizing their costs. We do not recognize any of the cost of operations outside Alaska when setting rates even though such capacity could be readily flown to Alaska and become available if the need arose. Weighting of costs by the frequency and amount of use, the primary issue in this update, is a recognized costing principle and is, as the carriers contend, appropriate in the Alaska mail context. Under the Postal Service's construction, the Department could determine mail rates by ignoring the cost of the aircraft and facilities actually moving the mail and instead recognize the cost of aircraft and facilities that *could* be used to carry mail. <sup>5</sup>

The correct construction of the phrase "used and useful" follows from the conjunction of the two terms. The carriers emphasize the first word in the phrase while the Postal Service emphasizes the last. Because of the conjunction, the word useful constrains the word used. If an asset is used in the transportation of mail but is not useful, its costs should be excluded from determining the rate. This protects the Postal Service. For example, we exclude flight attendant costs from the rate calculation, even though they are used on all of AS' combi-aircraft flights because they are not useful for the movement of mail. More generally, if carriers attempted to manipulate the rate by using assets clearly not useful for moving the mail, we would exclude those costs. <sup>6</sup> We thus believe that our construction is consistent with the statute.

### **Weighting by Amount of Mail Carried Discourages Efficiency**

The Postal Service repeated its earlier pleadings that weighting carrier costs by mail carried, especially linehaul costs by aircraft-specific RTMs of mail, would encourage carriers to manipulate the rate by using their most expensive aircraft to move the mail, since mail rates would thereby be increased over time. The Postal Service contends that adopting the new methodology would discourage carriers from replacing their older aircraft with more efficient aircraft, especially aircraft designed like the B-737-200 to carry proportionally more mail, because the influx of such new, efficient, mail-friendly aircraft would decrease the overall mail rate more than the current methodology. <sup>7</sup>

---

<sup>5</sup> See our discussion of the addition of Express in this order.

<sup>6</sup> This is a less stringent regulatory standard than the one requiring that only costs incurred by "honest, economical, and efficient" management be recognized. Under the "used and useful standard," costs mistakenly incurred by carriers in good faith would be included in cost calculations; under the "honest, economical and efficient standards" they would be excluded.

<sup>7</sup> The Postal Service's argument is as follows. B-737-200 combi aircraft currently carry the bulk of AS's mail because of their mail-friendly design. However, due to their age they are becoming increasingly expensive to operate. When deciding whether or not to replace those aircraft with similar but less-expensive-to-operate new aircraft, AS would have less incentive re-equip under the mail-weighting methodology because more mail presumably would continue to be assigned to the new aircraft and their lower costs would be more fully reflected in the rate. The new methodology would make the re-equipment decision more problematic for management.

The carriers restate some of their earlier arguments. AS already carries the most mail on its higher unit-cost B-737-200 aircraft, not to drive up the mail rate, but because it, unlike the other aircraft types, is “the optimal aircraft to accommodate the combined needs of Alaska’s three principal sources of revenue...-[and] Alaska’s other aircraft lack the belly capacity and adjustable interiors best-suited to transport”<sup>8</sup> mail. Among the other carriers, LAC will not be able to manipulate the rate by moving mail on more expensive aircraft because they have only one aircraft type, while ACE has only a single mainline aircraft, other than its fleet of DC-6s. NAC alone has a fleet mix (DC-6s and B-727s) that would theoretically allow it to change its current policy and carry more mail on its higher unit-cost aircraft type and so manipulate the rate.<sup>9</sup> The carriers continue to maintain that it would make no sense in the real world for them to intentionally increase the costs they incur individually in the hope that perhaps a year-and-a-half later those costs would be recovered as a rate increase shared among all carriers.

Disposition The Postal Service’s arguments against the weighting methodology reflect what it sees as currently expensive service with the prospect of even further cost increases. The Postal Service expects its costs to increase further in the future even without a change in methodology because of increased costs of AS’s 737 and NAC’s 727 maintenance and inspections due to new FAA-mandated requirements for those aircraft types. DC-6’s, B-737-200’s, and B-727-100’s currently move the bulk of mainline mail but they are old aircraft and will require increasing maintenance. This will only aggravate the current situation where, in 1999, the Postal Service states it paid an average of \$967 to move a ton of mail 463 miles in Alaska but only \$665 in the lower 48 to move it an average of 1,320 miles.

The Postal Service in its objection on September 22 did not respond to the several theoretical difficulties raised in the order militating against carriers’ manipulating the rate for their gain, i.e., a carrier manipulating its costs would directly and immediately<sup>10</sup> bear those costs by itself but would share the resulting rate increase, after a lag, with all other parties moving that category of mail. In addition, historically AS has moved the bulk of its mail on its higher unit-cost aircraft, the B-737-200, because its belly capacity and adjustable interiors make it the optimal choice for carrying mail, not to increase the reimbursement rate in the future.

The Postal Service modified its position slightly. It argues that adopting the new costing methodology might discourage carriers from readily replacing their older, more expensive aircraft.<sup>11</sup> Whatever the theoretical merits of this more refined position, it is the

---

<sup>8</sup> Carriers’ joint reply, September 29, 2000, page 9.

