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

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

BRIEF OF FEDERAL EXPRESS CORPORATION

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I. INTRODUCTION

This case presents the Department with both a rare challenge and an opportunity. It is a challenge because air express/cargo carriers are competing for the available frequencies with combination carriers. Since cargo and passenger services compete largely in different markets, this case requires a more complex analysis than many recent proceedings. The Department must grant the application of the carrier that will provide the greatest overall economic benefits to the United States. FedEx is that carrier.

This case is also an opportunity. China is a huge potential market for all U.S. businesses, not just air carriers. The right carrier will help exporters capitalize on new market opportunities available throughout China. Conversely, awarding the available frequencies to the wrong carrier will cause U.S. businesses to miss out entirely on those opportunities, allowing enterprises of other countries to establish a stronghold. For these reasons, the Department's selection here will influence future economic and trade relations between the United States and China for many years to come. Accordingly, the Department should carefully analyze each

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application under its established criteria to award the frequencies to the carrier that best furthers U.S. economic goals. Once again, FedEx is that carrier.

In this case, we have shown that FedEx can best further U.S. economic goals in three ways. First, we have a proven track record of promoting U.S. exports and helping U.S. businesses capitalize on market opportunities in China. Our proposal is solid, credible, and based on a sober, realistic analysis of the market.

Second, we are the only applicant to propose cargo service to a new Chinese city, Dalian. Our analysis has shown that opening up new markets with service to additional Chinese cities — not duplicating existing services — is the proper way to approach the Chinese market. The record also clearly shows that demand for expanded air express/cargo services far outstrips demand for passenger services.

Third, our AsiaOne network enables us to serve the U.S.-China market more efficiently than any other applicant, thereby reducing costs to shippers, strengthening the U.S. competitive position in foreign air transportation, and balancing U.S.-China trade flows. Today, more goods flow from China to the United States but, over the long term, we expect that flow to become more balanced. Our network will allow us to respond quickly to these changes.

U.S. businesses need daily, reliable air express/cargo service to China. To provide that daily service, we must have all eight of the frequencies we have requested. Two frequencies will be used to complete the service patterns we have already started, by increasing our services to Beijing, Shanghai, and Shenzhen to a full, daily, six-day-a-week pattern. Six frequencies will be used to start a first-time service to Dalian in the northern industrial province of Liaoning, home to more than 40 million people.

Finally, even though FedEx is the only incumbent carrier that lacks the frequencies necessary to provide double-daily service to China, it makes greater use of its limited allocation than any other carrier. It is the only carrier that operates to a city/region other than Beijing and Shanghai, and it is the only carrier that fully uses the routing flexibility of the bilateral. FedEx's proven record confirms the economic benefits that the United States will derive if the Department awards additional frequencies to FedEx.

II. ANALYSIS OF CARRIER SELECTION CRITERIA

1. Given The Lack Of Clear Precedent, The Department Must Return To First Principles: A Broad View Of The Public Interest.

The Department has rarely been forced to select between passenger and cargo services in a carrier-selection case.[1] Because such choices are rare, there is little clear precedent to guide the choice.[2] For this reason, we urge the Department to return to first principles and scrutinize its public interest mandate. The Department must clearly articulate public interest

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[1] A review of Department precedent reveals only a few cases in which the Department was forced to choose between passenger and cargo services. *See, e.g.*, *U.S.-Japan Route Authority*, Order 90-1-4; *New Route Opportunities (U.S.-Brazil)*, Order 91-8-4; *U.S.-China Air Services*, Order 99-8-9.

[2] For example, in the 1999 U.S.-China case, the Department decided to allocate the additional frequencies "as equally as possible" among the incumbents. *U.S.-China Air Services*, Order 99-6-17 at 7. Similarly, in the 1990 U.S.-Japan case, the Department allocated frequencies between cargo and combination services at the outset, saying "this distribution best reflects the need to introduce a competitive alternative for shippers . . . while reserving a sufficient number of frequencies for combination carriers." *U.S.-Japan Route Authority*, Order 90-1-4. No further explanation for these conclusions was given.

criteria that the statute and its written policy statements permit, such as promoting U.S. commercial interests. It must also disregard those criteria, such as political considerations, that the statute, Congress, and prior written Department pronouncements forbid.

In this brief, we review the broad principles that should govern the Department's decision in this case. We then propose specific selection criteria that those broad principles suggest. Finally, we evaluate the applicants' proposals in light of those criteria. Our analysis shows that FedEx's service proposal provides the greatest economic benefits to the United States.

