



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

<hr/>	)	<b>Docket OST-95-429</b>
<b>INTRA-ALASKA CLASS SERVICE</b>	)	
<b>MAIL RATES (Mainline Rates)</b>	)	
<hr/>	)	<b>(Docket 38961)</b>

**MOTION TO FILE LATE AND ANSWER OF  
ALASKA AIRLINES, INC. TO  
PETITION OF NORTHERN AIR CARGO, INC.**

Alaska Airlines, Inc. (“Alaska”) respectfully submits its answer<sup>1</sup> to the petition of Northern Air Cargo, Inc. (“NAC”) requesting a modification of the Department’s intra-Alaska mainline mail ratemaking methodology used for annual update purposes. In particular, NAC is requesting that the current update methodology be revised to specifically weight each carrier’s cost data on the basis of both (a) the volume of intra-Alaska mail carried and (b) the costs of the specific aircraft used by that carrier to carry the intra-Alaska mainline mail. Alaska now answers in strong support of NAC’s request.

Alaska would also like to take this occasion to comment on two closely-related issues raised by, inter alia, the answer of the United States Postal Service (“USPS”) filed in response to NAC’s petition. These two related issues are: (1) why the Department should continue to use a class rate, rather than an individual rate approach, to reflect properly weighted average costs for

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<sup>1</sup> Alaska respectfully requests leave to file late its answer to the petition of Northern Air Cargo, Inc. (“NAC”) requesting revisions to the Department’s intra-Alaska mainline mail ratemaking methodology. Alaska’s answer is only being filed now because other more pressing matters required the attention of Alaska’s management and its counsel. Moreover, since the revisions requested by NAC and now addressed by Alaska are only to be implemented, if at all, in the Department’s next annual update for the fiscal year commencing October 1, 2000, no one should be prejudiced by the Department’s acceptance and consideration of Alaska’s answer.

all carriers comprising the class; and (2) why the operating costs of Alaska's B-737-200 "combi" aircraft should be fully reflected within the class rate even though the "combi" costs are higher than those for other aircraft types Alaska uses in certain intra-Alaska markets.

A. Intra-Alaska Carrier Costs Should Be Weighted to Reflect Each Carrier's Pro Rata Share of Intra-Alaska Mail As Well As The Costs of the Aircraft Used to Carry Intra-Alaska Mail

NAC's primary request is that the Department significantly refine its current practice of weighting each intra-Alaska carrier's costs solely on the basis of each carrier's relative intra-Alaska capacity expressed in ATMs. Under the current ATM approach, the Department does not take into consideration either the relative volumes of mail transported by each carrier or the relative costs of the aircraft used by each carrier to transport mail. NAC's recommendation would have the Department weight each intra-Alaska carrier's costs on the basis of the mail volumes carried and on the basis of the costs of the particular aircraft used by each carrier to transport mainline mail. The logic behind NAC's suggestion is compelling. NAC's proposed approach would more closely reflect the cost of the actual carriage of intra-Alaska mail rather than simply continuing to weight each carrier's costs on the basis of that carrier's aggregate ATM output, a parameter which also measures the capacity provided—for passengers and freight—in addition to mail. NAC properly points out that the present aggregate ATM approach has resulted in Alaska's relatively low unit cost B-737-400 and MD-80 combination aircraft artificially decreasing the mainline mail rates even though these combination aircraft carry less than thirteen (13%) percent of the intra-Alaska mail Alaska transports.

The new approach would also fulfill one of the suggestions of the Department's staff in its 1997 Final Report On The Review Of The Alaska Mail Ratemaking Methodology<sup>2</sup> ("Report"). The Report expressly noted that further consideration would be given to weighting

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<sup>2</sup> Report, Office of Aviation Analysis, p.5.

each carrier's costs on the basis of the carrier's relative mail volume. That is precisely what NAC's proposal does and Alaska would encourage the Department to adopt these refinements in conjunction with the establishment of the mainline mail rate for the fiscal year commencing October 1, 2000.

B. The Department Should Continue Using a Class Rate Approach in Establishing Mail Rates

It seems almost self-evident that the more than twenty year-old class rate approach for establishing intra-Alaska mainline mail rates is the only fair and reasonable methodology. In fact, with the pending addition of two new carriers, Lynden Air Cargo and Air Cargo Express, to the class rate update costing formula, the alternative of abandoning the class rate, as implied by the USPS's answer to NAC's petition, would simply not be administratively workable.

