

U.S. – CHINA AIR SERVICES (2001)) Docket OST-99-6323

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SUMMARY OF ARGUMENT

This case challenges the Department of Transportation to take concrete action to acknowledge the reality of the new global economy and to advance the interests of the U.S. in that new environment. With its power to award access to one of the world's most important markets of the 21st century, the Department can make a bold choice -- one that will give substance to the rhetoric of globalization, and underscore the leadership role of the United States in the high-efficiency, high-technology world of international commerce in the new century.

This case, in short, challenges the Department to allocate its one new China designation to an air carrier that will most clearly advance these key objectives, while also promoting traditional and important goals of economic development for all affected elements of the economy, and competition to benefit American consumers. So conceived, the choice of an air express carrier -- United Parcel Service -- for the new designation to China is by no means a difficult one.

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Put aside the rhetoric in this docket about favoring "people over packages" or "trade over tourism," or the usual sniping over the precision of traffic forecasts. The big issues for the Department are the same as ever-- which applicant best serves the needs of U.S. consumers and shippers, which is the strongest new competitor and, in the end, who brings the greatest economic benefit to the U.S.

But the nature and importance of the U.S. – China market, now and for the future, and the dramatic shifts in world commerce occasioned by globalization, compel a rigorous consideration of the meaning of "public benefit." That criterion today means far more than "moving the most

people" from point A to point B. Rather, it must encompass how the new designee will enhance U.S. economic leadership in the global marketplace, and how it will ensure that the benefits of the global economy are equally open to all Americans -- including not only U.S. consumers, businesses, and their employees, but also the U.S. workers that form the backbone of the transportation infrastructure of globalization.

Applying this "public interest" test inexorably leads to the award of the new China designation to UPS. Just as "air transport is the circulatory system of the global economy," in the words of Under Secretary of State Alan Larson, air express is its lifeblood. As the world's largest express carrier, UPS is the key element in the process of "just-in-time" delivery that has revolutionized the global supply chain. UPS provides the indispensable infrastructure of a new economy based on high-value, high-technology U.S. exports to the global marketplace. It is the key to the growth and success of e-commerce, as the single largest transporter of internet-generated sales. UPS is, in short, one of the key engines of U.S. economic leadership for the 21st century.

This case is not, as some would have it, a simplistic choice "between people and packages." Nor would the selection of UPS ignore the significance of "people-to-people" contact -- in both economic and political relations. In fact, UPS serves every front door in America every day and, with a China designation, could connect each of these front doors to millions of Chinese homes and businesses. This ubiquitous and substantive "people-to-people" contact is most certainly no less important than facilitating additional tourist visits.

More importantly, there is a real operational and competitive need for a second U.S. air express carrier to China -- a need that is much more compelling than adding a sixth passenger

airline. As reliable traffic forecasts plainly demonstrate, and as even passenger carriers in this case have candidly admitted, there is little present or foreseeable need for additional passenger capacity to China. Conversely, the demand for cargo service is confirmed by high cargo load factors, and by the commercial decisions of incumbent carriers to add cargo, not passenger, service to the market.

But the need for a second air express carrier to China goes well beyond the need for additional capacity in what is likely to become one of the world's most important business markets. Rather, it goes to the critical need for competitive service in what is today effectively a monopoly market of Federal Express. This monopoly -- which allows Federal Express alone the critical opportunity to maintain custodial control of its shipments to and from China -- means higher prices for consumers and shippers. Further, the express market is more than just letters. It is comprised of small packages, express freight and expedited shipments. Carriers without access to China cannot serve large shipments of small packages. And this noncompetitive regime stifles competitive service options, innovations and better overall service for shippers.

Today, UPS has no comparable access to China, through Hong Kong or elsewhere, and Federal Express itself advertises it has no effective competitors in the China market. Studies demonstrate the lack of existing competitive service to key China regions. In a market of this magnitude and this importance to U.S. export leadership and the development of comprehensive trade relationships, it is simply inconceivable that U.S. shippers and consumers are forced to rely on a single, large-scale air express operator.

UPS can best fulfill this critical need for better and more competitive air express service. One of the nation's largest and most renowned companies, UPS has developed an extensive air

network in Asia, lacking only an effective competitive presence in China. UPS is deeply committed to expanding that market and has been an active champion of expanded trade with China. Contrary to the efforts of some in this proceeding to falsely characterize that commitment, UPS has a strong record of support for China's WTO status and for passage of Permanent Normalized Trade Relations ("PNTR") with China, including numerous and ongoing personal efforts of its Chairman and top management. UPS is a leader in expanding open trade and aviation throughout the region, with its Chairman now leading the important U.S.-ASEAN Business Council.

Competitive access to China is UPS' top international priority. Based on years of commitment to Asian markets, UPS will bring immediate benefits to this market, including highly-competitive prices and better service. In this and other ways UPS will ensure that the new U.S. designation creates maximum value for the U.S. economy. In fact, the beneficial impact on the U.S. economy of the proposed UPS service would dramatically outstrip that of all other applicants in this proceeding. UPS would clearly bring the greatest U.S. job growth – and ensure that the benefits of the new global economy are shared not just by U.S. business and consumers, but also by those whose labor facilitates the movement of goods and information to and throughout that new economy. UPS would also do more to expand trade with China and more to lower the trade deficit than any other applicant.

The unprecedented support UPS has received from public officials from across the entire nation, as well as from over one thousand businesses, underscores the importance of this route case and reflects their recognition that the benefits of UPS' proposal will flow throughout the country.

No other applicant in this case can offer the scope of the benefits that the designation of UPS would generate. Aside from the fact that none can provide the express cargo service so plainly important to the U.S. in the new economy, each of the other individual applicants offers benefits that are both limited and local. As American's proposal essentially overlies United's new service from Chicago to Shanghai, the benefits to consumers of the new service would be limited to only the very few markets not served by United from Chicago. An award to Delta for its New York City-China proposal would benefit only the New York metropolitan area (and even then, only marginally), given Delta's limited traffic at JFK. Also, Polar provides only general air freight service, rather than the air express service which is so critical to this growing market.

In short, the selection of UPS in this case makes the most sense-- for the U.S. in the new global economy, for U.S. consumers, shippers, and workers, and for the development of strong and lasting commercial ties with the world's most populous nation. For the reasons stated below, UPS respectfully urges that the Department grant it the new designation and the frequencies for which it has applied in this docket.

I. THE SELECTION OF UPS WOULD MAXIMIZE PUBLIC BENEFITS

A. With an award to UPS, the U.S. can best advance U.S. leadership in the new global economy that demands rapid and reliable express transport of goods to world markets like China.

Last month, in a speech to the International Aviation Club, Under Secretary of State Alan Larson underscored the critical importance of an adequate global transportation infrastructure necessary to support U.S. economic leadership in the 21st century:

The enormous potential for cross-border online sales of physical goods can be fulfilled only if the infrastructure exists to order, ship, track, clear, and deliver these goods to the customer's door The development and integration of telecommunications, transportation, customs, and delivery services in support of e-commerce will revolutionize the way we do business in the 21st century.

Of all of the applicants in this proceeding, UPS is by far the best equipped to advance this critical national priority – and to do so in China, the company's top international priority.

As the first major case to be decided by the DOT since the advent of the new global economy, this proceeding demands a careful consideration of the meaning of “public interest” in that economy. Fully-integrated air express service¹ using today's information technology² is the indispensable infrastructure of this new global economy.

¹ “Fully-integrated express service” means expedited, time-definite, guaranteed door-to-door air transportation under the control of a single carrier for the entire journey with real-time continuously-available shipment status for all aspects of the journey, including customs clearance being the responsibility of the carrier.