<sup>9</sup> NAC’s position is the opposite of AS in that Alaska currently carries most of its mail on its highest cost aircraft in the face of a costing methodology that does not weight for this effect.

<sup>10</sup> The carriers point out that the mail rate may recognize cost increases initially borne by the carriers after up to a 18-month lag.

<sup>11</sup> If the Postal Service in fact begins to modify its equitable tender policy to tender more mail to the least costly aircraft operator, there would clearly be an enhanced incentive for a carrier to buy new, cheaper aircraft, because it would thereby garner a greater share of the mail.

Department's responsibility in setting mail rates to fairly compensate the carriers for the current cost of moving the mail.<sup>12</sup> To not weight carrier costs by mail carried would ignore the greater cost of AS's B-737-200 equipment compared to its other less expensive jets that carry relatively little mail. The B-737-200 is the only combi-jet aircraft in operation designed for moving large volumes of passengers, mail, and freight. Moreover, although incentives to re-equip might be slightly diminished under the proposed change, real incentives would remain, because although mail is an important part of intra-Alaska traffic, it is far from the only part, at least for most carriers. Carriers that re-equipped and flew aircraft with lower unit costs<sup>13</sup> could lower passenger or cargo yields below levels that operators of older equipment could not match.

#### **Carrier's Reported Costs Were Overstated**

The Postal Service also felt that the cost increases experienced by NAC and AS were unreasonably high compared to the prior period. It noted that NAC's DC-6 unit cost per ATM were 50% greater than ACE's, and that NAC's B-727 unit costs had increased 58.5% from those in the preceding period.

Disposition As the carriers have stated, NAC has submitted revised data, with its costs substantially below previous levels, such that its non-fuel linehaul costs decrease by 20.9% for its B-727-100 and 9.3% for its DC-6s from those previously reported. The Postal Service's concern with NAC's reported costs were based partly on comparing their costs to ACE's much lower costs. ACE's reporting is currently being reviewed on-site by our Alaska Inspector. Although it is at least several months until the review can be completed, our inspector informs us that ACE greatly understated its maintenance expense because it only included maintenance labor expense in that account. When this correction is made, it is likely that NAC's and ACE's non-fuel linehaul costs will be more comparable, as their fuel and terminal unit costs are already. We have closely reviewed AS's linehaul expenses and it is clear that the increase in expense from the prior period is in the maintenance expense area, as the carrier had indicated, where maintenance costs per hour for its B-737-200s for the year ended March 31, 2000, increased 26.6% from the year before, while unit costs per hour for other non-fuel linehaul expenses actually decreased by 1.5% from the prior year. We anticipate that AS's total unit costs will not diminish significantly in the next annual update, notwithstanding the fewer number of D Checks it projects, as the carrier continues to work with the FAA to resolve some maintenance issues. For NAC, after the revisions made by the carrier, there were modest increases in hourly costs for the DC-6 of 3.5% from the prior year, while B-727-100 unit costs still increased by 25.4% from the prior year. In fact, as can be seen from Appendix C, NAC's B-727's unit cost per ATM for its non-fuel linehaul now exceeds that for its DC-6s.

---

<sup>12</sup> We also have a responsibility to ensure that appropriate incentives are in place. We continue to believe they are with the new weighting methodology. While under the class-rate system the entry of new, less expensive aircraft drives costs and subsequently rates down, arguably reducing somewhat the incentive to be efficient, in a free market when carriers buy new aircraft they also put pressure on prices with their reduced costs.

<sup>13</sup> All other things being equal, the savings associated with the new aircraft's decreased maintenance and fuel costs would have to exceed the increased ownership costs of the new aircraft.

### **New Equitable Tender Policy**

Finally, the Postal Service indicates that “especially in light of weighting unit costs by [amounts of mail carried by] aircraft” it would advocate a mail tender system that would award more mail to carriers with lower costs, while ensuring that higher cost carriers would get some share of the mail. The Postal Service would “work with the Department to develop the most appropriate way to determine how a total unit cost will be calculated...and ensure that all markets receive adequate service and that no carrier continually dominates markets as part of implementing such a system.”<sup>14</sup> The Postal Service contends that by modifying its current equitable tender policy along these lines, not only would it reduce its costs when the next rate was established,<sup>15</sup> but it would maintain the incentive of carriers to replace their older aircraft with newer, less expensive aircraft that the proposed costing methodology threatens.<sup>16</sup>

The carriers found the Postal Service’s proposal to replace “the longstanding fair and equitable tender system” with one providing more mail to the lowest unit cost carrier in individual markets to be ill-conceived. They maintained that this approach “would require a revision of the existing mail transportation statute in addition to destabilizing the critically important intra-Alaska air transportation network.”<sup>17</sup> According to the carriers, “there are only two conditions precedent for a carrier to be eligible for an equitable tender, i.e., the carrier must have operated for one year in the intra-Alaska markets and the carrier must publish schedules showing no fewer than three weekly frequencies in a particular city-pair market.”<sup>18</sup> They argue that the Postal Service’s proposal to tender mail on the basis of lowest unit costs would be merely a form of bidding, and that this sweeping change would be inconsistent with existing law.

