

Order 2004-2-12  
Served: February 13, 2004

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 February, 2004

**INTRA ALASKA BUSH SERVICE MAIL RATES**

**Docket OST-2003-14694**

**ORDER SETTING FINAL RATE UNTIL FURTHER DEPARTMENT ACTION**

**Summary**

By this order, the Department is adjusting the linehaul portion of the mail rate payable to intra-Alaska bush mail carriers providing service with Part 121 bush aircraft certificated by the manufacturer for 19 seats or more.<sup>1</sup> This rate will be effective immediately on a final basis, not subject to retroactive adjustment, and will remain in effect until further Department action. The terminal portion of the rate will remain unchanged from that set in Order 2002-8-7. Likewise, the rate for bush carriers in markets where there is no qualifying service with Part 121 bush aircraft will remain unchanged.

**Background**

The Rural Service Improvement Act of 2002 (RSIA), signed into law on August 5, 2002, made substantial changes in intra-Alaska bush mail service. Many issues raised by RSIA were fully discussed in Order 2003-10-10, and so we will not repeat them here.

The Department has been statutorily mandated to establish intra-Alaska mail rates to be paid by the United States Postal Service (Postal Service) since it inherited that function from the Civil Aeronautics Board on January 1, 1985. (See 49 U.S.C 41901). The Department has traditionally set mail rates for two classes of aircraft—mainline and bush—to reflect the different cost

---

<sup>1</sup> Aircraft with ten seats or more operated in scheduled passenger service must comply with the Federal Aviation Administration's "Part 121" regulations. Aircraft with fewer than ten seats may be operated under Part 135 of the FARs.

characteristics of large vs. small aircraft. RSIA directed the Department to set three separate bush mail rates<sup>2</sup>: one for larger bush aircraft certificated for 19 seats or more and operated under 14 CFR Part 121 (Part 121 rate); one for aircraft operating into airports requiring float or amphibious equipment (Amphibious rate); and one for all other aircraft (Part 135 rate). As discussed in Order 2003-10-10, the Part 121 rate would only apply where at least one carrier schedules and operates at least one round trip per week with aircraft certificated by the manufacturer for 19 or more seats and operated under Part 121 of the Federal Aviation Administration's Regulations; the Amphibious rate would apply wherever service with amphibious aircraft was required; and the Part 135 rate would apply everywhere else.

### **Decision**

We do not yet have sufficiently reliable data to set rates for the Amphibious and Part 135 classes of bush service.<sup>3</sup> However, we do have sufficiently reliable data and we find that good cause exists to set a rate for Part 121 linehaul operations now. Based on Appendix A, we find that the linehaul costs of Part 121 bush aircraft are in fact substantially lower than the current bush mail rate set in Order 2002-8-7. With this order, the Postal Service will immediately begin realizing these savings--one of the primary goals of RSIA.

We anticipate following with the Part 135 and Amphibious rates in the near future. While we will make the Part 121 rate effective on the service date of this order, we will allow objections to this order.<sup>4</sup> The current bush linehaul rate is \$11.1627 per mail RTM (revenue ton mile), and the rate we are setting here of \$4.5271 is less than half that amount. We will leave in effect for now the current unitary linehaul rate established by Order 2002-8-7<sup>5</sup> for the other two classes, wherever they apply under RSIA.

We have no current basis for separately determining a terminal rate for service with Part 121 or other aircraft, and so will not adjust the terminal portion of any bush rate at this time. In a subsequent order, we will set linehaul and terminal rates for all three classes of service.

### **Calculation of the Mail Rate**

This order uses a fully-allocated costing methodology to calculate the Part 121 linehaul rate as was used in the last bush mail rate investigation, and is detailed in Appendix A. The data are for the year ended June 30, 2003, and are from the carriers' T-100 reports, Schedule F-2 and, as discussed below, from Appendix F of the prior base-rate order. We have supplemented the summary information in the T-100 with additional information from the carriers, because we

---

<sup>2</sup> Aircraft having payloads exceeding 7,500 pounds are classified as mainline, while bush aircraft have payloads of 7,500 pounds or less, regardless of the number of seats. As a point of reference, the Saab 340, the largest bush aircraft currently operating with just under 7,500 pounds payload, can be configured with up to 34 seats.