² “Information technology” includes the technology necessary for obtaining real-time shipment status as well as electronic integration with customs, electronic pre-alert for consignees, electronic signature confirmation on receipt, logistics management information systems and electronic funds transfer between shippers, receivers and UPS.

The Department's decision here can have a significant impact on the strategic, economic and political relationships between the U.S. and China. Testifying for UPS, former Secretary of Commerce and U.S. Trade Representative Mickey Kantor explained: "In a world where economics is interdependent and strategic, political and economic issues overlap, it is vital that our policies and decisions mesh in order to be successful in achieving our economic goals." (Exhibit UPS-RT-3). Having created the tools to best "enable" U.S. business abroad, UPS can clearly do the most to further "our economic goals" with respect to China. It is important to the U.S. economy and the future role and growth of U.S. companies in the global economy that they have the best "enabler" to grow their business in China.

As the infrastructure of the global economy, air express service is revolutionizing the product supply-chain, allowing producers to access the world's key markets with previously unimagined efficiencies and speed. By definition, air express provides time-definite delivery and greatly reduced transit times – the essential requirements of the "just-in-time" business models that have so dramatically enhanced U.S. productivity and optimized supply-chain management. The time-definite services to China proposed by UPS promise to save U.S. businesses a wide range of supply-chain costs (Exhibit UPS-T-3 Table 19). Such services, for example, allow costly inventory stocks to be kept at a minimum without sacrificing assured availability of critical parts and supplies. This permits manufacturers to ship a full-day's production on the same day, thereby avoiding warehousing costs.

With the right to fly to China, UPS will be able to deliver virtually all time-definite shipments to and from China a full day faster than presently possible -- an improvement that is critical to exporters and importers in reducing daily ownership costs, accelerating sales revenue, and reducing physical inventory and back-order handling costs. Savings due to reduced transit

time at the direct exporter or importer level and similar savings available to every party in the supply chain will be multiplied many times.

The kind of express services proposed by UPS will become even more critical in the increasingly competitive global marketplace – particularly as that marketplace moves rapidly toward a high-value, time-definite and high-technology paradigm. The other applicants for the new designation simply cannot meet the accelerating need for fully-integrated express service. Indeed, in China, the relationship of high value, time-definite business to general air freight in the UPS traffic mix will shift over the next several years toward more high value, express shipments. The express segment of the market will grow rapidly from 42% to 70% express cargo over the next five years (Exhibit UPS-T-3, Table 25).

The air express market is important because the traffic is high value. This means higher economic benefits generally because high value products are produced by highly educated and skilled workers earning high incomes. High value shipments make up a substantial portion of the U.S. – China air traffic. U.S. – China cargo values, per pound and in total, have increased since 1994 (Exhibit UPS – 1107). High value goods—those that most often travel by express or expedited services—represented, by an overwhelming margin, the largest U.S. exports to China both by weight and value (Exhibit UPS-1108). High value U.S. exports also reduce the trade deficit.

In addition to offering air express service, UPS offers efficiency-enhancing logistics solutions that integrate with UPS' express service to enable U.S. businesses to streamline their distribution networks, for both the receipt of raw materials and for distribution of finished goods, to gain efficiencies. Major companies such as Dell, Nike, Sprint, General Motors, Motorola,

Microsoft, IBM, Hewlett Packard, Cisco, Phillips and Ford Motor Company all receive logistics assistance from UPS.

UPS express service is also becoming the infrastructure of the e-commerce revolution. This is a phenomenon of major importance to the future of U.S. commerce with China, an explosive internet/e-commerce growth market showing a ten-fold increase in on-line connections in only four years (Exhibit-UPS-710). Today, UPS is the leading carrier of e-commerce, having shipped the majority of holiday e-commerce packages in 1998. (UPS' 55% market share compares only to 10% for Federal Express (Exhibit UPS-706)). UPS has invested \$11 billion in information technology in the past ten years to create a supply-chain network serving over two million shippers and seven million customers daily (Exhibit UPS-T-1 and UPS-718). As a result of UPS' focus on technology, e-commerce and the new economy, it is now one of the few companies worldwide, and most likely the only airline, that offers "one source" capability for all three of the critical components of global e-commerce: the flow of goods, the flow of information and the flow of funds (Exhibit UPS-720, 721).

In short, air express service -- offered by UPS alone among those seeking the designation here -- is the critical conduit for the kinds of high-technology, high-value products that are the key to U.S. trade and continued U.S. leadership in the global market. Nowhere is this capability more important than in U.S. service to China, the critical emerging market of the 21st century.

B. There is a demonstrated need for competitive express air express cargo service to China that is far greater than the need for increasing passenger service in a market already served by five airlines.

The key determinant of the public interest in this case is which applicant will meet the greatest service need. There is already plentiful passenger service -- five carriers -- in this

market, and considerable unused passenger capacity that is now devoted to one-stop service over Japan, rather than to non-stop U.S. – China service. There is a large and growing need for U.S. – China air express/cargo service. The U.S. air cargo market to China is growing dramatically, and, since 1994, at an annual rate of 23.6%. In the reverse direction, China to the U.S., the market has grown at an average annual rate of 11.1% (Exhibit UPS-1102, 1104). China is the United States' second largest trading partner in Asia, and its market is growing at a faster rate than any other U.S. – Asia market (Exhibit UPS-502, 503). In 1998 (the latest year for which data are available), China represented one-sixth of all U.S. air trade with major Asian trading partners, including nearly a quarter of all Asian imports (Exhibits UPS-504, 506).

The UPS forecast demonstrates the shortage of existing air cargo capacity in China that is imposing competitive constraints upon both the air express and air cargo markets (UPS 1100 Series Exhibits). There is and will continue to be a shortfall in capacity in the express/all-cargo segment of the U.S. – China market. For example, in 2003, even with UPS in the market, demand will exceed capacity by almost 40% (Exhibit UPS-R-506, p.2). Also, the UPS limited stimulation demand forecast, when compared with the forecasts of available air cargo capacity show a shortfall in both the express and air freight sub markets (Exhibits UPS-1112 and UPS-R-205). At this time, UPS is unable to reduce this capacity shortfall since connecting service onto passenger airlines at Hong Kong is the only access available. This is an unacceptable alternative for serving Beijing, Shanghai and nearly all of China. The extra time, extra miles and extra connections all combine to undermine the service (Exhibit UPS-R-511).

The inadequacy of cargo capacity in the U.S. – China market is confirmed by Northwest which testified that freighter and combination belly space capacity on all U.S. and Chinese carriers in 1998 could handle only 60% of the year's demand (Exhibit NW-409). With increased

demand, Northwest testified that year 2000 cargo capacity will meet only 44% of the projected demand, an increasing shortfall clearly not in the public interest (Exhibits NW-N-1, p. 12 and NW-409). The situation will only worsen without added express/all-cargo capacity.

Northwest's load factors also show the shortage of cargo capacity in the China market. Northwest's cargo load factor on its eastbound combination service for the third and fourth quarters of 1999 averaged over 96%, and its new freighter service has achieved similar high load factors (Exhibit NW-105). The average load factor on Northwest's freighter service for November – December 1999 was 82.6%, and was as high as 97% on some flights (Exhibit NW-104). The fact that Northwest's freighter service has reached such high load factors immediately after being introduced further shows a strong, unmet demand for all-cargo capacity in the market.

The demand for cargo capacity is also confirmed by commercial decisions of incumbent carriers. For example, Chinese carriers in the U.S. – China market increased or will increase all-cargo flights 86% (from 7 to 13) from April 1999 to August 2000 (Exhibit UPS-R-110). Northwest, which can use its frequencies to operate either type of service, has converted two of its existing frequencies from passenger to all-cargo operations and proposes to use two of the frequencies it seeks in this proceeding to do the same.