Disposition The Department has long recognized that the Postal Service has both the primary authority and responsibility to determine the tender of mail under its statute and regulations. There is, however, some overlap of authority. As the Civil Aeronautics Board (CAB) noted in Order 83-3-7, Section 405(a) of the Act states that “The Postmaster General is authorized to make such rules and regulations, not inconsistent with the provisions of this Act, or any order, rule, or regulation made by the [Department] thereunder, as may be necessary for the safe and expeditious carriage of mail by aircraft.” In that order the CAB stated that it did not want “to unilaterally change the Postal Service’s policies and regulations...for which we have no statutory authority, but only to review these dispatch policies for consistency with the Federal Aviation Act” under section 41901 *et seq* of that Act.

---

<sup>14</sup> Answer of Postal Service, September 22, 2000, page 5.

<sup>15</sup> Assuming that rates were determined by mail-weighted costs, giving more mail to lower cost carriers would reduce the rate in the subsequent year.

<sup>16</sup> It should also be noted that such a mechanism could provide incentives for carriers to understate their costs, because lower costs would ensure the carriers received proportionately more mail.

<sup>17</sup> Carriers’ joint reply, September 29, 2000, page 5.

<sup>18</sup> Carriers’ joint reply, September 29, 2000, page 11.

The carriers maintain that the proposed Postal Service proposal is patently outside its statutory bounds. The Postal Service while advocating the new tendering system states that it will work with the Department to ensure that all markets receive adequate service and that no carrier continually dominates markets as part of implementing such a system. The issue is outside the scope of our proceeding here. We welcome the Postal Service's recognition that the Department's authority does have some overlap with this issue and their assurances that they will work with the Department to ensure that any modified tender system is "not inconsistent" with section 41901 of the Act.

#### **Addition of New Carriers**

Finally, the Postal Service notes that it is not concerned with the Department's anticipated addition of two new carriers, ACE and LAC, provided that their costs are reliable. However, it would oppose the addition of Alaska Central Express (Express) to the mainline cost pool because it only operates bush aircraft.<sup>19</sup> To be included in the mainline cost pool, the Postal Service argues the carrier must have mainline-size equipment having mainline-type costs and route characteristics. In fact, the Postal Service urges the Department to include Express in its bush mail cost pool since the carrier only operates bush aircraft. The Postal Service indicates it is actively reviewing its reliance on Express's lift for mainline mail.

The carriers do not disagree with the Postal Service's preference for including LAC and ACE. They maintain that the Postal Service's opposition to the inclusion of Express, even though it carries more mainline mail than LAC, indicates that the Postal Service merely favors actions which will reduce the mail rate it must pay.

Disposition We will not add Alaska Central Express to the mainline pool and no party recommends that we do so at this time, at least partly because we do not have the required data. We will not add Express to the bush pool because they carry very little bush mail. Because Express is able to compete in mainline markets with bush equipment, it appears that its costs may be more reflective of mainline than bush operations. By offering frequent service in large markets the carrier can reduce its terminal costs to mainline levels by fully utilizing its terminal and linehaul assets. Indeed, including Express in the bush pool would be inconsistent with our new costing methodology.

Whether to add Express to the mainline pool is a more difficult issue. If Express's increased mainline market share continued to grow it would be impossible to determine mainline mail rates, because other mainline carrier's costs would be weighted at zero (for carrying no mail) while Express's costs would be excluded. This example illustrates the need at some point to either include Express if it continues to grow or to modify our class rate system. In the event Express's share of mainline mail stabilizes or were expected to diminish over time, we would be less inclined to add them to the mainline cost pool. The Postal Service has apparently notified Express that it will no longer tender it mail in

---

<sup>19</sup> Bush aircraft are defined as those having a payload of 7,500 lbs. or less. Order 89-7-51 increased the threshold to its current level from 7,000 lbs.

certain mainline markets because it has determined that such tender is not beneficial to the Postal Service. We will monitor this development closely.

We have modified Order 2000-8-14 by including LAC's linehaul costs and excluding ACE's linehaul costs. Order 99-7-16 indicated that we would explore adding LAC and ACE because adding their data to the cost pool would make the update more representative of the system. It has been more than a year since we issued that order. There is no good basis for excluding them now. In view of our exclusion of ACE's linehaul costs, the comparable amount of mail that ACE and LAC transport, and our desire to have a representative sample of carriers, and the fact that we are in a transition period to including all of each carrier's expenses, we will include ACE's terminal expenses and LAC's linehaul expenses. We direct the carriers to work closely with the staff so that they may be fully included in the next update. We note that this may require them to revise information already submitted beginning with the QE June 30, 2000.

#### **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. 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 reported results of NAC and AS 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:

		<u>Prior Rates</u>	<u>Appendix A of this Order</u>	<u>Percent Change</u> <sup>20</sup>
Linehaul Charge per	Priority	\$1.6706	\$1.9129	14.50%
Billing Ton-Mile:	Non-Priority	\$1.0114	\$1.1151	14.50%
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 10.23 percent higher than those in effect for QE 9/30/00 for a 463-mile average length of haul. As quarterly fuel costs change, the linehaul charge will change accordingly.

