

Order 2010-2-15
Served: February 17, 2010

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



Issued by the Department of Transportation
on the 17th of February, 2010

Essential Air Service at

**AKHIOK, ALASKA
KARLUK, ALASKA**

Under 49 U.S.C. 41731 *et seq.*

**DOCKET OST-2007-0020
DOCKET OST-2004-19342**

ORDER TERMINATING CARRIER-SELECTION CASE

Summary

By this order, the Department is: (1) relying on Servant Air, Inc., to provide subsidy-free essential air service (EAS) at Akhiok and Karluk, Alaska, and (2) terminating the carrier-selection case effective April 1, 2010, when the currently effective EAS contract at each community expires.

Background

Order 2007-5-18, selected Redemption Inc., d/b/a Island Air Service, to provide subsidized EAS at Karluk. The service was set at three one-stop round trips per week to Kodiak with 9-seat Islander aircraft for an annual subsidy of \$29,481. Order 2009-2-5 extended that rate through March 31, 2010, so as to be on the same subsidy-rate cycle as Akhiok.

Order 2008-2-10 selected Servant Air to provide subsidized EAS at Akhiok. The service was set at three one-stop round trips per week in the peak and two one-stop round trips per week in the off-peak, all to Kodiak. All of the service was to be with 5-seat Piper Lance aircraft for an annual subsidy of \$51,079.

In anticipation of the end of those contracts, by Order 2009-11-10 the Department requested "best and final" proposals to both communities, with proposals due December 22. In response we received proposals from Island Air and from Servant Air.

Servant Air

Servant Air initially submitted a proposal for Akhiok only. It proposed to increase its frequency to three nonstop round trips per week year round, and would increase the size of its aircraft to 9-seat Cessna 208 turbine aircraft. All of that service would be to Kodiak (ADQ). Servant requested \$556,715 annual subsidy for this service.

Island Air

Island Air submitted proposals for both Akhiok and Karluk. The carrier also submitted two options at each community. All of Island Air's service would go to Kodiak (ADQ).

Akhiok: Under Option 1, Island Air proposes to provide three nonstop round trips per week year round with 5-seat Piper Cherokee aircraft (PA-32). Island Air requests \$42,803 annual subsidy for this service. Under Option 2, Island Air would provide three nonstop round trips per week with 9-seat Islander aircraft, and request \$56,592 annual subsidy.¹

Karluk: Under Option 1, Island Air proposed to provide three nonstop round trips per week year round with 5-seat Piper Cherokee aircraft. Island Air requests \$44,349 annual subsidy for this service. Under Option 2, Island Air would provide the same level of service as under Option 1, three nonstop round trips per week with 5-seat Piper Cherokees, but requests \$49,762 annual subsidy. The only difference from Option 1 is that Island Air projects reduced passenger revenue under Option 2 due to lower passenger fares.²

Revised Proposal from Servant Air

On December 24, 2009, we summarized these proposals and requested comments from the State of Alaska, regarding which carrier or option they wished to have us pick, with comments due January 13. We served copies of that letter on both carriers. On January 11, we received a revised proposal from Servant Air. In its revised proposal, Servant Air indicated that

Servant has invested in the facilities and equipment to service this market, and that significant investment will be lost if it does not continue to be the designated Essential Air Service provider at Akhiok.Servant withdraws its [initial] proposal for service to Akhiok. Instead, Servant proposes to provide the required Essential Air Service to Akhiok and Karluk for \$0 as the designated carrier for a period of two years. ...Specifically, Servant Air proposes to provide three round trips on a year-round basis to Karluk with small aircraft, and also three round trips per week in the peak season and two round trips per week in the off-peak season with small aircraft to Akhiok as the designated Essential Air Service carrier for the two markets. ...Servant is willing to begin this service on April 1, 2010, at the expiration of the existing rate agreements. While this bid represents some risk for Servant Air, it is less risky than losing its market

¹ Island Air projects significantly increased revenue under Option 2 because somewhat lower passenger and freight yields are more than offset by substantially increased volumes of passengers and freight. However, the increased revenue is less than the increased expense of operating the larger aircraft.

² The proposed lower passenger yields are not fully offset by slightly increased numbers of passengers.

at Akhiok. ...This proposal saves the Federal government subsidy expense and guarantees the current level of community service. Servant Air retains its right to reduce service on 90-days notice if the service situation at Akhiok and Karluk changes.