The extent of this unmet demand for additional cargo service is even further underscored by a comprehensive study financed by Federal Express. Federal Express and Delta in their respective rebuttal exhibits³ repeatedly refer to, and rely on, a study which was sponsored by the Pacific Economic Cooperation Council to assist the U.S. government negotiators in the U.S.-

³ Exhibits FX RT-2, pp. 9-10; FX R-111, 112, 113, 115 and 116. Exhibits DL RT-3, p. 3; DL R-211, pp. 3-6.

China bilateral negotiations in late 1998 and early 1999.⁴ This study describes the enormous potential of that market. Indeed, it forecasts the potential size of the market as almost twice that forecasted by UPS here, and the report projects eight times greater stimulation of cargo as a result of new service than UPS' projection in this case. Clearly, UPS has been conservative in its numbers.

While Federal Express relied heavily on the report's conclusion in the previous China case (Docket OST 99-5539),⁵ Federal Express' claims are dramatically less enthusiastic now that UPS seeks to end its monopoly in operating its own aircraft to China. Specifically, in the earlier China proceeding, Federal Express predicted that the market would grow, with their entry, from 145% to 239% depending upon the city served. In this proceeding, however, Federal Express would have the DOT believe that there will be virtually no stimulation of demand in the markets UPS proposes to enter (Beijing and Shanghai). Even still, Federal Express argues that in the market between the U.S. and the city of Dalian, where Federal Express would become the only service provider, its service would stimulate the market by a whopping 10,092%! This would make the Dalian market more than twice the size of the U.S. to Beijing market in less than two years. Apparently Federal Express believes stimulation occurs only in markets it exclusively serves. As such, the Department should regard with the greatest possible skepticism Federal Express' criticism of the major growth of the U.S. – China cargo market that UPS projects.⁶

⁴ Campbell-Hill Aviation Group, Inc. "An Analysis of Economic Benefits from Full Liberalization of Integrated Air Express Service in the Asia-Pacific Region, a Case Study: China." (October 26, 1998).

⁵ Application of Federal Express Corporation for allocation of U.S.-China's frequencies, p. 12, Exhibits FX-109, p. 4, and FX-110, p. 2.

⁶ Federal Express and Delta both argue that approximately 41% of all Chinese exports and imports are to/from Southern China, and infer that this traffic travels through Hong Kong or Shenzhen. (Exhibit FX-R-T-2, p. 6, FX-R-111 thru 113, and Exhibit DL-R-210)
(continued...)

No more credible is American's similar claim that there is ample cargo capacity in the U.S. – China market (Exhibit AA-124). American conveniently ignores both the double-digit historic growth in the U.S. – China cargo market and the further stimulation of growth from new service (Exhibits UPS 1102, 1104). Instead, it relies on unsubstantiated data found on the World Bank and United Nations websites. Aside from the fact that no carrier has hitherto resorted to these sources in a DOT route proceeding, American fails to provide any of the actual statistics from these websites, nor did it even indicate where in the websites it obtained the statistics on which it relies. Such vague references, which are impossible to validate, should be given no credence by the Department. Also unavailing is American's heavy reliance on the IATA poll.⁷

(...continued)

Therefore, they argue that to ensure accuracy UPS forecast traffic must be reduced 41% to remove all Southern China-related traffic. (UPS reduced its forecast by 11.8% in removing Southern China-related traffic).

UPS disagrees with Federal Express and Delta since their argument assumes that UPS' traffic forecast includes traffic moving on Hong Kong flights. This assumption is incorrect and contrary to the facts presented in Exhibits UPS-1140, -1141 and -1142. UPS' traffic forecast includes only Chinese traffic on the proposed UPS Beijing and/or Shanghai aircraft service, as reduced by the 11.8% Southern China experience factor imbedded in the UPS forecast. UPS' traffic forecast specifically excludes any consideration of its Hong Kong services or Hong Kong traffic since this is not a cost or time-efficient substitute service for direct U.S. aircraft operations from and to Beijing and Shanghai.

In addition, Federal Express' own Direct Exhibits belie the proposed 41% reduction. Federal Express forecasts that, for the year ending March 31, 2002, under its Base Line forecast, between 80% and 89% of its traffic will be from/to Beijing and Shanghai, and only between 10% and 20% from/to Shenzhen, depending on traffic direction. In fact, after the introduction of the Dalian service, the share of Shenzhen will drop to 18.3% from China to the U.S. eastbound traffic and to only 5.0% for the U.S. to China westbound traffic. (Exhibit FX-401) In short, Federal Express finds greater traffic from Southern China for UPS than for itself.

⁷ Still, even the IATA poll shows eastbound cargo capacity will be inadequate to handle the traffic demand (Exhibit UPS-R-505).

The poll fails to include the assessments of most U.S. and Chinese carrier actually serving the market, and includes mostly small third-country carriers (UPS-R-501).

The inadequacy of the existing U.S. express/all-cargo services in the market is further demonstrated by the fact that U.S. flag carriers have only one-third of the express cargo and freight capacity between China and the U.S., even with the new authority beginning April 2001 (UPS-R-205). If American or Delta were selected in this proceeding, U.S. carriers would be condemned to this minimal market share, and U.S. businesses would be denied additional competitive access to Chinese markets.

On the other hand, U.S. passenger carriers have ample capacity available through their current frequency allocations to serve the U.S. – China passenger market for many years without any frequency award in this proceeding (UPS 800 Series Exhibits). Today, much U.S. – China capacity is being operated over Japan to serve the needs of the U.S. – Japan and Japan – China markets, rather than the U.S. – China market. (Exhibit UPS-805). Until very recently, only four of the 25 weekly passenger frequencies were used to operate non-stop U.S.- China service (Exhibit UPS- 805). While passenger carriers can change the routings of these flights from one-stop to non-stop -- as United Airlines has recently done -- they choose to continue to operate one-stop flights.

The reason for this practice is not hard to discern: weak demand and low load factors on current passenger service for the U.S. – China market. In fact, even assuming a 20% annual traffic growth in the U.S. – China passenger market, U.S. carrier passenger load factors will remain extremely low (Exhibit UPS-818), especially as compared to those of other Asian destinations (Exhibit UPS-819). For example, United's 1997 load factor in the U.S. – China market was 28.3%, its load factors in Japan and Korea were 71.4% and 76.2% respectively.

This pattern of excess passenger capacity has been consistent in the U.S. – China market, with data for 1994 through 1998 showing extremely low load factors, often below 30% (Exhibit UPS-821). Again, assuming a dramatic 20% passenger growth rate, more than 800,000 U.S. carrier U.S. – China seats are projected to be flown empty each year (Exhibit UPS-823, 824).

Northwest, a market incumbent, testified to the lack of demand for additional passenger service, now and for the foreseeable future.

Northwest does not foresee a need for a great deal of new capacity in the U.S. – China passenger market. To the contrary, the market is suffering from a significant excess of capacity . . . [G]iven the current excess capacity, . . . it will many years before the market will require a large number of additional passenger frequencies.

(Exhibit NW-N-1, p. 2, p. 16 (emphasis added)).

There is a reason why the U.S.-China cargo market is underserved and the passenger market is overserved. While China is the second largest overseas air cargo market for the United States, it is only the 26th largest passenger market, ranking below Costa Rica. While almost 5% of all U.S. air trade is with China, the China market accounts for less than 1% of all U.S. international passengers (Exhibit NW-108).

C. Beyond the need for more cargo/express service, there is a critical need for direct competitive service in this important market.