Alaska takes particular issue with the USPS' apparent suggestion that the class rate should either be abandoned in favor of establishing the prevailing rate using only the most efficient carrier's costs or that the class rate should be artificially adjusted to assign greater than proportional weight to the most efficient carrier's costs. The USPS' stated concern is that adoption of a cost averaging approach which closely reflects and weights the actual operating costs of those aircraft used to carry the mail would remove an important incentive for the higher cost carriers to become more efficient. That, in turn, the USPS claims would saddle the USPS with paying higher rates for the carriage of mail than would either the current aggregate ATM approach or a formula heavily weighted in favor of the costs of the most efficient carrier.

The short answer to the USPS' apparent suggestion that the Department decline to adopt the newly proposed and more refined costing approach in favor of a de facto individual rate approach or one heavily weighted toward the costs of the most efficient carrier is that these same arguments were made and rejected twenty years ago. The average cost approach of the class rate

is not only time-honored, but it is also the approach used in all other ratemaking entities. As the former Civil Aeronautics Board said when establishing the intra-Alaska class mail rate:

The establishment of a class rate structure for Alaska conforms to our traditional unitary method of ratemaking in which rates are geared to recover the average costs of the carriers responsible for the preponderant amount of the mail carried. . . . The rate structure under this approach provides rates which apply uniformly to all markets, without regard to the specific costs of providing service in the individual markets. Since rates reflect average cost levels, carriers with above-average costs are encouraged to become more efficient, while those with below-average costs are rewarded for their efficiency. We have consistently followed this approach in the other geographic areas where we set mail rates and it apparently has the general endorsement of all of the parties to this case. Order 82-5-73, May 14, 1982.

It bears repetition that a class rate approach, whether the current approach or the more precise approach under consideration, still provides a substantial incentive for less efficient carriers to acquire lower unit cost aircraft in order to improve their overall financial performance. Apart from the USPS' generalized concern, there is simply 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. More importantly, carrier fleets inevitably change over time as a result of unrelenting marketplace pressures to achieve lower operating costs – not because of some prospective and uncertain change in mail rates.<sup>3</sup>

At the same time the USPS is concerned that the proposed approach might produce higher mail rates, the USPS must also acknowledge and certainly appreciate that the exclusion of Alaska Central Express' ("ACE") operating costs has produced a windfall for the USPS. Alaska Central Express, with its fleet of small commuter aircraft, has become a major participant in the

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<sup>3</sup> For example, in 1992, Alaska discontinued all B-727 operations even though they were almost certainly higher unit cost aircraft than the "combi" and other aircraft Alaska now operates.

carriage of intra-Alaska mail. Those small aircraft, including the Beech 1900, unquestionably have unit costs far in excess of those of Alaska or NAC. The exclusion of ACE's unit costs has a fortiori produced lower mail rates than would have resulted from an all-inclusive class rate. Notwithstanding the upward rate impact that inclusion of ACE's costs would have generated, neither Alaska nor NAC is recommending the immediate inclusion of ACE's unit costs in the upcoming class rate revision.<sup>4</sup> The continued exclusion of ACE's higher unit costs operations from the class rate should and will provide the USPS with a rather substantial comfort zone. However, to also seek to perpetuate the aggregate ATM class rate rather than the new more precise approach would produce a result which is both unfair and needlessly divorced from marketplace reality. Once again, the more precise costing approach recommended by NAC should be promptly adopted.

C. Alaska's B-737-200 "Combi" Aircraft Are The Workhorse of Alaska's Interior-Alaska Operation and Their Costs Should Continue To Be Fully Reflected In The Class Rate

Alaska's B-737-200 "combi" aircraft is the workhorse of Alaska's interior-Alaska fleet and the aircraft most suitable to accommodate the combined passenger, freight and mail requirements of these intra-Alaska markets. Alaska typically operates its "combi" aircraft in a two pallet, seventy-two passenger configuration. When operated in this configuration, the total main deck and belly cargo capacity of Alaska's "combi" aircraft is 1605 cubic feet and, assuming average cargo density, 23,500 pounds.<sup>5</sup> With its appreciably greater cargo capacity

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<sup>4</sup> At some future point it may be appropriate for the Department to consider some means of taking into account ACE's growing operation. As ACE's share of the overall intra-Alaska market grows with the concomitant decrease of mail carried by the other intra-Alaska carriers, one such approach might be to have the Department revise its update methodology to an RTM rather than ATM basis. An RTM approach would at least take into account the load factor impact of ACE's operation even if not of ACE's actual operating costs.