<sup>3</sup> The Department's Bureau of Transportation Statistics (BTS) has expedited its review of the costs and traffic of the three carriers currently operating qualifying Part 121 aircraft: ERA Aviation, Peninsula Airways, and Frontier Flying Service. These data allow us to determine the linehaul portion of the Part 121 rate. BTS is continuing to pursue its review of the data for the 30 remaining bush carriers for the other two rates.

<sup>4</sup> The filing of objections will not stay the effectiveness of this order. Any rate changes will be prospective.

<sup>5</sup> The current unitary bush rate was last updated by Order 2002-8-7, which made a final adjustment to the mail rate for changes in fuel prices.

found in our review that Peninsula Airways had overstated its charter block hours and understated its scheduled block hours, and because both it and ERA Aviation had overstated their T-100 Market Mail RTMs, as opposed to their T-100 Segment Mail RTMs.

#### Markup Factors of Overhead, Return and Tax Allowance, and Circuity

As our first step, we have calculated three system “markup” factors, as detailed in lines 1 through 8 of Appendix A. These markups must be applied to all costs, including mail, because we are using a fully-allocated methodology, and the carriers are not required to report the level of accounting detail that would allow us to apply them on a specific route or even aircraft-type basis.

First, we have determined a capacity-related markup per carrier. Capacity-related<sup>6</sup> expense, an indirect expense element, applies to all other direct and indirect expenses by the ratio of its costs to all other direct and indirect costs, and is calculated in Appendix A, lines 1 thru 4. For example, if a carrier’s capacity-related expense were 10 percent of its total costs, we would add 10 percent to the linehaul costs to represent its share of capacity-related costs.

We have also determined a return and tax markup. We have used, from Order 90-10-34, a return and tax markup of 9.46 percent<sup>7</sup> and have applied that to all three carriers. That markup was based on an extensive examination of return on investment (ROI) conducted as part of the last base-rate investigation. We find that markup calculation remains reasonable, and is incorporated here. We have no recent data to update the calculation, and to require the carriers to report the necessary information would be onerous on the carriers. As discussed in Order 2003-10-10, we will use the markup on expenses as a proxy for an ROI calculation.

Next, we have applied a circuity markup for each carrier<sup>8</sup>, as shown in lines 6 through 8. The T-100 segment report calculates all passenger, freight, and mail revenue ton miles on an as-flown basis.<sup>9</sup> Assume an aircraft is routed A to B to C, and the nonstop distance from point A to point B is 100 miles, 120 miles from B to C, and 200 miles A to C, and there is one ton of mail flown from A to C (ignoring for the moment any mail flown A to B). Then there would be 200 nonstop Mail RTMs but 220 as-flown Mail RTMs going from A to C. In other words, by making an intermediate stop at B, as-flown RTMs exceed nonstop RTMs by 20, or a Circuity Markup of 10%. If the linehaul mail rate is determined by dividing costs by as-flown RTMs, while at the same time payments are made on the basis of nonstop RTMs, the carriers would have incurred the expense of transporting the mail 220 miles but would be compensated as if

---

<sup>6</sup> Capacity-Related is sometimes referred to as General and Administrative or Overhead.

<sup>7</sup> See Appendix F: \$3,351,876, scheduled direct return and tax allowance, column 4, divided by \$35,436,803 scheduled direct expenses, column 2.

<sup>8</sup> Nonstop RTMs cannot exceed as-flown RTMs. Where carrier reported data shows nonstop RTMs exceeding as-flown RTMs, we assumed no circuity factor. See Appendix A, line 8.

<sup>9</sup> The T-100 *Market* Report, on the other hand, calculates traffic on a nonstop basis, and the ratio of the two provides a circuity factor.

they only flew 200 miles.<sup>10</sup> In fact, the Postal Service pays carriers on a nonstop basis in all of its markets, regardless of routing, so we have determined a Circuity Markup (line 8) and applied it to the rate (line 14), such that on average the carriers will be properly compensated.<sup>11</sup>

#### Expense and Traffic Calculations by Aircraft Type<sup>12</sup>

RSIA makes clear that Passenger Liability insurance is not to be assigned to the carriage of mail, because such insurance is required for passengers, but not for the mail. We have therefore deducted Passenger Liability Insurance from Direct Expenses (lines 9 thru 11) to determine Linehaul Expenses properly allocable to mail. All other direct expenses—pilot, fuel, hull insurance, third party liability insurance,<sup>13</sup> maintenance, and aircraft depreciation and lease—are included in line 11, Linehaul Expense. As discussed above, markups for capacity-related are reflected in line 12, for Return and Tax Allowance in line 13, and for Circuity in line 14.