The selection of UPS in this proceeding would break the monopoly of Federal Express as the only express/cargo carrier in the U.S. – China market able to operate a complete portfolio of shipper-to-recipient services in which it maintains full control of the service, end-to-end. This control necessarily includes Federal Express' exclusive right to operate its own aircraft in the China market. Because UPS cannot operate its own aircraft to China, UPS' current service is not only substantially slower than Federal Express' service, but UPS also cannot provide general air

freight, expedited or express freight service to China (Exhibit UPS-R-511) Federal Express is taking full advantage of this exclusive power, exemplified by its ongoing nationwide television advertisement in which it proclaims: “Next time, use the only express shipper with direct routes from China” (Exhibit UPS-R-632 (emphasis supplied)). Federal Express clearly knows the value of its position in the marketplace.

As Federal Express knows, to compete effectively in the express cargo market, it is essential to be able to control and oversee each step of the process – from pickup, to flight, to sorting, to dispatch and delivery. This is a key reason UPS has, over just the last decade, built the tenth largest airline in the world. The need for critical custodial control from origin to destination demands that UPS, like Federal Express, conduct its own flights to China.

In fact, Federal Express itself reiterated the importance of an air express carrier’s ability to control shipments from pick-up to delivery. In a recent speech, for example, the Vice President of Federal Express, Asia-Pacific Division, addressed the “critical success factors” for express service in Asia and affirmed that “custodial control” of the packages from pick-up to delivery is essential. He stated: “The express carrier must maintain custodial control over the shipment for the entire time it is in transit . . . interjecting an outside party into the process . . . could compromise quality and generally adds unnecessary time and cost to the process.” (Speech before the Airports Council International-Pacific Division, April 9, 2000, p. 16 (emphasis added)).

The great competitive importance of being able to conduct one’s own air operations in an international market is well understood by the Department. The Department first addressed this issue in 1992 in the U.S. – Mirabel All-Cargo Proceeding (Docket 47717). The Department had

to decide whether to authorize UPS to serve Montreal for the first time with its own aircraft, or to enhance Federal Express' existing direct service, thus keeping UPS in the position of having to place its traffic on other carriers. The Department chose UPS, noting:

Federal Express can and does operate its own aircraft five times per week in the Memphis – Montreal market and has full control of the traffic carried, an ability that Federal Express has stated on many occasions, including in this proceeding, is critical to providing effective service to the shipping public UPS currently has no authority to operate . . . with its own aircraft Thus, UPS has far less control over its Montreal traffic than does Federal Express and is in a vastly inferior competitive position.

(Order 92-8-7, p. 4. (emphasis added)). The situation is identical here. UPS cannot operate its own aircraft to China and thus has “far less control over its traffic” placing it in “a vastly inferior competitive position.”

By selecting UPS in another recent route case, the U. S. – Philippines All-Cargo Service Proceeding (Docket OST-96-1074), the DOT reiterated the importance of being able to operate one's own aircraft in a market:

We are not persuaded that UPS' ability to serve the Philippines as an indirect air carrier should prevent it from being selected to serve the market as a direct air carrier, as other applicants argued. Direct air service offers considerable public interest benefits and quality of service to shippers that result from the direct air carrier of being able to control the transportation and handling of cargo; this quality of service cannot be matched by service performed as an indirect air carrier.

Order 96-11-7, p.4 (emphasis added).

Despite the well-recognized importance of custodial control to compete effectively, some parties have labored mightily to demonstrate that UPS can adequately serve China by placing its cargo traffic on other carriers (Exhibit AA-140). American even sponsored a study purporting to show that UPS is not at a competitive disadvantage in China today (Exhibit AA-T-5). Yet, that

study is so flawed as to be of no evidentiary value. To reach the spurious conclusion that “shippers such as UPS already provide express service comparable to Federal Express” (Exhibit AA-T-5, p. 9.), the American study relied on tests carefully structured to show Federal Express’ service in its worst light. To show that UPS could deliver letters from China as quickly as Federal Express, the study sent its “test” letters from China to the U.S. on Monday—the only day of the week that Federal Express does not fly from China to the United States. Thus, all the Federal Express shipments picked up in China on the Monday of the test sat overnight waiting for the next day’s flight. If the “test” had been conducted on a Tuesday, or on any other day Federal Express operates, Federal Express’ service would have beaten UPS’ service by roughly 24 hours – a period that makes all the difference in the world for express shipments. UPS reviewed American’s report and has shown that UPS’ longer transit times for service to and from China are wholly and exclusively a function of UPS’ inability to serve China directly with its own aircraft (Exhibit UPS-R-511).

To counter the grossly distorted nature of American’s “study”, UPS requested ACNielsen to conduct a transit time study of UPS’ and Federal Express’ service to and from Beijing and Shanghai (Exhibit UPS-RT-7). The ACNielsen study found that Federal Express has a clear one day advantage in transit time both to and from Shanghai – an advantage based solely on the ability of Federal Express to operate its own aircraft to China. In fact, during the course of the ACNielsen trial, all nine UPS shipments from the U.S. to Shanghai were “bumped” by the air carrier UPS uses from Hong Kong to China because of capacity limitations (a frequent problem),

further delaying their delivery. This highlights the severe problems that UPS faces when it is forced to rely on third-party passenger airlines to transport its customer's packages to China.⁸

Not only did American's study fail to describe accurately the competitive situation for express letters, it inaccurately implied that the "test" represented the competitive situation of the entire express market. In fact, letters represent only a tiny fraction of weight and volume in the express market. Just as importantly, UPS cannot offer express freight products, or expedited and general air freight, because it cannot rely on a third-party to provide these services. As such, Federal Express enjoys the greatest advantage in being the only one able to offer these services.

The conclusion is inescapable: when Federal Express chooses to take advantage of its unique ability to provide direct service into and out of China, its service is faster than the UPS service by a significant margin since UPS has no option but to use other carriers to move its shipments. There is, in short, no competitive express service in this market, as Federal Express' advertising so proudly states.

The importance of such competitive service, of adding a first major competitor to this key cargo market, is underscored in this proceeding by the former Chairman of the President's Council of Economic Advisers, Dr. Joseph Stiglitz. In his testimony, Dr. Stiglitz highlighted the impact of such first-time competition in lowering prices to consumers when compared to the effect of simply adding more firms to an already well-served market: "There is a strong

⁸ Not surprisingly, American Airlines also argues that UPS need not fly to China in order to serve the market effectively since DHL does so. The facts are that DHL carries almost exclusively letters and documents. As the General Manager of DHL Worldwide Express recently stated, "Traditionally DHL started as a document carrier, and we still are." (New Straits Times, Malaysia (April 13, 2000)). Letters and documents take very little space (continued...)

presumption in economics that adding a second firm to a market with a single extant firm would produce a larger decline in price than adding a third U.S. firm to a market with two extant U.S. firms.” (Exhibit UPS-RT-4 (emphasis added)). If one considers the market presence of not only the two U.S. incumbent passenger carriers, but also the three Chinese carriers, Dr. Stiglitz’s views are even more clearly applicable since the addition of yet another passenger carrier to a market with five existing firms would only marginally affect competition.

Dr. Stiglitz’s policy conclusions are borne out in the case of Federal Express’ China dominance. For key market segments, Federal Express enjoys actual yields for its traffic in the China market considerably higher than its yields in other Asian markets where it faces open competition on a level playing field (Exhibit FX-R-131).⁹ For example, Federal Express’ yield for its popular “courier pak” is 33% higher in China than its yield in Singapore, where Federal Express faces competition. (*Id.*) Federal Express enjoys a similar premium in yields on the transport of heavier shipments (*Id.*).

To the same effect, in the U.S.-Mexico All-Cargo Service Proceeding (Docket 45959), UPS compared Federal Express’ yields before, during and after UPS commenced competitive next day air service domestically. UPS showed that yields per package, beginning at \$25.04 the year UPS commenced overnight service, declined steadily until 1988 when they reached \$17.22 (Exhibit UPS-R-102). Just as UPS’ competition lowered Federal Express’ yields in the domestic U.S. market, its competition against Federal Express in China will have the same effect.