Starting with first principles, the instituting order identified the selection criteria the Department would use in this case:

> In determining which carrier(s)/gateways(s) will be authorized, our principal objective will be to maximize the public benefits that will result from award of the authority in this case. In this regard, we will consider which applicant(s) will be most likely to offer and maintain the best service for the traveling and/or shipping public. We will also consider the effects of the applicants' service proposals on the overall market structure and level of competition in the U.S.-China market, and any other market shown to be relevant, in order to promote an air transportation environment that will sustain the greatest public benefits. In addition, we will consider other factors historically used for carrier selection where they are relevant.[3]

Essentially, the Department has identified four broad guiding principles in this paragraph:

1) the carrier/gateway that will maximize public benefits;
2) the carrier that will offer and maintain the best service most needed by the public;

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3 DOT Order 2000-1-21 at 3.

3) the service proposal that will have the greatest effect on market structure and competition; and

4) other factors historically used by the Department.

The Department's application of these principles in this case also must be guided by the statutory policy statement[4] and by its own policy on carrier selection criteria, published in the Federal Register on December 1, 1986.[5] Further, the Department's application of these principles must recognize that this case involves competing applications by combination and all-cargo carriers, even though all-cargo services do not compete with the passenger services offered by combination carriers. Because there is limited competition between passenger and cargo services, it is not possible to compare them directly in assessing the quality of service proposals or their effect on market structure and competition. Consequently, a comparison among proposals can only be made on the basis of sensible estimates of a proposal's economic benefits to the U.S. economy.

Based on these considerations and as discussed further below, the Department should use the following criteria to evaluate the competing applications:

1. The extent to which a proposal makes the most effective use of the rights granted in the U.S.-China Protocol.

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4 49 U.S.C. § 40101.

5 DOT Policy Statement on Procedures and Criteria for Selecting Carriers for Limited-Entry Markets, 51 Fed. Reg. 43181, 43186 (1986).

2. The extent to which a proposal furthers the development of an air transportation system responsive to the needs of U.S. commerce, shippers, postal service, and defense.

3. The credibility of a proposal.

4. The ability of a proposal to enhance the market structure in the highly competitive U.S.-China air express/cargo market.

5. The ability of an applicant to flow traffic to and from points behind the U.S. gateway and beyond the foreign gateway (route integration).

6. The ability of an applicant to contribute to the development of U.S.-China economic relations.

In this brief, we discuss the basis for applying each criterion and then evaluate the record in light of those criteria. Proper application of the six criteria to the evidence in the record confirms that FedEx's service proposal provides the greatest economic benefits to the United States and that the Department should, therefore, grant FedEx's application for all eight frequencies.

III. ARGUMENT

1. The Department Must Select The Proposal That Makes The Most Effective Use Of The Rights Granted In The U.S.-China Protocol.

In instituting this proceeding, the Department stated that its principal objective is to maximize the public benefits that will result from awarding the authority. DOT Order 2000-1-21 at 3. The Department can best achieve that objective by awarding the frequencies to the U.S. carrier that can make the best use of the bilateral rights, including those available to U.S.

carriers designated under the U.S.-China all-cargo route. Specifically, a U.S. airline designated under the all-cargo route (U.S. Route B) may

> operate all-cargo services with full traffic rights . . . from any point or points in the United States of America, via any intermediate points to any point or points in the People's Republic of China open to scheduled international operations, and beyond to any points outside of the People's Republic of China.[6]

By contrast, airlines designated under U.S. Route A, the so-called "combination route," enjoy very limited routing flexibility: an intermediate point in Japan, up to five Chinese points, and no beyond points.[7]

Of the applicants in this case, FedEx is the only carrier that has made, and will continue to make, full use of the broad routing flexibility provided for in the bilateral. FedEx is the only carrier proposing to serve four Chinese cities (in addition to Hong Kong) in a country that is the geographic size of the United States and has four times the population.[8] The other applicants would neglect the more than one billion people living outside of Beijing and Shanghai. Only FedEx proposes to inaugurate daily service to Liaoning, a province whose population is greater

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6 Protocol to the Agreement Between the United States and China Relating to Air Transport, art. 3 (route rights), paragraph IB (Apr. 8, 1999).

7 Protocol to the Agreement Between the United States and China Relating to Air Transport, art. 3 (route rights), paragraph IA (Apr. 8, 1999). The broad routing flexibility is available only to U.S. carriers designated under U.S. Route B, the all-cargo route. They are not available, for example, to Northwest, which is currently designated under the combination route, even if it chooses to provide all-cargo service. The same is true for United, should it decide someday to offer U.S.-China all-cargo service.