<sup>20</sup> Difference in percentage change between priority and non-priority is due to rounding.

<sup>21</sup> 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**

We have excluded the costs of AS's 737-700s, NAC's wet-leased Hercules aircraft, and LAC's wet-leased DC-6s. These aircraft types were not operated by the carriers during both the YE 3/31/00 period used for calculating the non-fuel cost and the QE 6/30/00 used for calculating fuel cost components of the linehaul. AS's B-737-700 only began operating in Alaska in the QE June, while NAC's and LAC's wet-leased aircraft were used very slightly in the YE March but not at all in the QE June. Because the presence of these various aircraft was *de minimis* in one period and totally absent in the other, we will exclude them completely.

In this order we are continuing 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 Appendix E and the regression in Appendix D. In calculating the long-term trend we have excluded LAC's and ACE's results and have not weighted AS's and NAC's costs by the amount of mail transported. In other words, in calculating long-term trends we are consistent over time because we have changed neither carriers nor methods. When sufficient time has passed that we can determine a long-term trend consistent with the addition of these two carriers and this methodological change, we will do so.

The results of the long-term trend indicate that, on average over the last ten years, unit costs have increased annually by 2.12% for the non-fuel linehaul and 1.53% for the terminal element. While these long-term increases are in line with general inflation, it is readily apparent by examining the regression plots in Appendix D that there has been an acceleration of terminal and linehaul unit cost increases over the last several years. For example, non-fuel linehaul costs for NAC and AS, computed without any changes in weighting, increased by 7.1% during the year ended March 31, 1999, and 10.8% in the most recent year. Similarly, terminal costs increased by 6.8% during the year ended March 31, 1999, and an additional 7.4% in the following year.

As can be seen from Appendix D, which only includes the costs of AS and NAC and are not weighted by amount of mail carried, unit costs for the linehaul increased by 10.8% and for the terminal by 7.4%. In addition to the usual changes in unit costs, the results are also affected by our adding carriers and making methodological changes in this order. On the terminal side, it is clear that the addition of ACE's terminal costs and the weighting of costs by amount of mail enplaned work together to moderate the increase in the terminal charge. Not only is ACE the lowest cost carrier, but it enplanes more mail as a percentage of its intra-Alaska operation than any other carrier in the pool. For the linehaul side, LAC's total linehaul expenses of \$.57077 per ATM were almost identical to those of other carriers combined of \$.573956. Thus, the additional increase in the linehaul rate of 14.5% vs. a 10.8% increase in unit linehaul costs is attributable to the weighting of costs by amount of mail carried, not to the inclusion of LAC.

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 wish to make it clear that

our 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 make final the above findings and conclusions, effective October 1, 2000;
2. The fair and reasonable final 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 therefor, and the service connected therewith, by each holder of a certificate authorizing the transportation of mail by aircraft within the State of Alaska for the period October 1, 2000, through September 30, 2001, or until further order of the Department, whichever occurs later, are those specified in the attached Appendix A;
4. This docket will remain open until further order of the Department;
5. We shall serve this order upon parties on the Service List for this Docket;
6. These rates are in lieu of, and not in addition to those interim rates set by Order 2000-9-27; and
7. 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)

INTRA-ALASKA MAINLINE CLASS SERVICE MAIL RATES

Appendix A

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

Base Year	Adjustment	Proposed	Prior Rates:	Change from
<u>Rates 1/</u>	<u>Factors 2/</u>	<u>Final Rates 3/</u>	Orders 2000-6-5	<u>Prior Rate</u>
			and 99-9-13	

Linehaul Charge per Billing Ton-Mile

Priority	\$1.1969	59.82%	\$1.9129	\$1.6706	14.50%
Non-priority	\$ .7246	59.82%	\$1.1581	\$1.0114	14.50%

Terminal Charge per Pound Originated

Priority	\$ .1697	53.89%	\$ .2612	\$ .2519	3.69% 4/
Non-priority	\$ .1458	53.89%	\$ .2244	\$ .2165	3.65% 4/

1/ Per Order 82-11-23

2/ See Appendix B

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

4/ Differences due to rounding.

**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	Estimated Unit Cost at	Percent Change 1980 Base Year to
			9/30/80 1/	3/31/00 2/			
Fuel						\$ 201738	
Nonfuel						\$ 436691	
Total						\$ 638429	

Unit Cost per Ton Enplaned (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 E. 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 only, unweighted by mail carried.

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. 1.0212 x 1.0106; where 1.0106 is the average annual unit cost increase projected for a 6-month period.

5/ Fuel, most recent unit cost of \$.201738; Non-fuel linehaul \$.423150 x 1.0320; Terminal, \$288.11 x 1.0231.

6/ \$.638429 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 weighted available ton-mile for QE 6/30/2000. See Appendix C.