Rebuttal of Island Air

On January 15, Island Air answered Servant Air. Island Air notes that Servant Air had ample opportunity to submit a subsidy-free proposal prior to the December 22 deadline, and notes that Order 2009-11-10 stated that “interested carriers should prepare proposals with every expectation that their initial proposals will also be their final and only proposals.” Island anticipates that Servant will file a 90-day notice in the near future, thus triggering a new subsidy case.

Community Comments

We received informal comments from the state. The state was concerned that relying on Servant Air’s subsidy-free service not impair or prejudice the future eligibility of these communities in case Servant Air proved unable to continue to provide subsidy-free EAS.

On January 21, 2010, we received comments from Akhiok’s Mayor. The Mayor in general supported Servant Air, the company, and not any specific proposals. He noted that “Servant Air, Inc., has become the most dependable, safe, and affordable air service for the community. This company has been very respectful to the People of the villages. [Servant Air] has made positive impacts on Kodiak Island. We fully support the continuation of this company in to our community” In addition, the Mayor supported Servant Air’s initial proposal. “We would like to support Servant Air in obtaining a turbine-engine aircraft. A turbine-engine aircraft is essential for Kodiak Island taking into consideration the diverse and fast changing weather on the island.”

On February 1, we received comments from the Karluk Tribal Council. The council endorses Island Air’s Option 2. The council notes that Island Air performs a much needed service to Karluk. Also, the community has been impacted with a downturn to its tourism and fishing, and Option 2 would provide relief with reduced seat fares from the high cost of travel.

On February 10, we received comments from State Senator Gary Stevens. Senator Stevens stated that “Given [Island Air’s] established history of operation on, and familiarization with Kodiak Island, I believe they have the necessary experience and qualifications required of this contract.

Decision

As we do in all our requests for proposals, we asked for proposals “with or without” subsidy. Footnote one of Order 2009-11-10 states:

In cases where a carrier proposes to provide essential air service without subsidy and we determine that service can be reliably provided without such compensation, we do not proceed with the carrier-selection case. Instead, we simply rely on that carrier’s subsidy-free service as proposed.

In addition, 49 U.S.C. 41733(d) states that the “Secretary shall end payment of compensation to an air carrier for providing basic essential air service to an eligible place when the Secretary

decides the compensation is no longer necessary to maintain basic essential air service to the place.” The Department’s policy is that we will not terminate a subsidized EAS carrier’s contract in mid-term, but we will not renew it upon expiration if subsidy-free service exists. Moreover, under deregulation, any carrier may enter any market on a subsidy-free basis at any time. We will therefore rely on Servant Air’s subsidy-free EAS at the end of the existing contracts on March 31. Servant is the incumbent at Akhiok and its contract will expire on March 31, 2010. At Karluk, it will have to inaugurate service and, if it has not done so by April 1, 2010, we will compensate Island Air at the rate contained in its proposal until Servant inaugurates service.³

Regarding the state’s concern, Akhiok and Karluk remain eligible essential air service communities, and Servant must continue providing at least the minimum EAS levels⁴ at both communities unless it files a 90-day notice of intent to suspend service or reduce it below the EAS level, at which point we would hold in Servant, request proposals for replacement service, and conduct a carrier-selection case.

This order is issued under authority delegated in 49 CFR 1.56a(f).

ACCORDINGLY,

1. We rely on the subsidy-free air service proposed by Servant Air, Inc., at Akhiok, Alaska, effective April 1, 2010.
2. We rely on the subsidy-free air service proposed by Servant Air, Inc., at Karluk, Alaska, effective April 1, 2010, or when the carrier inaugurates essential air service, whichever comes later;
3. If Servant Air, Inc., has not inaugurated subsidy-free essential air service at Kodiak, Alaska, by April 1, 2010, we set the final rate for Island Air’s essential air service at Karluk Alaska, as described in Appendix C, to be effective April 1, 2010, until Servant Air inaugurates essential air service. If Servant Air inaugurates essential air service at Karluk before April 1, Island Air will continue to receive its existing rate through March 31, 2010;
4. If Servant Air has not inaugurated subsidy-free essential air service at Karluk, Alaska, by April 1, 2010, we direct Redemption, Inc., d/b/a Island Air Service, to retain all books, records, and other source and summary documentation to support claims for payment, and to preserve and maintain such documentation in a manner that readily permits its audit and examination by representatives of the Department. Such documentation shall be retained for seven years or until the Department indicates that the records may be destroyed, whichever comes first. Copies of

³ Such subsidy is calculated and distributed on a fiscal year basis, subject to the availability of appropriated funds.