8 China has 80 cities with more than 2 million people and at least 18 airports capable of receiving the large equipment used in transpacific service. UPS 406, 1312; CIA World Fact Handbook 1999, http://www.odci.gov/cia/publications /factbook/ch.html (visited Apr. 17, 2000).

than that of New York, New Jersey, and Pennsylvania combined.[9] The other applicants simply ignore the needs of U.S. shippers for fast, reliable access to the markets in Liaoning. Faced with a similar situation in an earlier U.S.-China case, the Department favored Evergreen's proposal to serve Beijing, Shanghai, and a new Chinese gateway in southern China, over services focusing solely on Shanghai.[10] Consistent with its prior decisions, the Department should broaden U.S. air coverage of China rather than opt for the marginal public benefits afforded by service to cities that already receive ample air express/cargo capacity.[11]

Further, FedEx would make full use of the unlimited beyond and intermediate rights in the U.S.-China bilateral. All FedEx's flights stop en route in either Japan or Korea, and its Philippine hub allows it to combine traffic flows for maximum efficiency and to fully exploit the unlimited fifth-freedom rights available only to carriers designated on the all-cargo route. All six of FedEx's proposed U.S.-Dalian flights would operate through Seoul, Korea and Tokyo, Japan; its U.S.-Beijing flights would operate through Osaka; and its U.S.-Shanghai/Shenzhen flights would operate through Tokyo and be connected to FedEx's AsiaOne hub.[12] This

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9 U.S. Census Bureau, *State Population Estimates and Demographic Components of Population Change, July 1, 1998 to July 1, 1999* (Internet Release Date: December 29, 1999). *See* http://www.census.gov/population/estimates/state/st-99-1.txt (visited April 17, 2000).

10 *U.S.-China Frequency Allocation Proceeding*, Order 94-12-7, at 17.

11 *See, e.g., U.S.-Colombia Combination Service Case*, Order 93-9-12 at 11; STATEMENT OF U.S. INTERNATIONAL AIR TRANSPORTATION POLICY, 60 Fed. Reg. 21841 (1995) (recognizing the demand for "more and better quality service to more places").

12 Application of FedEx, FX-102-103, 105-106.

enables FedEx to transfer U.S.- and China-originating packages to 15 Asian points outside of China in its AsiaOne network or, indeed, to anywhere else in the world.

No other applicant proposes to make significant use of the broad routing flexibility offered by these unlimited intermediate or beyond rights. Most other applicants, if they use these unlimited rights at all, do so by operating their flights through only one other Asian city, as shown in Table 1:

Table 1
Only FedEx Would Make Full Use of the Routing Flexibility In the U.S.-China Bilateral

Applicant	Proposed Asian Intermediate/Beyond Point
American	None
Delta	None
FedEx	Osaka, Seoul, Tokyo, Subic Bay and 11 points outside China through the AsiaOne network
Northwest	4 frequencies would operate through Tokyo; one would operate nonstop
Polar	Seoul[13]
United	None
UPS	4 frequencies would operate through Japan; the remaining 6 have no intermediate or beyond points

In contrast to FedEx's proposal, the other applicants would thus waste the valuable opportunity presented by the broad U.S.-China routing flexibility. Indeed, UPS's proposal makes so little use of the routing flexibility available under U.S. Route B that the Department

[13] Application of Polar, PO-1. However, Polar plans to completely discontinue service through Seoul once it generates enough westbound cargo to eliminate the stop and operates only B747-400 service. PO-T-1 at 6.

could meet UPS's route flexibility needs by designating it for combination service under Route A.

The primary reason UPS cannot take advantage of the routing flexibility is its decision to establish its Asia network hub in Taiwan. This decision, standing by itself, shows that UPS's claims both that "direct access to China is UPS's top priority"[14] and that UPS has "prepare[d] for the day when UPS would operate its own service"[15] cannot be taken seriously. At best, UPS's decision shows a lack of foresight and little faith in the Clinton Administration's efforts to liberalize U.S.-China trade. It also shows that China is not UPS's top priority; instead, "it is Europe that he [UPS Chairman James Kelly] seems most focused on."[16]

Similarly, Northwest's proposal fails to exploit the agreement's routing flexibility. Considering the extremely low load factors Northwest's all-cargo service experienced during the peak fourth quarter, it is hard to understand why Northwest did not propose to exploit any of the beyond rights.[17] Therefore, neither UPS's nor Northwest's proposal will benefit U.S.

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14 UPS-T-1 at 1.

15 UPS-RT-2 at 5.

16 Attachment 1, Betty Liu, *Inside Track: Wrapping the Parcel Business in Extra Layers*, FINANCIAL TIMES at 15 (Jan 24, 2000).