(...continued)

⁹ and are therefore much more easily carried in the bellies of passenger aircraft than can be UPS’ mixed cargo of express freight, heavier expedited freight, and general air freight. Of the markets listed in FX-R-131, Singapore best exemplifies a “level playing field” in terms of open operating and traffic rights between UPS and Federal Express.

Without competitive pressure, Federal Express has little incentive to improve its service in the market. As important as the benefits of competition in lowering prices, so are the quality of service and market innovations generated by multiple strong competitors in a market. The lack of significant competitive pressure on Federal Express in the U.S.-China express market naturally limits Federal Express' incentives to ensure that U.S. shippers and exporters can access that market with the best and fastest non-stop service (Exhibit UPS-RT-4). Thus, absent daily nonstop competition from UPS, there is little incentive for Federal Express to provide nonstop service in the U.S. – China market, or to change its primary focus from the U.S. – Japan and China – Asian markets. For example, Federal Express now operates all of its U.S. – China flights over Japan and/or other intermediate Asian stops, and indeed proposes to add new flights only over Japan. (UPS-R-544; FX-206). Only the addition of UPS as a competitor can provide the incentive for Federal Express to improve service.

D. UPS best fulfills the need for the enhanced infrastructure necessary to maximize trade with China.

The United States can have no better example of a corporate citizen to represent the United States and U.S. business, political and social interests in China than UPS. The quality and extent of UPS' service, and its leadership and experience, have been recognized on countless occasions, including most recently by Forbes magazine in naming UPS "Company of the Year." (UPS 100 Series Exhibits).

But beyond the company's unmatched overall business reputation, UPS has demonstrated a long-standing commitment to serve Asian markets – a commitment not shared by other applicants in this proceeding. UPS has taken full advantage of the open skies opportunities negotiated by the U.S. government to develop an extensive Asian system. It has also competed

vigorously and won contested route cases where necessary (*e.g.*, in the Asia Pacific region, the Philippines and Japan) in order to build its Asian system.

Today, UPS serves Tokyo, Osaka, Seoul, Taipei, Hong Kong, Manila, Kuala Lumpur, Singapore, Mumbai, Penang, Fiji and Sydney in the Asia Pacific region (UPS-303). Indeed, while Delta and American serve only Japan, they have discontinued service to a total of six Asian points. Indeed, UPS operated its first flight to Asia – to Seoul and Hong Kong – in 1990, only two years after becoming an airline (Exhibit UPS-302). In the ten years since that first flight, UPS has built an Asian network that today serves 12 cities in nine countries with UPS' own aircraft (Exhibits UPS-303, 302, p. 18). UPS' exhibits describe graphically the step-by-step methodical approach taken to develop Asian system.

American and Delta have not developed Asian networks and declined to take advantage of the open skies agreements negotiated by the U.S. government in Asia. Neither Delta nor American has demonstrated tangible support for the U.S. government's Asian open skies initiatives by actually serving and continuing to serve the Asian open skies countries (Exhibits UPS-R-604, 605); UPS, in contrast, serves 4 major Asian open skies economies-- , Singapore, Taiwan, Korea and Malaysia (Exhibit UPS-R-603).

This commitment to Asia is indicative of a broader UPS commitment to open markets including, specifically, China. UPS has long demonstrated strong support for opening the China market. Since before the commencement of this proceeding, UPS consistently supported WTO status for China. For example, on April 8, 1999, UPS stated that it “strongly supports admitting China into the World Trade Organization.” UPS added:

As a global company, UPS believes that the best route to a cooperative and open trading relationship with China is through China's accession to

the WTO. This would result in more opportunities, not fewer, for American companies.

In light of UPS' public and active support of WTO status for China, it is difficult to understand how Federal Express could misrepresent UPS' widely advocated position in favor of China's accession to WTO. In particular, Federal Express stated:

Federal Express, unlike UPS, is committed to expanded trade and commerce with China. The Department should select an applicant that is unequivocally committed to expanding trade with China and to China's accession to the World Trade Organization ("WTO"). Federal Express is such an applicant, UPS is not.

(Exhibit FX-RT-1, p.3 (emphasis added)). Federal Express is incorrect.

In the same vein, some have suggested that UPS should not be designated because some of the organized employees of UPS disagree with the company's position supporting PNTR with China and WTO status for China. Aside from the fact that this diversionary effort has nothing to do with which carrier in this case will best serve the public interest, UPS is confident that this unjustified and inappropriate ploy will be recognized for what it is.

UPS is working actively for the passage of Permanent Normal Trade Relations ("PNTR") with China – a vital component of increasing trade and creating new jobs for all Americans. UPS launched a major campaign to raise awareness of the need for PNTR with Members of Congress. This campaign will include sending thousands of letters to key legislators from UPS employees outlining the fact that PNTR will create jobs in the United States while also helping to build bridges with the Chinese people so that issues like human rights can be addressed in a constructive manner.

UPS CEO Jim Kelly has personally devoted significant effort in Washington meeting with members of Congress, and participating in the President's Export Council and The Business

Roundtable to promote passage of PNTR. In addition, Mr. Kelly has met with the editorial boards of the Washington Post and the National Journal on this subject, and appeared on CNBC, CNN and Fox Morning news to discuss the importance of PNTR passage. Furthermore, UPS has allocated substantial resources to help fund a national advertising campaign to garner additional Congressional support for PNTR. UPS firmly believes that China accession to the WTO is in the United States' best interests and the best interests of UPS and its 340,000 employees.

E. UPS will maximize U.S. economic benefits derived from the new designation in the U.S. – China market.

1. An Award to UPS Will Enhance U.S. Leadership in the Global Economy.

By facilitating high-value trade and investment between the U.S. and China, the designation of UPS will most significantly enhance U.S. economic interests, improve economic development, and develop the 21st century business relationships that the growing U.S. – China trade relationship demands. While a full passenger aircraft may transport a few hundred people, a full UPS B-747 will, on average, transport 10,000 shipments benefiting potentially 10,000 shippers, 10,000 consignees and all those having jobs related to the shipments. Express/all-cargo service, in short, creates vastly more economic benefits than does passenger service, and helps maintain U.S. leadership in Asian trade. In serving these huge numbers of shippers and consignees, UPS will carry \$2.3 billion worth of new exports and \$1 billion worth of new imports in its first year of direct aircraft operations in China. The value of these exports and imports to the U.S. economy in terms of jobs and sales far exceeds the economic value that passenger carriers would bring, as detailed below.

2. An Award to UPS Would Result in the Greatest U.S. Job Growth.

An extensive study by Dr. David Smith of the University of Virginia demonstrated that the benefits that would be derived from adding the cargo flights which UPS proposes would be larger – by a magnitude of almost 11 to 1 – than the benefits of the additional passenger operations proposed here (Exhibits UPS-T-3 and 1200 Series). The economic benefits of UPS' proposal may be summarized as follows:

UPS's proposed service would:

- Create 77,000 new u.s. jobs throughout the country in the first year of service. These employees would be paid \$3.1 billion the first year, and \$5.8 billion by the fourth year of service.
- Increase employment and trade which will add \$8.4 billion to the u.s. economy in the first year of service.
- Reduce the trade deficit by over \$1 billion in the first year of service by increasing the amount of high-value exports from the u.s. to china.

