BEFORE THE
U.S. DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Intra-Alaska Class Service Mail Rates (Mainline Rates)	Docket No. OST-95-429 (Docket 38961)

MOTION AND ANSWER OF ALASKA AIRLINES, INC.

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DATED: October 22, 1999

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MOTION[1] AND ANSWER OF ALASKA AIRLINES, INC.

Alaska Airlines, Inc. ("Alaska") respectfully submits its Answer in strong support of Northern Air Cargo, Inc.'s ("NAC") petition requesting that the Department, on an *ad hoc* basis, adjust the intra-Alaska mainline service mail rates for the ratemaking period commencing no later than October 1, 1999. In just the past few months, Alaska's intra-Alaska fuel costs have increased by more than 45% over the baseline fuel costs assumed in the intra-Alaska mail rate for the 12-month period October 1, 1999-September 30, 2000. NAC's intra-Alaska fuel costs (consisting of a mix of both avgas and jet fuel costs) increased by only a slightly lesser amount for the same period.

1 Alaska respectfully asks that the Department accept its answer even though it is being filed more than seven days after NAC's petition. The delay was occasioned by the time required for Alaska to assemble the latest economic data to prepare its answer. That data appears in the Attachment. Moreover, no party would be prejudiced by acceptance of Alaska's answer.

	Alaska	NAC
	Intra-Alaska Fuel Cost Per ATM	
12 mos. ended 3/31/99	.0826456	.1353
Quarter ended 6/30/99	.102278	.1751
Quarter ended 9/30/99	.119303	.18917
% Increase 12 mos. 3/31/99 v. Quarter ended 9/30/99	44.4%	39.8%

Source: Attachment A and NAC Petition, dated October 6, 1999, Appendix

Indeed, even the above increases understate the magnitude of the dramatically higher fuel costs which both Alaska and NAC are likely to be paying throughout much of the one-year ratemaking period which commenced only twenty-two days ago. The fuel costs paid by Alaska during the third quarter of this year continued to increase month by month with Alaska's September '99 per gallon fuel cost being 7.1% higher than Alaska's July '99 per gallon average fuel cost. With the plateauing of fuel costs which has occurred in the past several weeks, Alaska is now estimating that its average fuel costs for October and the next several months will more closely approximate September's costs in contrast to the somewhat lower third quarter average. Therefore, using Alaska's September '99 average fuel costs, instead of the average for the third quarter, as a proxy to compare against the baseline fuel costs translates into a 49% increase in fuel costs over the baseline fuel rate assumed in the brand new intra-Alaska mainline mail rate.[2]

[2] Alaska's per gallon systemwide fuel cost for September was 3.2% higher than Alaska's average fuel cost for the third quarter. Consequently, using September's average fuel cost as a proxy for the third quarter average fuel costs increases the third quarter "average" cost to 12.31 cents per ATM or an increase of 49% over the baseline rate fuel costs.

It also needs to be said that the consequence of not making an *ad hoc* fuel adjustment would be unfair and unreasonable in the extreme to the carriers operating within the intra-Alaska mainline ratemaking entity. Failing to give prompt recognition to the extraordinary increase in fuel prices of the last few months would require each of the carriers to accept the brand new rate – with its implicit fuel cost understatement of almost 49% -- for the next 12 months with relief only coming on October 1, 2000. In an entity in which mail revenues are the primary revenue source for several of the carriers and, on a comparative basis, more than twice the percentage of Alaska's "Lower 48" mail revenues, that would be an extraordinary burden for the Department and the USPS to ask the intra-Alaska carriers to absorb.[3]

A refusal to make an *ad hoc* fuel adjustment in the face of such an extraordinary fuel cost increase would also violate the understandings between the Department and the intra-Alaska carriers reflected in the Department's exhaustive multi-year intra-Alaska mail rate study which led to the revised ratemaking update formula. That new update formula was first adopted for the ratemaking period October 1, 1998-September 30, 1999. Order 98-9-28 finalizing Order to Show Cause 98-7-3. The new rate for the fiscal year just started is only the second time the new update formula has been applied. Order 99-9-13 finalizing Order to Show Cause 99-7-16. Two of the fundamental changes reflected in the revised update formula were the lengthening of the ratemaking period from six months to one year and the separation of fuel costs from non-fuel costs.[4] The reason stated for the lengthening of the ratemaking period for both fuel and non-fuel costs from six months to one year included the "increas[ing] . . . stability and predictability of the

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3 NAC recited in its petition that its budgeted increase in fuel costs for the 12 months ended March 31, 2000 is greater than the carrier's system profit for 1998.