17 Northwest's direct exhibits show that its U.S.-China 1999 peak season (November/December) freighter load factor averaged 33.8%. FX-RT-2 at 37. Even worse, Northwest's westbound load factor (U.S. to China) was 19.5%. *Id*.

shippers and exporters that rely on the benefits of an Asia network, like the AsiaOne network built by FedEx.[18]

By taking advantage of the route flexibility, FedEx will generate the maximum economic benefits for the United States. To make a realistic comparison, FedEx first made the adjustments necessary to make UPS's result-oriented traffic forecast more reasonable. FX-R-125 at 1. With these adjustments and using UPS's own benefits analysis methodology, UPS's proposed service could produce an economic impact of $2.4 billion, or $242 million per frequency for each of its ten frequencies. FX-R-125. By contrast, and after accepting UPS's own methodology for the purpose of argument, FedEx's overall benefit to the U.S. economy would be $312 million per frequency for each of our eight frequencies — approximately 30% greater than the impact of UPS's proposal. UPS-R-401. Further, nearly 14,000 new jobs would be created in the forecast year by awarding all eight requested frequencies to FedEx, with total employee compensation amounting to $536 million. FX-411. No other applicant has suggested that FedEx claims unattainable benefits; in fact, the primary criticism of FedEx has been that it *understates* the economic benefits it will generate.[19]

Further, the economic benefits resulting from FedEx's proposal would far exceed those forecast from adding increased combination service. For the first year of service, United

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18 Even if UPS could connect to its Asia network, its network is inferior to FedEx's AsiaOne network. Moreover, contrary to UPS's bald assertions, FedEx did not acquire its AsiaOne network. UPS-T-2 at 4. FedEx established its AsiaOne hub at Subic Bay in 1995, six years after it acquired Flying Tigers.

19 UPS-RT-6 at 2; NW-RT-5 at 17.

forecasts $100.9 million in total output from its proposed two frequencies[20] and American forecasts $295 million in total output from its proposed ten frequencies.[21] In its rebuttal exhibits, Delta estimates $623 million in benefits or $62.3 million per frequency.[22] Northwest and Polar do not estimate the economic benefits that the United States would derive from their proposals.

Of course, granting FedEx's application for all eight frequencies would permit the United States to use only two frequencies for the fourth designation. We are quite familiar with the kinds of limits that are inevitable when the market is less than completely open. FedEx, too, started in this market with only two frequencies, and even now we are the only incumbent that lacks the frequencies necessary to offer even two daily flights. But the luxury of designating a fourth U.S. carrier under the U.S.-China protocol is secondary to the necessity of ensuring that U.S. carriers exercise these scarce rights to the greatest benefit of U.S. shippers, importers, consumers and workers, which can only be achieved by awarding FedEx the eight frequencies it has requested.

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[20] UA-706 at 1. The figure above is the "Enhanced U.S. Economic Output Per Annum" without market growth. *Id*.

[21] AA-601 at 1. The figure cited above does not include the one-time $2 billion economic benefit to the U.S. economy from American's purchase of four new B777s and ground equipment for use in the U.S.-China market. *Id*.

[22] DL-R-101.

2. The Department Must Choose the Service Proposal That Best Responds to the Needs of U.S. Commerce, Shippers, Postal Service, and Defense.

Congress expressly directed the Secretary of Transportation to pursue a transportation policy that meets the present and future needs of the commerce of the United States, the United States Postal Service, and the national defense.[23] In the all-cargo context, "the commerce of the United States" includes "the present and future needs of shippers."[24] As the record in this case demonstrates, meeting the needs of shippers is the best way to promote our nation's economic and commercial interests.

This congressional directive requires the Department to further the economic policies of the United States, as articulated by Congress and by the Clinton Administration. The importance of international trade to the future prosperity of the United States cannot be overstated. Exports account for about $1 trillion (12%) of GDP and provide 1 in 7 American jobs. FX-R-104 at 3. Because exports play such an important role in our nation's economy, the U.S. Department of State has declared U.S. export promotion a top priority of American foreign economic policy. *Id*.

In reaching its decision, therefore, the Department must seriously consider the contribution that its successful efforts to liberalize the U.S.-China air transport market can make to developing China's potential as a market for U.S. exported products. Logically, the

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[23] 49 U.S.C. § 40101(a)(7)(A)-(C).

[24] *Id*.; 49 U.S.C. § 40101(b)(1)(A).

Department should give credit to the carrier with the best record for facilitating the exports of U.S. products by air — FedEx. We carry approximately 35.5% of all U.S. air exports, more than three times the percentage carried by DHL, our nearest competitor.[25] Proof of our export-oriented approach to business is evident in this case. Only FedEx proposes daily service to the main air-importing region of southern China; daily service to northeastern China, an area ripe for major increases in U.S. air exports; and increased connectivity to our AsiaOne and intercontinental global networks. Accordingly, our proposal is far better suited to achieving the important goal of increasing U.S. exports than: (a) merely duplicating existing air express/cargo or general freight service to Beijing and Shanghai, as proposed by UPS, Northwest, and Polar;[26] or (b) the slight improvement in the quality of passenger service that United, Northwest, American, and Delta propose.