⁴ Akhiok’s EAS requires a minimum of three scheduled round trips per week in the peak, two in the off-peak, to Kodiak, with small aircraft and up to two intermediate stops. Karluk’s EAS requires a minimum of three scheduled round trips per week year round to Kodiak, with small aircraft and up to two intermediate stops.

flight logs for aircraft sold or disposed of must be retained. The carrier may forfeit its compensation for any claim that is not supported under the terms of this order;

5. We will serve copies of this order on the State of Alaska, Servant Air, Inc., and Redemption, Inc.

By:

Susan Kurland
Assistant Secretary for
Aviation and International Affairs

(SEAL)

An electronic version of this document is available on the World Wide Web at
<http://www.regulations.gov>

Appendix A



Nonstop Great Circle Miles

AKK-ADQ	84
KYK-ADQ	74
AKK-KYK	44
ANC-ADQ	252

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Appendix B

Redemption Inc., d/b/a Island Air Service, Annual Subsidy Need at Karluk, Alaska, Docket 2004-19342

	<u>Karluk</u>
Total Block Hours	280
Aircraft Type:	PA-32
Departures	312
Passenger & Cargo	\$86,645
<u>Mail Revenue</u>	<u>\$14,185</u>
Total Revenue	\$100,830
Pilot	\$20,965
Fuel & Oil	\$27,054
Maintenance	\$23,431
Lease	\$12,332
<u>Insurance</u>	<u>\$9,249</u>
Total Directs	\$93,031
Traffic Related	\$11,596
Departure Related	\$9,641
<u>Capacity Related</u>	<u>\$23,998</u>
Total Indirects	\$45,235
Operating Expense	\$138,266
<u>Profit @ 5%</u>	<u>\$6,913</u>
Economic Cost	\$145,179
Annual Compensation	\$44,349

Appendix C

Island Air Service, Inc., Inc., Essential Air Service to be Provided to Karluk, Alaska, Docket OST-2004-19342

Effective Period: If Servant Air has not inaugurated essential air service by April 1, 2010, this rate will be effective from April 1, 2010, until Servant Air does so.

Scheduled Service: Three nonstop round trips per week, ADQ-KYK-ADQ.

Aircraft: Piper Cherokee, PA-32, 5 seats

Rate per Eligible Flight: \$142 ¹

Weekly Ceiling \$852 ²\$

Note: The carrier understands that it may forfeit its compensation for any flights that it does not operate in conformance with the terms and stipulations of the rate order, including the service plans outlined in the order and any other significant elements of the required service, without prior approval. The carrier understands that an aircraft take-off and landing at its scheduled destination constitutes a completed flight; absent an explanation supporting subsidy eligibility for a flight that has not been completed, such as certain weather cancellations, only completed flights are considered eligible for subsidy. In addition, if the carrier does not schedule or operate its flights in full conformance with the order for a significant period, it may jeopardize its entire subsidy claim for the period in question. If the carrier contemplates any such changes beyond the scope of the order during the applicable period of this rate, it must first notify the Office of Aviation Analysis in writing and receive written approval from the Department to be ensured of full compensation. Should circumstances warrant, the Department may locate and select a replacement carrier to provide service on these routes. The carrier must complete all flights that can be safely operated; flights that overfly points for lack of traffic will not be compensated. In determining whether subsidy payment for a deviating flight should be adjusted or disallowed, the Department will consider the extent to which the goals of the program are met and the extent of access to the national air transportation system provided to the community.

If the Department unilaterally, either partially or completely, terminates or reduces payments for service or changes service requirements at a specific location provided for under this order, then, at the end of the period for which the Department does make payments in the stipulated amounts or at the stipulated service levels, the carrier may cease to provide service to that specific location without regard to any requirement for notice of such cessation. Those adjustments in the levels of subsidy and/or service that are mutually agreed to in writing by the Department and carrier do not constitute a total or partial reduction or cessation of payment.

Funds are not currently available for performance under this order beyond September 30, 2010. The Government's obligation for performance under this order beyond September 30, 2010, is subject to the availability of appropriated funds from which payment for services can be made. No legal liability on the part of the Government for any payment may arise for performance under this order beyond September 30, 2010, until funds are made available to the Department for performance. If funds are not made available for performance beyond September 30, 2010, the Department will provide notice in writing to the carrier.

Subsidy contracts are subject to, and incorporate by reference, relevant statutes and Department regulations, as they may be amended from time to time. However, any such statutes, regulations, or amendments thereto shall not operate to controvert the foregoing paragraph.

All claims for payment must be submitted within 60 days of the last day of service provided under this order.

¹ Annual compensation of \$44,349 ÷ 312 one-way flights per year = \$142

² ADQ-KYK-ADQ, 3 round trips/week * 2 directions * \$142.