None of the passenger carrier applicants in this proceeding can provide even a small fraction of the benefits UPS can offer. In the data American submitted to DOT, it forecast the creation of only 3,663 jobs. (Delta did not provide any data as to the jobs their proposal would create.) While American predicted that its proposal would bring only one-quarter of a billion dollars in total economic benefits to the U.S. economy, UPS forecasts \$8.4 billion in economic growth. Again, Delta failed to provide the relevant data.¹⁰

Sebago Associates confirmed Professor's Smith analysis in a study entitled, "The Economics of the U.S. – China Air Services Decision." It stated:

Professor Smith's conclusions appear reasonable in three important respects: First given the level of capacity and competition in the cargo and passenger markets, awarding the designation to UPS does appear to offer higher economic benefits than alternative designations. Second, such a designation would provide transportation services for higher-valued products than non-express cargo shippers. Third, the UPS jobs created as a result of the designation would be relatively high-paying ones.

Sebago concluded that "the evidence suggests that designating an express cargo carrier offers more economic benefits than alternative designations." (Exhibit UPS-RT-5, pp. 26, 27 (emphasis

added)). Significantly, none of the competing applicants offered any substantial evidence to rebut the methodology used by Professor Smith to estimate the economic benefits.¹¹

3. An Award to UPS Will Best Improve the Balance of Trade Between the U.S. and China.

Adding competitive UPS service to China will significantly contribute to improving the balance of payments with China – in part because UPS will transport to China U.S. goods that have a far greater value than the Chinese goods UPS will transport to the United States. Typical exports UPS will carry to China include semiconductors, jewelry, chemical and electronic sensors and medical products (Exhibit UPS-1223). By exporting higher value goods to China and importing lower value goods from China, UPS service will facilitate improvements in the

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¹⁰ Dr. Smith has prepared estimates for the economic benefits of all applicants. (UPS Exhibit R-400 series). He demonstrated the large gulf in benefits between UPS and the passenger airlines.

¹¹ Federal Express mistakenly concludes that UPS valuation of transportation benefits double counted UPS direct revenues, compensation and jobs. Federal Express subtracts UPS direct benefits from amounts clearly labeled “Indirect Benefits” in Exhibits UPS-1206 and UPS-1207. Clearly indirect benefits do not include direct benefits. American, in Exhibit AA-R-252, claims that UPS multipliers are too high, claiming that Federal Express multipliers are more realistic. Exhibit AA-R-253, compares Federal Express multipliers with UPS multipliers. Then, Exhibit AA-R-254 estimates UPS benefits using “Federal Express assumptions.” As usual, American does not explain why the Federal Express multipliers are more realistic nor do they explain their calculations. Professor Smith describes the difference between Federal Express multipliers and UPS multipliers in his rebuttal testimony (Exhibit UPS-RT-6). Moreover, American failed to compare its own methodology (Exhibit AA-601) to that of UPS. American employs the IMPLAN model to estimate economic benefits of its proposed China service. American uses multipliers of the IMPLAN model but does not set forth their values. In his rebuttal testimony, Professor Smith makes the observation that the multiplier used to estimate economic benefits of American’s purchase of four B-777 aircraft appeared to be approximately 3.0. American provides no basis to test this observation, but Professor Smith notes that a value of 3.0 puts the American multipliers in line with the UPS multipliers which are derived from the U.S. Department of Commerce, Bureau of Economic Analysis, RIMS-II model.

U.S. – China trade balance of over \$3 billion by 2005 (UPS-T-3, p. 9, Table 6).¹² This large increase in high value exports creates high-paying, high skill level U.S. jobs which raise the U.S. standard of living.

4. UPS' nationwide network produces nationwide benefits.

The substantial economic benefits of UPS' service will flow to every front door in the United States (UPS 100 Series Exhibits). Perhaps the most graphic example of the scope of UPS' system is that it carries 13 million packages each day (Exhibit UPS T-1, p. 2), or over 3 billion packages per year. UPS' closest competitor, Federal Express, carries only 3.2 million packages per day (Exhibit FX-204, p. 1). Delta serves approximately 107 million passengers per year and American 95 million passengers (Exhibit UPS-116). Through UPS' extensive network, UPS serves almost four times more customers on an annual basis than either Delta or American (Exhibit UPS-116).

II. NO OTHER APPLICANT FOR THE NEW DESIGNATION OFFERS THE BENEFITS OF UPS

A. No other applicant for the new designation can provide the express services so critical to U.S. – China business in the new global economy.

Neither the other applicants for the new designation, American, Delta and Polar, nor the incumbents, Northwest and United, can provide the vitally important fully-integrated express services market essential to U.S. – China trade in the coming century. This fact alone should lead to the designation of UPS. The support for UPS by 53 U.S. Senators, 305 Members of the

¹² At Exhibit UPS-T-3, p. 4, Table 3, the commercial value per pound of time-definite products is shown to be about double the average value per pound of all export and import shipments by air in the U.S. – China market. The average value per pound of express shipments is over seven times that of airport-to-airport general air freight shipments (Exhibit UPS-1250).

House of Representatives, 37 governors, and over 80 mayors underscores UPS' claim that no other applicant for the new designation can provide the express services so critical to U.S.-China business in the new global economy.¹³

Passenger carriers cannot adequately serve the express/cargo market for multiple reasons. First, their "belly capacity" is limited. Passenger carriers necessarily give priority to passengers and their baggage, and relegate cargo to a lower priority. An American Airlines B-777, for example, will have a belly capacity just under 18,000 lbs. at a passenger load factor of 70% while UPS' B-747-200 freighter has a capacity of 168,000 lbs. (Exhibits UPS-617, 908).

Second, passenger carriers must schedule their flights to suit passengers, not shippers. For example, passenger carriers from the United States to Asia never leave after midnight. For cargo shippers, and particularly air express shippers, these passenger departure times are not only inconvenient, and terribly inefficient. Anything other than an after-midnight departure does not allow shippers to complete a full day's production, pack it up, have it picked up and loaded on the aircraft that same night. Anything other than an after-midnight departure means the loss of one day's production and perhaps additional (and unnecessary) warehousing costs. UPS departs from the United States for Asia in the 2:00 a.m. to 4:00 a.m. range to meet the needs of its customers, and the customers' customers (Exhibit UPS-905). Later departures also permit broader geographic coverage because there is more time to move the cargo from its point of

¹³ Federal Express claims that UPS overstates its political support (Exhibit R-108). A review of the exhibits and rebuttal exhibits filed by American, Delta and Polar indicates that they have received the support of 64 members, 12 members, and zero members, respectively. Thus, even assuming UPS' and American's support completely overlap, UPS has 294 more members' support than any other applicant.

origin to the airport. Passenger schedules result in an extra day (24 hours) for a package to transit from shipper to recipient in U.S. to Asia markets (Exhibit UPS-912).

Third, passenger carriers do not provide door-to-door, fully-integrated express service but rather only airport-to-airport general air freight service. UPS provides both general air freight and fully-integrated-express service. Passenger airlines simply do not have the infrastructure to serve the booming U.S. – China express and expedited air freight market, as they cannot provide integrated door-to-door service, cannot guarantee express and cargo space every day on every flight, and do not carry outsized cargo or offer fully-integrated logistics services (UPS 900 Series Exhibits). In addition, passenger carriers do not provide comprehensive electronic tracking and tracing of shipments from pickup to delivery, do not have electronic proof of delivery, do not have door-to-door single-entity control of shipments, and offer no supply/distribution chain management services (Exhibit UPS-903). Nearly all of these deficiencies apply also to the two other applicants proposing freighter service, Polar and Northwest. They serve only the general air freight market.

The nature and importance of fully-integrated express service was well described by James P. Kelly, Chairman and Chief Executive Officer of UPS. In his direct testimony (Exhibit UPS-T-1, p.7) Mr. Kelly states:

High value products must rely on air express movement for export to China, as well as other markets. Their value and inventory carrying costs requires guaranteed transit times direct from the manufacturer to the importer. Their high value also requires the security of a door-to-door movement with the complete assurance that the shipment will be delivered to the correct consignee in the time promised by the carrier. These products cannot be moved in the bellies of passenger aircraft, where they have no priority, and where integrated pickup, brokerage [door-to-door tracking] and delivery services are simply not available.