Moreover, the U.S. economy cannot afford the selection of a carrier like UPS whose employees are vehemently opposed to expanding trade with China and to China's accession to the World Trade Organization.[27] Although UPS' unionized employees say that they "stand in strong support of UPS's quest to serve China,"[28] they are zealous opponents of extending

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25 Answer of Federal Express Corp. and Request for Oral Evidentiary Hearing at 2, 4 *citing* The Colography Group, Inc., www.colography.com/press/parity/html citing its report titled "U.S. Domestic And Export Air Traffic And Yield Analysis By Competitor And Market Segment" (Aug. 1999).

26 Polar also proposes to use two frequencies to serve Shenzhen.

27 As we noted in our rebuttal testimony, UPS very carefully stopped short of supporting China's accession to the WTO and the extension of permanent normal trade relations to China. FX-RT-1 at 3-4.

28 UPS-T-1 at 9.

permanent normal trade relations (PNTR) to China — a key Clinton Administration objective.[29] Of course, their position is untenable unless, as U.S. Trade Representative Charlene Barshefsky says, they expect UPS to carry "empty boxes."[30] The failure to achieve a stable commercial environment will have adverse economic consequences for the United States. Air express/cargo carriers necessarily depend upon their logistical and delivery services to provide reliable service to their customers. Shipper uncertainty as to whether reliable service will be available due to the lack of permanent normal trade relations will stunt the growth of U.S. exports to China and U.S. investment in China.

In direct contrast, FedEx strongly supports the Clinton Administration's effort to extend permanent normal trade rights to China. For many years, FedEx has been a vocal supporter of furthering U.S.-China trade relations, and it continues to strive for stronger economic relations between the two nations.[31]

As we have stated throughout this proceeding, an award of additional frequencies to FedEx will allow us to meet the documented needs of U.S. shippers and exporters in the U.S.-

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29 *See, e.g.*, FX-R-101.

30 Attachment 2, "Demand to Land: U.S. Airlines Pull Out the Stops in Lobbying for New China Route," WALL STREET JOURNAL (April 28, 2000).

31 FedEx Corp. Chairman Fred Smith has worked actively to support extension of PNTR to China, including testifying before Congress. FX-205. He also accompanied the late Secretary of Commerce Ron Brown in 1994 on a commercial diplomacy mission to China, following which FedEx increased its commitment to U.S.-China service. Frustrated by limits in the U.S.-China bilateral at the time, FedEx set out to acquire the operating rights held by Evergreen. Throughout this period, UPS showed no interest in direct U.S.-China services.

China market.[32] The primary need of U.S. shippers and exporters is reliable integrated air express/cargo service that provides the greatest number of price and service options. With our unmatched international priority service to business and residential customers throughout the United States and our service to 144 cities in China, FedEx offers broader coverage of China than any other U.S. carrier. When FedEx's AsiaOne network is added to the equation, our superior service options become even more evident. Granting our current application for eight additional frequencies will allow us to increase our services to Beijing, Shanghai, and Shenzhen to a daily, six-day-a-week pattern and to initiate service to Dalian.

Like FedEx, UPS also serves virtually every U.S. address. Under its arrangement with Sinotrans, the Chinese government's nationwide cargo carrier, it serves 21 cities with its own branded service and 108 total cities. FX-R-106 at 2. But UPS's connectivity beyond China is limited, because the placement of its hub in Taiwan essentially limits the scope of its China services to U.S.-China transportation. Further, UPS proposes only to duplicate service that it, FedEx, DHL, TNT, and many others already provide for U.S. shipments to two markets: Beijing and Shanghai.

Selecting UPS or any other applicant will not result in lower rates for U.S.-China express shipments. Despite its innuendo, UPS has provided no evidence that it will undercut FedEx's prices for express service in the U.S.-China market. Instead, its own exhibits show

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32 *See, e.g.*, Application of FedEx at 1.

that UPS's forecast express revenue yields are uniformly higher than FedEx's forecast yields.[33] Moreover, FedEx has shown that it does not charge U.S. shippers a "premium" for existing U.S.-China express services. Rather, the price differentials for U.S.-China services are effectively the same for both FedEx and UPS, and reflect the higher cost of doing business in China. FX-R-130. FedEx will continue to compete vigorously against the other providers of air express services in the U.S.-China market such as DHL, which has at least 29% of the U.S.-China express market, and charges considerable premiums over FedEx's rates.[34]

It is no surprise that FedEx carries 35.5% of all U.S. air export shipments worldwide, nearly three times the amount carried by DHL, our nearest competitor.[35] First, we target the areas of the world that are ripe for U.S. exports. One such key area is southern China, where we serve 41% of the U.S.-China cargo market through Shenzhen.[36] By contrast, UPS will not improve services to that region and will continue to serve southern China inefficiently through Hong Kong. However, because FedEx has only ten frequencies, U.S. shippers do not have the daily, six-day-a-week service to southern China that they need. Our service pattern is thus incomplete, and the Department should permit us to offer daily service to this growth region.