Our next step was to exclude charter expenses, because all mail moves in scheduled service.<sup>14</sup> Also, as discussed in Order 2003-10-10, the Part 121 rate should exclude the cost of all-cargo service, because only bush service with 19-seat Part 121 passenger aircraft qualifies for the Part 121 rate. Accordingly, we have allocated Linehaul Expenses by Aircraft Type (including the three markups discussed above, line 14) to scheduled service with passenger aircraft on the basis of the ratio of scheduled block hours in passenger service to system block hours (lines 15 thru 17) for each aircraft type.<sup>15</sup>

---

<sup>10</sup> In our example, if the carrier chose to operate to each market on a nonstop basis, with one flight operating A to B, and a separate flight operating A to C, and in addition to that one ton of mail flown A-C there were another ton flown A-B, then such an operation would produce 300 Mail RTMs. Thus, in this example, flying on a linear basis, A-B-C, reduces overall Mail RTMs by 80 (220 vs. 300).

<sup>11</sup> The Postal Service pays carriers on a nonstop basis. Otherwise, they would have to track the actual routing and mileage of each mail shipment, rather than merely its origin and destination, and it would be extremely difficult for the Postal Service to do so.

<sup>12</sup> There are currently four qualifying, 19-seat, Part 121 passenger aircraft types in use in Alaska: 19-seat DHC-6 Twin Otters for ERA Aviation, 19-seat Beech 1900s for Frontier Flying Service, 19-seat Metro IIIs and 34-seat Saab 340s for Peninsula.

<sup>13</sup> There has been some confusion about 3<sup>rd</sup> Party Liability Insurance. There are two parties to any transaction: the carrier and either the passenger, the freight shipper, or the Postal Service. A “3<sup>rd</sup> party” would be someone not directly involved in the transaction, such as the owner of a building that might be struck in a crash. The Postal Service should not be charged for the passenger liability insurance of a passenger-only flight, but a mail-only flight would still incur the cost of Third Party Liability Insurance.

<sup>14</sup> In charter service, the charterer buys the service of the entire aircraft, rather than particular seats. Load factor could be significantly different between scheduled and charter service, which would ultimately affect the cost per RTM. Also, by allocating expenses between charter and scheduled service, the problem the T-100 has with determining charter miles is eliminated. In Alaska, many charter flights operate to nondesignated points, such as a temporary fishing camp, and while the hours can be readily determined, the miles and therefore the RTMs cannot be.

<sup>15</sup> We assume that the expense per block hour for scheduled passenger service should be the same as that for charter and all-cargo service. However, we are ultimately seeking the average cost for moving a scheduled RTM of mail. It is reasonable to assume that the cost per RTM for Charter and All-Cargo service is not the same as for scheduled passenger service, since it is unlikely that the load factor for these operations is the same as for scheduled passenger service.

The expenses in line 17 were incurred to move scheduled passengers, freight, and mail, and we are, of course, only interested in mail. The prior base-rate order determined that freight's cost-causative characteristics were slightly lower than those of mail or passengers, while those of mail and passengers were equal to each other. It thus weighted each passenger and mail RTM at 1 and each freight RTM at .75. As discussed in Order 2003-10-10, we see no basis for changing these weights. The carriers have argued that an RTM of mail costs more to move than a corresponding volume of passengers or freight because of special burdens imposed by the Postal Service. They state that approximately 90 percent of mail moves outbound from the hub (as does freight) while 50 percent of passengers typically move in each direction, and that the Postal Service imposes greater administrative burdens on the carriers now than it did when the last base-rate investigation was conducted.