The Department has itself clearly recognized the importance of being able to serve all segments of the market, from the airport-to-airport general air freight market to the door-to-door, fully-integrated express market in the U.S. Philippines All-Cargo Service Proceeding, Docket OST-96-1074. There, the choice was between UPS and carriers that did not serve the fully-integrated/express segment of the all-cargo market. In that proceeding, the Department, in Order 97-1-17, page 7, noted:

UPS is the only carrier offering comprehensive, integrated express/small package service plus general air freight service, thereby enabling it to provide the most meaningful competition to the incumbent, Federal Express, an integrated all-cargo carrier. As we stated in Order 96-11-7, the selection of UPS, with its emphasis on serving the express/small package market, in combination with any of the other applicants, stressing the general air freight market would provide the best and broadest range of service options for shippers in the market . . . UPS offers the greatest range of services over the largest transportation network with the greatest geographic coverage of any of the applicants . . . In addition, UPS is the only applicant that can fully and effectively compete with Federal Express . . . thus furthering the goal of benefiting the overall market structure and level of competition.

The situation is identical here.

Accordingly, the DOT should award the designation and frequencies to a fully-integrated all-cargo carrier able to provide both the significant economic benefits and the trade enhancements available from fully-integrated all-cargo service, as well as first-time competition for the incumbent monopolist, Federal Express.

B. The other applicants for the new designation offer only limited and local benefits.

1. American's Chicago service would be a useless duplication of United's B-747 Chicago service.

The selection of American, which would result in wingtip-to-wingtip, duplicative service by American and United from Chicago to China, would be a waste of this valuable designation.

In fact, considering Northwest's China service from Detroit, American's Chicago – China service would result in the Midwest having 71.4% of the U.S. – China frequencies, but only 18.9% of the traffic (Exhibit UPS – R-106). In effect, the United States is getting Chicago – China service from United without sacrificing this new designation because United will soon operate Chicago – Shanghai service under its current authority.

United's planned service from Chicago is fatal to American's proposal and leaves American to argue that the Department should merely ignore United's service. United's motivations for instituting its non-stop Chicago – Shanghai service are irrelevant in determining what is best for the U.S. public interest. Ignoring this key issue, American relies on a long-outmoded Civil Aeronautics Board decision from the pre-deregulation era – tellingly, this case was decided in 1971 at a time when the CAB was authorizing virtually no new route authority because it was more concerned with the financial “plight” of airlines than improving service and increasing competition. Service to Lincoln, Nebraska Civil Aeronautics Board Order 71-4-75 (June 24, 1971).

Every one of American's traffic forecast assertions are predicated on a core falsity: that American, and only American, will operate from Chicago (Exhibits AA-300-317). How else could American forecast that it will carry 78% of the passengers between Chicago and Shanghai? (Exhibit UPS-R-302-309). When one considers the reality of United's Chicago – Shanghai service, nearly two-thirds of American's local projected Chicago – Shanghai would in fact shift to United, and American's Chicago – Shanghai load factor would drop to a dismal 37.9% (Exhibit UPS-R-310). This is because United, not American, is the larger airline at Chicago, both domestically and overall (Exhibit UPS R-309). Further, United, not American, would be operating the larger aircraft; United's B-747 has 66% more capacity than American's B-777 on

the Chicago – Shanghai sector. For the United States to create a duplicate service would be a shocking waste of a scarce international commodity. Moreover, the selection of American, in addition to United’s new service, would result in more than two-thirds of all China service going to the Midwest (Exhibit UPS R-304).

Of the 91 markets American listed as generating traffic for its proposed service (again, failing to adjust for United’s Chicago– Shanghai service), United’s Chicago– Shanghai service would offer travelers better elapsed time in 53 of those markets (Exhibit UPS R-311). And while American claims its service would provide “first time, non-stop-to-non-stop service to 80 new U.S. cities,” that number declines to 22 cities when United’s service is taken into account (Exhibit UPS R-318). In only 18 of these 22 cities did American forecast any traffic (representing only 1.8% of American’s Chicago– Shanghai forecast passengers (Exhibit UPS R-318)). In short, the public benefits which would accrue from American’s duplicative service are insignificant.

Finally, there must be real doubt as to the validity of American’s proposal to use the very expensive B-777 aircraft on the Chicago – Shanghai route (Exhibits AA-T-1, AA-222, 223). Aircraft layovers of 17 hours at Shanghai and 18 hours at Beijing in American’s proposed schedule are longer by five and six hours, respectively, than any aircraft layover on American’s extensive international system, and it is hard to imagine that American would, in fact, keep such valuable assets so underutilized (Exhibits AA-201, 204) (Exhibits UPS-R-307, 308).

Given these doubts, it is not surprising that, of all the applicants, American, and only American, insisted that the certificate awarded in this case should give it complete “routing flexibility” (Petition of American Airlines, Inc., for Reconsideration of Order 2000-1-21,

February 2, 2000). In plain English, American does not want to be held accountable for operating the service it proposed. Given the extreme traffic dilution American will suffer as a result of United's service, and the aircraft scheduling difficulties which American will encounter on the route, one must wonder what service American would actually operate if it is awarded the new designation. In the past, American has shown extreme "flexibility" in altering its service pattern worldwide to accommodate its financial interests to the point that it abandons service completely.¹⁴

Faced with these insurmountable difficulties, American seeks to undermine UPS proposal with exhibits purporting to demonstrate that the market for express service is stagnant and presently adequately served. As was discussed more fully above, *supra* pp. 9- 14, there is (1) historic double-digit growth in the market for all-cargo air services; (2) rapid growth of this market in the future; and (3) severe capacity constraints now existing in this market.

A choice of American would inject a sixth passenger carrier (the third U.S. passenger carrier) into the U.S. – China market and would result in the duplication of United's announced service at Chicago. On the other hand, the selection of UPS will inject first time direct competition in the express/all-cargo market, resulting in far greater economic benefits to every section of the United States. Sound policy demands the choice with far broader benefits.

2. [Delta's proposal does little to improve existing service and generates little new traffic.](#)

Delta's proposed service provides no national benefits, and provides only minimal benefits to its nearly sole beneficiary – the New York City metropolitan area. Delta's lack of

¹⁴ For example, American abandoned Nashville-London service in 1995, Philadelphia-
(continued...)

flow traffic at JFK severely limits its network benefits. New York travelers are already well-served in the China market through their excellent connections.

Flow traffic is required to make any U.S.-China passenger route viable and sustainable over time. Delta's own route proposal for China demonstrates this in two respects. First, Delta would not have proposed single-plane service behind JFK at Atlanta if the flow traffic that it could forecast from Atlanta and behind-Atlanta were not necessary to justify a "route case acceptable" forecast. That Delta needed the Atlanta and behind-Atlanta flow to present an acceptable New York-China forecast does not mean that the behind-New York service will be used by many passengers. As UPS has shown, neither the Atlanta-China passengers nor behind-Atlanta passengers would be well-served by Delta's proposed JFK-China service (UPS-R-300 series exhibits). Second, in addition to Atlanta and behind-Atlanta service, Delta obviously needed to operate beyond Beijing to Shanghai to make its forecast "route case acceptable."

Even for New York City itself, the service improvements of Delta service would be small. This is because of the excellent connections New York City will enjoy to China via United's Chicago service and over multiple other gateways (Exhibit UPS-R-312). In fact, Delta's proposed New York – Shanghai service would have the same elapsed time (17:25 hours) as that available over Chicago on United from LaGuardia Airport (Exhibit DL-101, p. 1).