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33 UPS-600; FX-R-133.

34 PO-T-1 at 4; FX-R-102 "Orient Express: Just How Hard Should a U.S. Company Woo a Big Foreign Market?", WALL STREET JOURNAL, Apr. 6, 1998.

35 Answer of Federal Express Corp. and Request for Oral Evidentiary Hearing at 2, 4 *citing* The Colography Group, Inc., www.colography.com/press/parity/html citing its report titled "U.S. Domestic And Export Air Traffic And Yield Analysis By Competitor And Market Segment" (Aug. 1999).

36 FedEx serves Shenzhen with a brand new sorting and customs facility. *See* FX-213.

Second, we focus on developing new markets of importance to the U.S. economy, as reflected in our proposal to serve Dalian, in the province of Liaoning, six days a week. This province is home to more than 40 million people and already accounts for 5.1% of all air import tonnage. Only southern China, Beijing, and Shanghai account for a significantly greater percentage of air cargo traffic than Liaoning. FX-R-113. Further, Liaoning accounts for 11.2% of Chinese technology imports,[37] and its share of technology imports is four-and-a-half times greater than Beijing's. FX-209 at 5. This is especially significant because technology imports are generally shipped by air express. Accordingly, the most effective way the Department can promote U.S. products is by awarding FedEx six frequencies to introduce service to Liaoning province through Dalian.

FedEx is also well-positioned to assist the U.S. Postal Service in its mission to deliver U.S.-China mail efficiently. FedEx would carry more mail on each of its eight new frequencies than any other applicant in this case — a total of 387,486 pounds in the forecast year.[38] UPS, consistent with its policy in all parts of the world, proposes to carry no mail. Clearly, FedEx will be of valuable assistance to the U.S. Postal Service, whereas UPS will provide absolutely no benefits to postal shippers.

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[37] FX-R-112; FX-209 at 5.

[38] FX-401 at 2. American would carry slightly more total mail spread out over ten weekly frequencies. AA-404 and AA-405, showing that American will carry about 4% more mail.

Concerning the needs of the national defense, all seven applicants are committed participants in the Long-Range International Section of the Civil Reserve Air Fleet (CRAF).[39] Nevertheless, participants are not required to commit their entire fleet to be eligible to carry military cargoes. For instance, UPS has committed only seven of its aircraft. FedEx, by contrast, has taken the extraordinary and unusual step of dedicating its entire long-range, wide-body fleet (77 aircraft) to the CRAF program, reflecting its well-known commitment to supporting the nation's security.[40]

3. The Department Must Choose A Credible Service Proposal.

A key factor in any carrier selection case is the extent to which a carrier's service proposal is credible and presents basic evidence as to the public benefits to be gained by selecting a particular applicant.[41]

In this case, using credible forecasting methodology, FedEx projects that the total economic impact of its proposal would be $1.6 billion in the first year of its operation. FX-409, 411. Because the methodology we used in our direct testimony was more conservative than UPS's approach, UPS adjusted the FedEx proposal's impact to $2.5 billion so it could be compared directly with UPS's number. UPS-R-406.

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[39] *See* http://www.af.mil/news/factsheets/Civil_Reserve_Air_Fleet.html (visited April 14, 2000).

[40] Civil Reserve Air Fleet (CRAF) Capability Summary, AMC HQ Form 312, as of 1 April 2000.

[41] DOT Policy Statement on Procedures and Criteria for Selecting Carriers for Limited-Entry Markets, 51 Fed. Reg. 43181, 43187 (1986).

UPS's proposal contains forecast errors and excessive assumptions that expose the forecast for what it is: a device to block expansion or entry and "park" the six to eight frequencies it cannot currently justify.[42] We have adjusted UPS's forecast to correct its methodological errors, and its excessive and unsupported stimulation factors.

Moreover, UPS filed direct exhibits and economic forecasts that are riddled with errors. UPS's most notable errors are: (1) its traffic forecast improperly includes traffic attributable to the express service it will continue providing to southern China through Hong Kong;[43] and (2) its forecast stimulation rates are not credible because they are not based on market analysis but rather on the need to fill planes.[44] Indeed, the rates UPS used to stimulate its forecast of westbound general air freight are 20¢ a pound <u>below</u> the cost of the fuel to carry it.[45] Further, UPS's assumptions about diversion from other airlines are completely unfounded in that the carriers from which UPS says it will divert traffic do not provide small-package express service.