The Postal Service, on the other hand, argues that an RTM of mail costs less than a corresponding volume of freight or passengers because (1) mail does not require the freeze and chill treatment that some freight does, (2) mail is boarded at a lower priority than passengers, and (3) the Postal Service has eased some of the burdens it previously imposed on the carriers when the last base-rate investigation was conducted. Neither party has calculated actual costs or savings with any precision. As the previous base-rate investigations for both the bush and mainline rates concluded, the relative cost of passengers vs. freight vs. mail is a difficult issue involving complex arguments and facts. Accordingly, we have not adjusted the previous ratios. If the parties wish to pursue these issues further, they will have to document their arguments in a much more detailed and precise manner than they have up to now, and also should state precisely the impact of their proposals on the mail rate.

In summary, we have decided to allocate linehaul expenses between mail and the other categories of traffic on the percentage of mail RTMs (line 19) to weighted RTMs for all traffic (line 21), with freight weighted at .75. In the next base-rate review, as load factor<sup>16</sup> increases or decreases in response to RSIA and market forces, this cost per RTM will adjust accordingly and will be reflected in the mail rate.

Consistent with our findings in the mainline mail rate proceeding, Order 2001-11-9, we weight mail costs for each aircraft by the amount of mail carried on that aircraft. Otherwise, the costs of a carrier that transported very little mail but a great deal of passengers and freight would be over-represented in the mail rate. The Postal Service acknowledges that costs should be weighted by mail volume per carrier, but continues to state that they should not be weighted by aircraft type. We note, however, that the fundamental thrust of RSIA is to more closely match bush mail rates to the costs of the three classes of aircraft. The Postal Service is concerned that carriers will either try to move mail on their more expensive aircraft types or fraudulently report mail as moving on one aircraft type instead of the other. We continue to maintain, as we did in Order 2001-11-9, that such concerns are misplaced, because the risks and costs incurred by a carrier trying to manipulate the mail rate in such a manner would be borne directly by that carrier, but it

---

<sup>16</sup> Load factor is the ratio of Revenue Ton Miles to Available Ton Miles (ATMs). Because load factor is indirectly very important in determining the level of the mail rate, we have calculated it in line 26, although line 26 *per se* is not directly used in the calculation of the mail rate.

would have to share any possible gains with its competitors on a significantly delayed basis after the next mail rates were determined.

Finally, although the data are based on the year ended June 30, 2003, the midpoint of which was twelve months ago, we cannot adjust the rate for inflation because annual data are not currently available.<sup>17</sup>

**ACCORDINGLY,**

1. We make final the rate per mail revenue ton mile calculated in Appendix A of \$4.5271 per billable (nonstop) mail revenue ton mile, for markets where a carrier scheduling and operating at least one round trip per week with Part 121 aircraft in passenger service qualifies for the carriage of mail, effective with the service date of this order, until further Department action;
2. Parties wishing to object to this order may file objections within 30 days of the service date of this order. Any objection should contain clear and specific objections to how the rates were calculated, and state what methodology should be employed. The filing of objections will not stay the effectiveness of this order; and
3. We will serve this on the parties to this proceeding.

By:

**KARAN K. BHATIA**  
Assistant Secretary for Aviation  
And International Affairs, X-1

**(SEAL)**

---

<sup>17</sup> By Order 2002-1-4, the Department froze the bush mail rate almost two years ago because it found that the update methodology relied on since 1990 relied on parameters that were biased by size of aircraft. Because unbiased parameters were unavailable, the order required the carriers to begin reporting more detailed T-100 information. Long-term T-100 information is not available for these carriers at this time, because the carriers only began reporting this information in January 2002.