For the remainder of the United States, the benefits of Delta's proposal would be negligible. For example, Delta's single plane service from Atlanta would provide Atlanta-originating passengers with longer elapsed travel times to Beijing than would Northwest's

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London service in 1995, and New York-Rio de Janiero service in 1999.

service via Detroit and significantly longer elapsed travel time to Shanghai than United's service over both Chicago and San Francisco (Exhibit UPS-R-336). Delta's proposed JFK service will provide few benefits beyond the New York City area because:

- Fully half of Delta's 58 total online connections at JFK for its proposed JFK – Beijing – Shanghai service (Exhibit DL-208) would have circuitry exceeding 30%, and even Delta concedes they would produce no traffic whatsoever (Exhibit UPS-R-329);
- Of the 52 points Delta serves from JFK, 21 are European points. None of these would have an elapsed time to China via Delta at JFK even close to their current elapsed times traveling to China in the eastbound direction (Exhibit UPS-R-330); and
- Of the 20 U.S. cities for which Delta would provide online connections to JFK, Delta would provide the best elapsed time to Beijing in only five of those cities (Exhibit UPS-R-331), and in none of those cities to Shanghai (Exhibit UPS-R-332).

The narrow focus of benefits of Delta's proposal is underscored by the lack of improved service even to other points in New York State. The proposed JFK – Beijing – Shanghai service would provide online connections at JFK for only one upstate New York point—Rochester—and the elapsed time from Rochester to Beijing is not better on Delta than on Northwest via Detroit, and is far worse to Shanghai on Delta than on United from San Francisco or Chicago (Exhibit UPS-R-333). Basically, no one from upstate New York would fly on Delta to China because Delta's proposed service for upstate New York points (such as Albany, Buffalo and Syracuse) is to fly on Delta all the way to Atlanta, connect with the originating segment of the China flight, then fly back to JFK to connect with the onward flight to China (Exhibit UPS R-335).

Also, with American, the choice of Delta would inject a sixth passenger carrier (the third U.S. passenger carrier) into the U.S. – China market and improve service slightly for a single U.S. metropolitan area over the existing excellent connecting service. On the other hand, the

selection of UPS will inject first time direct competition in the express/all-cargo market resulting in far greater economic benefits to every section of the United States. Again, sound policy demands the choice with far broader benefits for more Americans.

3. By failing to build an Asian network, Delta and American cannot offer the synergies that maximize the value of these frequencies.

UPS has demonstrated a long-term commitment to Asia by developing an extensive Asian network. Selecting UPS to serve China will add the critical missing link to that network which will increase the network synergies that, in turn, amplify consumer benefits. This is why UPS Chairman and CEO James Kelly has made clear that “China is UPS’s top international priority” (Exhibit UPS-T-1, p.1). Delta and American have demonstrated no similar level of commitment to providing U.S. travelers comprehensive access to Asia, focusing narrowly on the limited entry markets of Japan and, now, China (Exhibit UPS-302). See also, supra at 21.

Indeed, neither American nor Delta is using all of the U.S. – China code sharing authority that the U.S. government negotiated for and received on American’s and Delta’s behalf (Exhibits UPS R-611, 621, 622). In fact, both American and Delta will be able to code share to nine additional points in China in April 2001, and five additional points in April 2002 (Exhibits UPS R-612, 613, 623, 624). Thus, by April 2002, American and Delta each will be able to code share at over 20 points in China and have the ability to participate in extensive U.S. China markets (Exhibits UPS-R-614, 625).

While American and Delta both try to lay claim in this proceeding to the one available U.S. designation to China, neither has invested in building an Asian network as UPS has done. Nothing is preventing American and Delta from building an Asian network today to benefit its passengers, as UPS has for its shippers. Instead, American and Delta want the best of both

worlds: direct access to China, -- a limited entry market -- without investing in an Asian network. In contrast, UPS has invested in China and Asia, and maintained service even as the economy declined. Today, UPS serves 12 points in the Asia-Pacific Region, including the four fully-open markets (Exhibit-UPS-303).

In fact, Delta recently confirmed explicitly its relative lack of interest in developing an Asian system. In the testimony of its Executive Vice President, Frederick W. Reid, in the 1999 U.S. – Argentina Combination Service Proceeding, “Atlanta -- Argentina is Delta’s highest international route priority” (Exhibit UPS-R-618 (emphasis added)). In addition, Mr. Reid added “Latin American routes are the most profitable, fastest-growing and most important growth market in the world for Delta.” *Id.* Given Delta’s primary focus on Latin America, it is not surprising that Delta has largely withdrawn from Asia. In fact, Delta has abandoned service from Taipei, Bangkok, Hong Kong, Seoul and Fukuoka (Exhibit UPS R-619).

4. Polar does not serve the business-critical air express market.

Polar serves only the airport-to-airport general air freight market and does not serve the fully-integrated, door-to-door express segment of the market (UPS R-500 Series Exhibits). While Polar describes itself as a “general freight specialist,” UPS serves both segments specifically as part of its core business (Exhibit PO-T-1, p. 4).

There are also extensive problems with Polar’s service proposal. Because less than one-third of Polar’s forecast freight originates in the three states it serves, 63% of Polar’s freight to China must be trucked for one, two or three days prior to aircraft loading (Exhibits UPS R-561, 562, 563). Also, Polar reported severe financial losses showing a net loss of \$38.4 million in 1998 similar to those of Evergreen when that company was awarded China rights (Exhibit UPS-

R-568 and 569). These difficulties should be considered in determining whether Polar would be able to maintain the service.

Even a cursory comparison of the Polar and UPS systems demonstrates that Polar cannot offer anything approaching the broad benefits that UPS will provide. For example, Polar has 14 freighter aircraft (Exhibit PO-201), compared to 229 for UPS. Polar has 600 employees (Dunbr Database, April 12, 2000), compared to 346,000 for UPS, and UPS has 157,000 surface vehicles to serve its shippers. Polar simply can not offer shippers the scope and depth of service offered by UPS and required by shippers. Polar is also incapable of providing effective competition to the incumbent Federal Express.

Finally, in terms of an increase in economic growth, UPS' combination of fully-integrated express and general air freight service will provide growth 2.45 times that of a traditional general air freight operation per departure. For example, in terms of total jobs created, UPS forecasts that its operation would result in 155 total jobs per weekly departure while a traditional all-cargo general air freight operation would result in 66 jobs per weekly departure (Exhibit UPS T-3, p.3). Accordingly, the public interest would be much better served by designating UPS, a carrier which serves the entire market nationwide as opposed to an applicant such as Polar which serves only the airport-to-airport general air freight market over a limited geographical area.

CONCLUSION

The relationship between the United States, the largest economy in the world, and China, the most populous nation in the world with a rapidly developing economy, is of profound

importance. The decision to be made in this proceeding is how best to enhance that relationship to bring China further into the world community and ensure a major place for the United States in trade with China. The selection of UPS would do more to further these objectives than would the selection of any other applicant. The selection of UPS would also provide far more economic benefits, including a larger increase in U.S. exports, more U.S. jobs and a greater reduction of the trade deficit, than would the selection of any other applicant.

In addition to doing the most to enhance the United States' relationship with China, the selection of UPS would inject first-time competition into the express/all-cargo market in contrast to the selection of a passenger carrier which would inject the sixth (and third U.S.) carrier into the passenger market. American would provide service at Chicago which would duplicate United's service, and Delta would provide a negligible service improvement principally to one metropolitan area. The benefits of UPS' service, in contrast, are nationwide.

Accordingly, UPS urges the Department to grant it the new designation and the ten available frequencies in this proceeding to enable it to begin providing the service improvements U.S. shippers and businesses deserve.

Respectfully submitted,

David L. Vaughan
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