After correcting UPS's proposal to account for the totality of its errors, the record shows that UPS cannot support more than four U.S.-China frequencies. FX-RT-2 at 5. Further, an adjustment of FedEx's proposal to match UPS's forecast shows that FedEx will provide greater benefits to the U.S. economy.

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[42] *See* FX-R-125 at 1. Further, Delta contends that UPS "would generate only enough traffic to fill two or three weekly B-747 all-cargo flights." DL-R-T-1 at 5; DL-R-215.

[43] FX-RT-2 at 7-10.

[44] FX-R-109. *See also,* FX-RT-2 at 14, AA-R-252, 253.

Unfortunately, UPS was not the only carrier to inflate its traffic forecast. Polar exaggerated its forecast in several ways: (a) by incorrectly assuming that flow traffic for its China gateways is the same as O&D; (b) by ignoring vast amounts of sixth freedom capacity when developing its capacity shares; (c) by claiming traffic benefits for a non-existent wide ranging road feeder service; and (d) by failing to account for the market's demand for daily service in stark contrast to Polar's proposed two-day or four-day service.[46] After reasonable adjustments to the traffic forecast, Polar would use only 11.4% of its aircraft capacity in the U.S.-China market. It thus overstated its U.S.-China traffic forecasts by 90% westbound and 74% eastbound.[47]

Similarly, Northwest's all-cargo proposal is not credible because it fails to address the directional imbalance in favor of eastbound services. The U.S. to China cargo market does not need an injection of additional general freighter capacity, as Northwest proposes; instead, it needs connectivity to a network, such as FedEx's AsiaOne system, to sustain reliable service and to provide reasonable rates to U.S. exporters and shippers.[48]

Thus, after examining the quality and credibility of the all-cargo proposals, FedEx's proposal stands above those of its competitors.

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[45] FX-RT-2 at 15-16.

[46] FX-RT-2 at 3.

[47] FX-RT-2 at 35-36.

4. The Department Must Select the Carrier That Will Most Enhance the Market Structure in the Highly Competitive U.S.-China Air Express/Cargo Market.

The Department's definition of the market structure criterion states:

> Market structure encompasses the impact that a route award will have on the overall level of competition in a particular market. In order to evaluate this issue, the Department looks at potential intergateway competition—the competitive effect of the proposed service on flights offered to the same destination at possible alternative gateways. We also examine the degree to which each applicant might increase competition with existing services at the same gateway.[49]

Under this definition, the Department must determine: (a) the relevant market and (b) the extent to which an applicant's proposal can enhance intergateway and/or intragateway competition.

These determinations are particularly complex here because the Department must initially decide whether additional combination or all-cargo capacity is needed between the United States and China. Some people have described this threshold issue as should the Department choose people or packages?[50] The issues of capacity[51] and current levels of competition[52] are addressed in each applicant's proposal.

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48 FX-RT-2 at 38-39. This example provides another reason why UPS's inability to connect to its Asia network works against U.S. exporters and shippers.

49 DOT Final Rule and Policy Statement, 51 Fed. Reg. 43181, 43186-87 (1986).

50 Attachment 3, Cindy Skrzycki, *In Hopes of Being China's Air Apparent*, WASHINGTON POST, March 3, 2000 at E1.

51 *See, e.g.,* AA-126; DL-R-212; UPS-820.

52 *See, e.g.,* AA-T-4; DL-R-230; UPS-604.

Because the passenger capacity already in the U.S.-China market is sufficient to meet the projected needs of passengers for the next five years,[53] the Department need not choose between people and trade. If the Department chooses trade, it must decide whether to increase general freight services or air express/cargo services.

In the realm of air express/cargo services, the relevant market for this proceeding is the provision of air express/cargo service between the United States and China.[54] In that market, FedEx, UPS, DHL, TNT, Sinotrans, EAS, the U.S. Postal Service, the Chinese Post Office, BAX Global, Airborne Express, and Emery Worldwide all offer U.S.-China express service to at least 100 Chinese cities and guarantee delivery on shipments between the United States and China in four days or better.[55] UPS's argument that there is a "direct express market," referring to an imaginary subset of the air express/cargo market in which express service providers operate their own airplanes, is simply wrong. *See, e.g.*, UPS-T-1 at 8. UPS made its own strategic decision to operate in the China market without direct service, reflecting its assessment

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[53] UPS-800 series, NW-N-1 at 16.

[54] FX-RT-1 at 8-12. In any event, an analysis of the "direct express service" market clearly demonstrates that UPS has consistently lagged far behind FedEx in pioneering service around the world. Specifically, in the Asia/Pacific region, FedEx initiated direct service before UPS did to Japan, Korea, Taiwan (where UPS has its hub), Hong Kong, Singapore, the Philippines, Thailand, Malaysia, Australia, China, India, and Indonesia. The same holds true for Europe and the Americas. Although imitation is the sincerest form of flattery, the Department should not reward UPS for merely following in FedEx's footsteps. UPS's presentation in this case is the same as it has been in every other case for the past 15 years — nothing more than a "me too" argument. FedEx has always been the market innovator and risk-taker. UPS remains comfortable as the risk-averse "follower."