8/ Per Appendix C, weighted per Mail RTM for YE 3/31/2000. See Appendix C

9/ Per Appendix C, weighted per Mail Ton Enplaned for YE 3/31/2000. See Appendix C

Operating Expenses, Alaska Airlines, Northern Air Cargo, Lynden Air Cargo, and Air Cargo Express  
Intra-Alaska Class Service Mail Rates--Year Ended March 31, 2000

	Alaska Airlines (AS)				Northern Air Cargo (NAC)		Lynden (LAC)		Total
	#621, B-737-2C	#617, 737-400	#655, MD-80	#711, B-777	#216, DC-6	#556, Hercules			
LINEHAUL COSTS									
Domestic Non-Fuel Linehaul	\$56,718,000	\$251,551,000	\$221,038,000	\$6,894,539	\$7,365,842	\$24,590,065	\$568,157,446	1/	
Intra-Alaska Skd. Block Hours	18,911	9,113	2,154	2,311	6,326	2,097	40,912	1/	
Domestic Total	26,886	166,594	152,242	2,440	7,309	9,501	364,972	1/	
Intra-Alaska Non-Fuel Linehaul Expense	\$39,894,149	\$13,760,305	\$3,127,362	\$6,530,033	\$6,375,197	\$5,427,362	\$75,114,408	1/	
Intra-Alaska Skd. Available Ton-Miles	89,330,589	45,713,885	10,123,254	14,758,995	15,497,538	12,805,927	188,230,188	1/	
Unit Cost per ATM, Non-Fuel Linehaul	\$,446590	\$,301009	\$,308929	\$,442444	\$,411368	\$,423816	\$,3999056	1/	
As-flown, Intra-Alaska RTMs of Mail	6,827,754	1,214,475	299,433	3,238,605	3,601,359	3,820,350	19,001,976		
RTM Percent of Total	35.93%	6.39%	1.58%	17.04%	18.95%	20.11%	100.00%		
W/d. Cost per ATM, NonFuel Linehaul	\$0,160460	\$0,019234	\$0,004881	\$0,075392	\$0,077954	\$0,085229	\$0,423150		
W/d. Cost/ATM, Fuel, App. C, Page 2 of 2	\$0,059116	\$0,008942	\$0,002554	\$0,032847	\$0,071048	\$0,027231	\$0,201738		
Total Fuel + Non-Fuel Linehaul	\$0,219576	\$0,028176	\$0,007435	\$0,108239	\$0,149002	\$0,112460	\$0,624888		

TERMINAL COSTS

	Alaska (AS)	NAC	ACE
A/C & Traffic Svc., #6900		\$10,551,697	
System Tons Enplaned		36,294	
Intra-Alaska Skd. Svc., Expenses	\$47,844,438	\$10,415,345	\$5,034,396
Intra-Alaska Skd. Svc., Tons Emp.	158,235	35,825	19,450
Unit Cost per Ton Enplaned	\$302.36	\$290.73	\$258.84
Alaska Tons of Mail Enplaned	20,269	14,535	11,165
Mail Tons Enplaned, % of Total	44.09%	31.62%	24.29%
W/d. Cost per Ton Enplaned	\$133.31	\$91.93	\$62.87

1/ These totals are not used to calculate the rate, but are shown for comparative purposes only.

Note: Alaska's 737-700 and NAC's wet-leased Hercules were not flown during both the fuel and non-fuel update periods. Their impact on the rate is *de minimis* and so we have excluded each aircraft type from the calculation above.

Operating Expenses, Alaska Airlines, Northern Air Cargo, and Lynden Air Cargo  
Intra-Alaska Class Service Mail Rates--Quarter Ended June 30, 2000  
FUEL LINEHAUL COSTS

	Alaska Airlines (AS)			Northern Air Cargo (NAC)			Lynden (LAC)		Total
	#621	#617	#655	#711	#216	#556	Hercules		
Domestic Fuel Linehaul	B-737-2C	737-400	MD-80	B-727	DC-6				
	\$4,831,000	\$24,326,000	\$21,715,000	\$758,343	\$1,588,035	\$700,391	\$53,918,769	2/	
Intra-Alaska Skd. Block Hours	4,502	2,117	521	452	1,858	404	9,854	2/	
Domestic Total	6,043	36,701	28,084	469	2,098	788	1/	74,183	2/
Intra-Alaska Fuel Linehaul Expense	\$3,599,067	\$1,403,181	\$402,846	\$730,855	\$1,406,372	\$359,084	\$7,901,405	2/	
Intra-Alaska Skd. Available Ton-Miles	21,557,999	10,843,529	2,507,950	3,046,055	4,727,002	2,443,507	45,126,042	2/	
Unit Cost per ATM, Fuel Linehaul	\$166948	\$129403	\$160628	\$239935	\$297519	\$146954	\$175096	2/	
As-Flown, Intra-Alaska RTMs of Mail	1,535,912	299,659	68,832	594,032	1,035,790	803,584	4,337,809		
RTM Percent of Total	35.41%	6.91%	1.59%	13.69%	23.88%	18.53%	100.01%		
Wtd. Cost per ATM, Fuel Linehaul	\$0.0591116	\$0.008942	\$0.002554	\$0.032847	\$0.071048	\$0.027231	\$0.201738		

1/ Lynden's system operations outside of Alaska included operations for which no fuel expense was incurred, because the entity chartering the aircraft paid for the fuel. In addition, substantially reduced fuel prices were incurred for Lynden's Air Mobility Command operations. We have accordingly backed out both the fuel expense and associated hours from system traffic and expense totals to calculate adjusted system hours and adjusted system fuel expense, which are more representative of intra-Alaska operations.