4 Final Report on the Review of the Alaska Mail Ratemaking Methodology (hereinafter "Final Report"), dated September 2, 1997.

rates," "enabling carriers and the USPS to plan more accurately" and "ensuring that significant cost changes will be reflected in the rates reasonably promptly." Final Report at 6. To now require the intra-Alaska carrier for the next twelve months to absorb a rate predicated on fuel costs almost 49% less than those assumed in the new rate would run directly counter to each of the Department's stated objectives for adopting a one-year rather than six-month update.

Even more to the point as NAC pointed out in its petition, both Alaska and NAC had argued, albeit unsuccessfully, that the inherently more volatile fuel cost ratemaking element should be updated semi-annually with only the more predictable non-fuel costs being adjusted annually. In rejecting Alaska's and NAC's recommendation, the Department said that a semi-annual adjustment would lead to "reduced stability and predictability of the rates." Final Report at 8. Similarly, in deciding to separate fuel and non-fuel costs, the Department said that "[s]eparation . . . gives the Department flexibility to make quick adjustments to the linehaul rates in the event of sudden major changes in fuel costs stemming from outside factors." Final Report at 7. It is this very flexibility which Alaska (and NAC) is asking the Department to exercise in the face of the unacceptable alternative of imposing the burden on the intra-Alaska carriers of having to wait for another twelve months for any offsetting relief.

The relief Alaska is requesting is also fully consistent with and supported by the Department's decision to adopt an *ad hoc* fuel adjustment during the 1990 Gulf War. When fuel prices surged on that occasion, the Department adjusted the mainline mail rates for the sudden increase in fuel prices and did so on a quarterly basis.[5] Order 91-1-34. Unlike the 1990 Gulf War period

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[5] In making its Gulf War fuel cost adjustment, the Department examined changes in crude oil per barrel prices and assumed that future per gallon jet fuel prices would change at 75% of the per barrel spot fuel price change. The adoption of the 75% factor was based on a correlation of

during which fuel prices precipitously increased and then decreased almost as rapidly, the current spike in fuel costs appears to be plateauing for at least the next six months. Unfortunately, Alaska is estimating that that flattening is and will continue to be at or near the September 1999 peak in prices. That rather different price fluctuation "footprint" may suggest that the Department consider an *ad hoc* adjustment period of longer duration – perhaps six months instead of just a quarter. The "stair-step" pattern of increases would also suggest that the Department consider using a very recent actual price – perhaps September's price – as the proxy for the assumed fuel price for the post-October 1 *ad hoc* adjustment period.[6]

Alaska appreciates that the Department may prefer to fashion a different *ad hoc* fuel cost update methodology than was used in 1990-91 or than Alaska is now suggesting. Alaska would only underscore that the methodology used should be based on fuel cost changes, for the reasons already expressed, and that the Department should make every effort to make the adjustment with all deliberate speed. To assist the Department and its staff, Alaska is appending its updated

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historic changes in crude oil per barrel prices in relation to the historic rate of change in the delivered per gallon jet fuel price.

[6] Although Alaska is providing in Attachment A its non-fuel as well as fuel costs for the second and third quarters of this year, there are a number of reasons why the ad hoc fuel cost adjustment should be based on the change in fuel costs without consideration of changes, up or down, in non-fuel costs. First, the Department only reviewed fuel cost changes when it made the Gulf War ad hoc fuel cost adjustment. Second, the explicit assumption incorporated in the Final Report was that fuel costs were being separated from non-fuel costs for the very purpose of permitting *ad hoc* adjustments solely based on changes in fuel prices whenever a sudden fuel spike occurred. Third, use of quarterly non-fuel costs for the second and third quarters as proxies for the October 1-March 31, 2000 period would create an unjustified downward bias in the rates. With the typically higher second and third quarter volumes in the highly seasonal Alaska markets and the resulting economies of scale, the considerably higher peak season volumes generally produce lower non-fuel unit costs than would be experienced during the October 1-March 31 off-peak period. Fuel costs, by comparison, are volume-related and therefore less affected by seasonality. Since the fuel cost adjustment period in this case is likely to be an off-peak period, extrapolating high volume peak season non-fuel costs into that off-peak period would lead to a understatement of actual unit costs.

fuel, as well as non-fuel costs, for the second and third quarters of 1999. This data is set forth in the same format in which those costs appear in Appendix C of the Department's annual mail rate orders.

CONCLUSION

WHEREFORE, Alaska Airlines, Inc., respectfully supports NAC's petition and urges the Department to adjust the intra-Alaskan mainline mail rates on an *ad hoc* basis for all of the reasons stated herein.

Respectfully submitted,

Marshall S. Sinick

CERTIFICATE OF SERVICE

I hereby certify that I have this day served, by telecopier, a copy of the foregoing Motion and Answer of Alaska Airlines, Inc. on the following:

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DATED: October 22, 1999