<sup>5</sup> The comparative respective cubic and payload capacities of Alaska's B-737-400 and MD-80 aircraft are: (1) B-737-400 -- 1364 cu. ft. and 16,400 pounds; and (2) MD-80 -- 1253 cu. ft. and 18,800 pounds.

than either Alaska's B-737-400 or MD-80 and the "combi's" large cargo door, more than eighty-seven (87%) percent of the mail Alaska transports is carried on Alaska's B-737-200 "combi" aircraft. The suitability of Alaska's "combi" aircraft for the interior Alaska markets is undeniable. The theoretical alternative of operating either 138 seat MD-80 or 140 seat B-737-400 aircraft—neither of which is convertible—in the interior Alaska markets would be completely contrary to the requirements of the marketplace.

Alaska acknowledges that the more precise costing approach Alaska supports will in the short-term give greater weight to the higher ATM unit costs of its "combi" aircraft. However, the fact that somewhat higher ATM cost aircraft will now be assigned greater weight and Alaska's B-737-400 and MD-80 aircraft less weight under the class rate does not provide any legitimate basis for the "combi's" higher unit costs to be excluded or otherwise artificially reduced. Nor has there been any suggestion that Alaska's "combi" ATM unit costs are unusually high in comparison with the costs of any other operator of comparable "combi" aircraft. Most importantly, the overriding fact is that these "combi" aircraft are and remain ideally-suited for the interior Alaska markets.

Alaska would also point out that the fundamental underpinning of the class rate is that mail rates are established on the basis of a by-product rather than joint product costing methodology. The only capacity costs assigned to mail under the class rate are those directly associated with the cubic space in the aircraft belly and, in the case of "combi" aircraft, the additional cubic space on the main deck occupied by mail shipments. The main deck capacity costs of the traditional combination aircraft are completely excluded from the rate base. However, if the Department were to consider rejecting or otherwise artificially lowering Alaska's "combi" unit costs in favor of Alaska's lower B-737-400 or MD-80 unit costs, the Department would first have to completely revise the class rate costing formula. Any

assumption that a 138-140 seat aircraft should artificially be assigned greater weight than justified by actual usage for mail carriage would mean that mail revenues would now be dictating the type of aircraft the Department is prepared to recognize for ratemaking purposes. That elevation of mail from a by-product to the primary determinant of which aircraft are to be used for ratemaking purposes would require the complete conversion of the class rate to a joint product costing approach. Instead of a by-product approach, a pro rata share of the main deck passenger costs would have to be included. The Department would also be obliged to revise significantly upward the priority weightings for both priority and non-priority mail if mail revenues become the principal determinant of which aircraft type is recognized. There are undoubtedly a number of other categories that would also have to be included under a joint product costing approach.

As long as the Department does not adopt an approach which either rejects or artificially lowers the relative weights assigned to the operating costs of the actual aircraft used to transport mail in the intra-Alaska markets, there would be no reason for the Department to undertake a wholesale revision of the class rate. The Department should avoid any artificial adjustments to the intra-Alaska carriers' actual costs and simply adopt the more precise weighting approach NAC is advocating.

## CONCLUSION

Wherefore, Alaska Airlines, Inc., respectfully urges the Department to move forward to adopt the more precise costing approach which would weight the relative mail carriage of each participant in the intra-Alaska ratemaking class and would similarly weight the costs of each participant by the actual aircraft used to transport the mail.

Respectfully submitted,

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Alaska Airlines, Inc.  
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DATED: May 23, 2000

**CERTIFICATE OF SERVICE**

I hereby certify that one copy of the foregoing Motion and Answer of Alaska Airlines, Inc. has this day been served on the following persons via first class mail, postage prepaid.

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DATED: May 23, 2000

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