2/ These totals are not used to calculate the rate, but are shown for comparative purposes only.

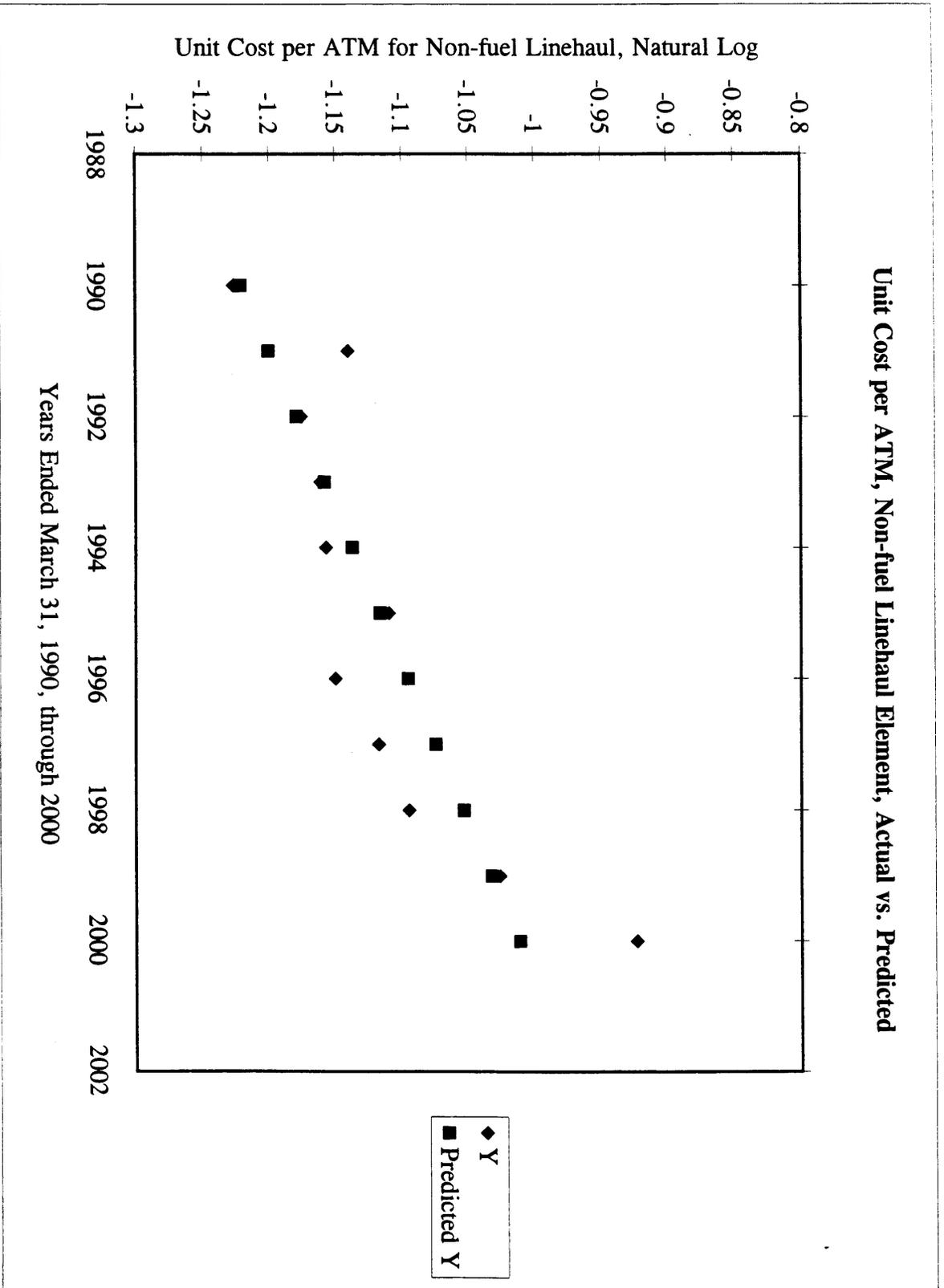
Calculation of the Linehaul Portion of the Ten Year Trend