## Linehaul Mail Rate for Part 121 Aircraft, Based on YE June 30, 2003

	System Parameters				
	Peninsula	Peninsula	Frontier	ERA	
1. Capacity Related Expense (CR), Skd. F-2	\$5,019,360	\$5,019,360	\$1,657,158	\$8,081,425	
2. Direct Expense, including fuel, Skd. F-2	\$25,548,757	\$25,548,757	\$12,596,268	\$21,130,267	
3. Indirect Expense, Skd. F-2	\$15,104,295	\$15,104,295	\$5,520,739	\$16,886,689	
4. CR Markup: [1/(2+3-1)]+1 1/	114.09%	114.09%	110.07%	127.00%	
5. Return and Tax Markup 2/	109.46%	109.46%	109.46%	109.46%	
6. T-100 Segment Skd. Mail RTMs, As-Flown	789,357	789,357	299,450	125,945	
7. T-100 Market Mail RTMs, Nonstop	903,399	903,399	278,744	125,940	
8. Circuity Factor, [6/7] 3/	100.00%	100.00%	107.43%	100.00%	
	By Aircraft Type				
	Saab 340	Metro III	B-1900	Twin Otter	
	Exclude Pax. Liab. Expense From Eligible Linehaul Expense				
9. Direct Expenses, Skd. F-2	\$7,781,712	\$9,857,048	\$10,081,448	\$8,284,097	
10. <u>Less Passenger Liability Insurance, Skd. F-2 4/</u>	<u>\$433,269</u>	<u>\$475,911</u>	<u>\$511,215</u>	<u>\$174,537</u>	
11. Linehaul Expense Allocable to Mail [9-10]	\$7,348,443	\$9,381,137	\$9,570,233	\$8,109,560	
	Increase Linehaul Expense Allocable to Mail by the Markups				
12. Linehaul + CR [11*4]	\$8,383,839	\$10,702,939	\$10,533,955	\$10,299,141	
13. Linehaul +CR + Return and Tax [12*5]	\$9,176,950	\$11,715,437	\$11,530,467	\$11,273,440	
14. Linehaul + CR + Return and Tax + Circuity [13*8]	\$9,176,950	\$11,715,437	\$12,387,181	\$11,273,440	
	Allocate Expenses to Scheduled Pax. Svc. On Blk. Hours				
15. System Rev. Blk. Hrs., T-100 Segment	5,693	11,458	14,390	12,406	
16. <u>Skd. Rev. Blk. Hrs. in Pax. Service T-100 Segment</u>	<u>5,492</u>	<u>10,850</u>	<u>13,815</u>	<u>11,136</u>	
17. Linehaul Expense in Pax. Service [14*16/15] 5/	\$8,852,944	\$11,093,777	\$11,892,210	\$10,119,380	
	Determine Unit Cost per Weighted RTM				
18. Skd. Passenger RTMs in Pax. Svc., T-100 Segment	2,042,013	2,055,559	2,360,082	1,125,888	<u>Mail Total</u>
19. Skd. Mail RTMs in Pax. Svc., T-100 Segment	143,009	509,027	156,225	68,429	<b>876,690</b>
20. <u>Skd. Freight RTMs in Pax. Svc., T-100 Segment</u>	<u>69,891</u>	<u>128,756</u>	<u>131,991</u>	<u>26,063</u>	
21. Total RTMs, with Frt. Wtd. @ 75% [18+19+20*.75] 6/	2,237,440	2,661,153	2,615,300	1,213,864	
22. Unit Cost per Wtd. RTM [17/21]	\$3.9567	\$4.1688	\$4.5472	\$8.3365	
	Unit Cost of Mail Weighted by Volume of Mail				
23. Mail Percentage, Cells in Line 19 divided by <b>876,690</b>	16.31%	58.06%	17.82%	7.81%	<u>Wtd. Total</u>
24. Unit Cost, Wtd. By Mail RTMs As-Flown [22*23]	\$0.6453	\$2.4204	\$0.8103	\$0.6511	<b>\$4.5271</b>
	Implicit Load Factor, For Reference				
25. ATMs in Skd. Pax. Service, T-100 Segment	4,739,886	5,472,598	5,444,806	2,302,992	
26. Load Factor, [(18+19+20)/25] 7/	47.57%	49.22%	48.64%	52.99%	

1/ Numbers in brackets refer to line numbers.

2/ Per Order 90-10-34, Appendix F.

3/ Nonstop Mail RTMs cannot exceed As-flown Mail RTMs, so circuity is forced to Zero.

4/ Passenger Liability Expense.

5/ Calculation excludes non-scheduled and all-cargo costs.

6/ Total RTMs weights Freight RTMs at .75, per Order 90-10-34.

7/ The Load Factor calculation *per se*, lines 25 thru 26, does not affect the rate. However, if RTMs of traffic doubled with no increase in ATMs, then load factor would double. If other things stayed the same, the rate would be cut in half.