YE 3/31/	Order Number	Actual Y		Predicted Y	Residuals	Y (EXP)	Annual % Increase	Regression Statistics
		\$/ATM	Natural Log					
1990	93-1-19	\$0.293476	-1.2259594	-1.221208917	-0.004750498	\$0.2948735	2.12%	Multiple R 0.8517586
1991	93-2-26	\$0.319788	-1.140097	-1.200217895	0.060120892	\$0.3011286		R Square 0.7254927
1992	94-12-25	\$0.308645	-1.1755635	-1.179226873	0.003663343	\$0.3075164		Adj. R Square 0.6949919
1993	95-6-17	\$0.313231	-1.1608143	-1.158235851	-0.00257849	\$0.3140397		Std. Error 0.0451408
1994	95-8-8	\$0.314536	-1.1566567	-1.137244829	-0.019411913	\$0.3207014		Observations 11
1995	96-7-8	\$0.329670	-1.1096631	-1.116253807	0.006590683	\$0.3275044		
1996	97-6-27	\$0.316760	-1.1496109	-1.095262786	-0.054348104	\$0.3344517		
1997	97-6-27	\$0.327227	-1.1171012	-1.074271764	-0.042829396	\$0.3415464		
1998	98-7-3	\$0.334821	-1.0941592	-1.053280742	-0.040878477	\$0.3487916		
1999	99-7-16	\$0.358447	-1.0259745	-1.03228972	0.006315252	\$0.3561904		
2000	App. E	\$0.397249	-0.923192	-1.011298698	0.088106707	\$0.3637463		

ANOVA

	df	SS	MS	F	Significance F
Regression	1	0.0484685	0.0484685	23.78601143	0.000874894
Residual	9	0.0183392	0.0020377		
Total	10	0.0668077			

	Coefficient	Std. Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	-42.993343	8.5865008	-5.0070854	0.000731859	-62.41737165	-23.569313
X Variable	0.020991	0.004304	4.8770905	0.000874894	0.011254679	0.0307274



Calculation of the Terminal Portion of the 10-Year Trend

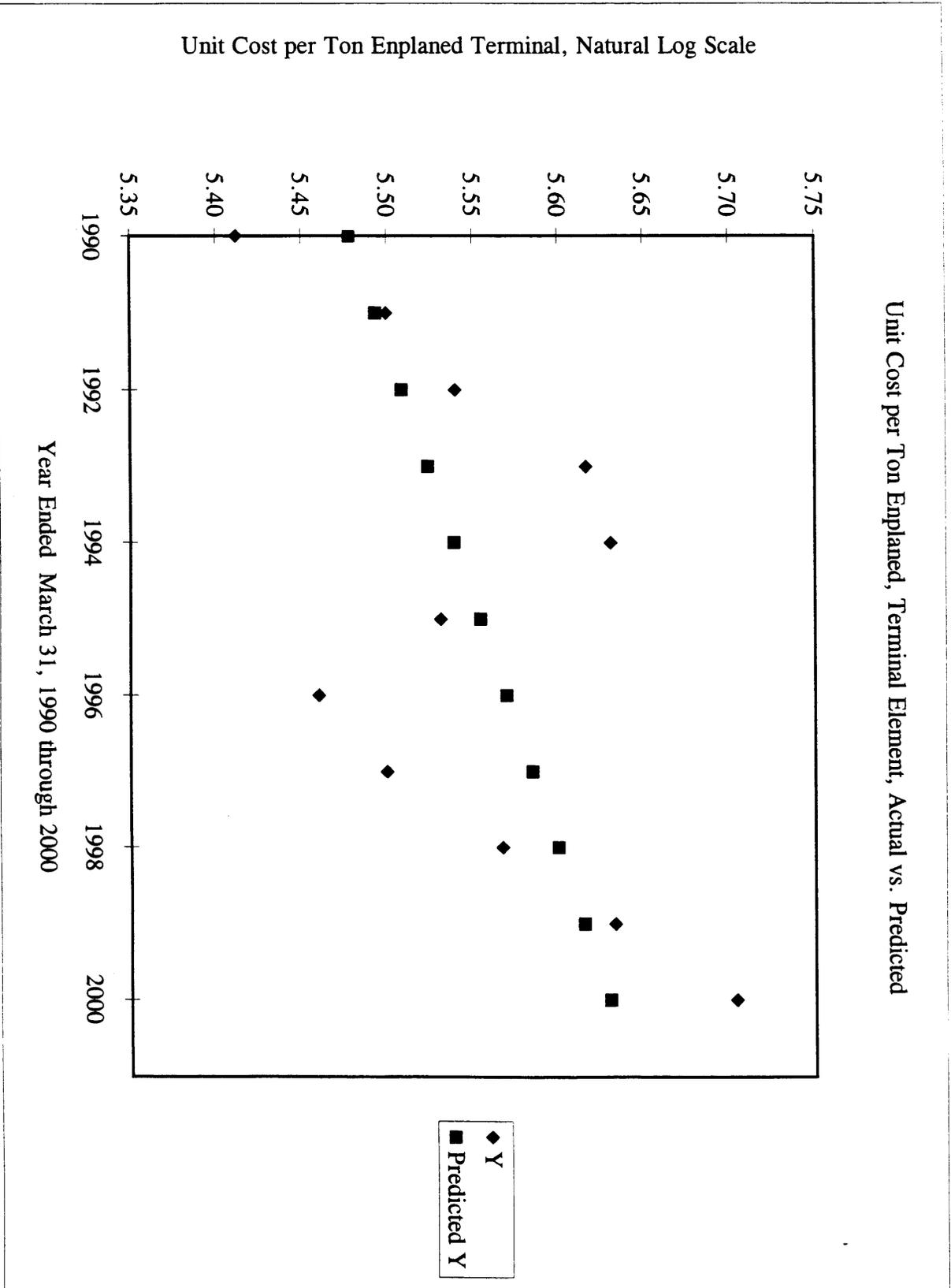
YE 3/31	Order \$/Ton Emp. \$/Ton Emp.		Actual Y		Natural Log		Annual Increase	Regression Statistics
	Number	Terminal	Terminal	Predicted Y	Residuals	EXP(X)		
1990	93-1-19	\$224.13	5.412226	5.4782762	-0.066050182	\$239.433611	1.53%	Multiple R 0.583767
1991	93-2-26	\$244.68	5.4999951	5.4934615	0.006489527	\$243.097227		R Square 0.3407839
1992	94-12-25	\$254.70	5.540086	5.5086468	0.031439236	\$246.816899		Adj. R Square 0.2675376
1993	95-6-17	\$275.00	5.616771	5.5238321	0.092938945	\$250.593488		Std. Error 0.0738368
1994	95-8-8	\$278.97	5.631104	5.5390173	0.092086655	\$254.427862		Observations 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. E	\$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.



Operating Expenses, Alaska Airlines and Northern Air Cargo  
Intra-Alaska Class Service Mail Rates--Year Ended March 31, 2000

	Alaska Airlines (AS)			Northern Air Cargo (NAC)		Alaska and NAC Total
	#621, B-737-2C	#617, 737-400	#655, MD-80	#711, B-727	#216, DC-6	
Domestic Non-Fuel Linehaul	\$56,718,000	\$251,551,000	\$221,038,000	\$6,894,539	\$7,365,842	\$543,567,381
Intra-Alaska Skd. Block Hours	18,911	9,113	2,154	2,311	6,326	38,815
Domestic Total	26,886	166,594	152,242	2,440	7,309	355,471
Intra-Alaska Non-Fuel Linehaul Expense	\$39,894,149	\$13,760,305	\$3,127,362	\$6,530,033	\$6,375,197	\$69,687,046
Intra-Alaska Skd. Available Ton-Miles	89,330,589	45,713,885	10,123,254	14,758,995	15,497,538	175,424,261
Unit Cost per ATM, Non-Fuel Linehaul	\$,446590	\$,301009	\$,308929	\$,442444	\$,411368	\$0,397249
Unit Cost per ATM, Fuel	\$,166948	\$,129403	\$,160628	\$,239935	\$,297519	\$0,176707
Total, Fuel + Non-Fuel Linehaul	\$0,613538	\$0,430412	\$0,469557	\$0,682379	\$0,708887	\$0,573956
RTMs of Mail 2/	6,827,754	1,214,475	299,433	3,238,605	3,601,359	15,181,626 2/
Mail RTMs, % of Total 2/	44.97%	8.00%	1.97%	21.33%	23.72%	99.99% 2/
Wtd. Cost per ATM 2/	\$0,275908	\$0,034433	\$0,009250	\$0,145551	\$0,168148	\$0,633290 2/
<b>TERMINAL COSTS</b>						
A/C & Traffic Svc., #6900			Alaska (AS)		NAC	
System Tons Emplaned				\$10,551,697	36,294	
Intra-Alaska Skd. Svc., Expenses			\$47,844,438		\$10,415,345	\$58,259,783
Intra-Alaska Skd. Svc., Tons Emp.			158,235		35,825	194,060
Unit Cost per Ton Emplaned			\$302.36		\$290.73	\$300.22
Alaska Tons of Mail Emplaned			20,269		14,535	34,804 2/
Mail Tons Emplaned, % of Total			58.24%		41.76%	100.00% 2/
Wtd. Cost per Ton Emplaned			\$176.09		\$121.41	\$297.50 2/

1/ Alaska's 737-700 and NAC's wet-leased Hercules were not flown during both the fuel and non-fuel update periods. Their impact on the rate is *de minimis* and so we have excluded each aircraft type from the calculation above.

2/ Computed for comparison purposes only.

Operating Expenses, Alaska Airlines and Northern Air Cargo  
Intra-Alaska Class Service Mail Rates--Quarter Ended June 30, 2000  
FUEL LINEHAUL COSTS

	Alaska Airlines (AS)			Northern Air Cargo (NAC)			(L-T Trend) Alaska and NAC Total
	#621 B-737-2C	#617 737-400	#655 MD-80	#711 B-727	#216 DC-6		
Domestic Fuel Linehaul	\$4,831,000	\$24,326,000	\$21,715,000	\$758,343	\$1,588,035 1/		\$53,218,378
Intra-Alaska Skd. Block Hours	4,502	2,117	521	452	1,858		9,450
Domestic Total	6,043	36,701	28,084	469	2,098		73,395
Intra-Alaska Fuel Linehaul Expense	\$3,599,067	\$1,403,181	\$402,846	\$730,855	\$1,406,372		\$7,542,321
Intra-Alaska Skd. Available Ton-Miles	21,557,999	10,843,529	2,507,950	3,046,055	4,727,002		42,682,535
Unit Cost per ATM, Non-Fuel Linehaul	\$ .166948	\$ .129403	\$ .160628	\$ .239935	\$ .297519		\$ .176707

1/ NAC did not report operating the Hercules in the QE June 30, 2000.