[55] FX-RT-1 at 9-10. DHL and UPS are parties to agreement with Sinotrans, the China National Foreign Trade Transportation Corporation, to serve customers within China.

that its shippers do not care whether or not their express service providers operate their own aircraft. FX-RT-1 at 6. Thus, as FedEx explained in its rebuttal testimony, the air express/cargo market is not limited to "direct" service, and UPS's claim is legally baseless.[56]

Both UPS and FedEx are already incumbents in the U.S.-China air express/cargo market and compete vigorously there. FedEx serves 144 Chinese cities[57] and UPS serves 108 Chinese cities.[58] Both provide direct air service, with UPS using its own airplanes to serve China's largest gateway, Hong Kong.[59] Nonetheless, both FedEx's and UPS's market shares are well below that of the U.S.-China air express/cargo market leader, DHL, which holds more than 30% of the market, despite not operating any aircraft directly to China.[60]

The U.S.-China air express/cargo market is thus already highly competitive, and both UPS and FedEx are active participants in it. This case nonetheless presents the Department with an opportunity to enhance the market's competitiveness by enhancing FedEx's ability to serve the market. Increased service by FedEx will (1) afford shippers additional price and service options; and (2) increase competition among gateway cities in China. By contrast, designating UPS will not significantly improve shippers' price and service options, and could

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[56] FX-RT-2 at 24.

[57] FX-208.

[58] Application of UPS at 7.

[59] DL-R-T-1 at 7, DL-R-204, 226-229.

[60] FX-R-102 "Orient Express: Just How Hard Should a U.S. Company Woo a Big Foreign Market?", WALL STREET JOURNAL, Apr. 6, 1998.

increase its Chinese partner's dominance over ground services within China, decreasing the market's competitiveness.

Because FedEx and UPS already compete in the U.S.-China market, the Department must weigh the additional benefits each carrier's proposal will offer to U.S. shippers, exporters, and consumers beyond what is available today. FedEx developed its proposal to compete for a greater share of the overall U.S.-China air express/cargo market, not just the U.S.-Beijing and U.S.-Shanghai markets. By granting FedEx's proposal, the Department will thus introduce daily air express/cargo service to Shenzhen in southern China, where more than 40% of air imports to China are destined. FX-115. Further, the Department can open up a new Chinese market for U.S. exporters and shippers — Liaoning province — home to more than 40 million people and a burgeoning high-technology area. FX-209.

By selecting FedEx, the Department can enhance intergateway competition in the U.S.-China market — not among U.S. gateways but among Chinese gateways. Within the United States, inter- and intra-gateway competition play no role in the air express/cargo market. Among the all-cargo applicants, FedEx, Northwest, and UPS have extensive hub-and-spoke systems which, coupled with the liberal U.S. regulatory regime, ensure that nearly all U.S. shippers have immediate access to high-quality services. As Delta correctly notes, "neither the package, nor the shipper"[61] cares what plane the package travels on as it heads for China.

[61] DL-R-T-1 at 2.

Therefore, it is irrelevant whether that plane originally departs from Memphis or Ontario, or whether the shipper is located in Peoria or Los Angeles—the service is the same!

However, these competitive forces could play a significant role in enhancing competition for service to and from Chinese cities. U.S. carriers do not have extensive, carrier-controlled distribution systems within China, and the Chinese government strictly controls their access to internal markets. The Department has not traditionally looked at the effect of intergateway competition within a foreign country on overall competition in the U.S.-foreign market, probably because very few foreign countries have the population and infrastructure to maintain effective multiple gateways. But China is unique in this regard, and requires such an analysis. With its large population and rapidly developing infrastructure, it already has several strong international gateways, and more will emerge. FedEx and Polar are the only applicants that have proposed service to any Chinese city other than Shanghai and Beijing — and only FedEx proposes to mount a new daily service to a city unserved by any U.S. airline. Thus, on the factor of intergateway competition, FedEx emerges as the clear winner.

Although designating UPS will not significantly improve shippers' price and service options, it could increase its Chinese partner's dominance over ground services within China, and thus decrease the market's competitiveness. Even though UPS argues that FedEx enjoys a "monopoly," and wields excessive market power,[62] if there is any danger of creating excessive

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[62] *See, e.g.,* UPS-601.

market power in this proceeding, it would result from designating UPS, not from the award of additional frequencies to FedEx. Both UPS and DHL are joint venture partners with Sinotrans, the government-owned China National Foreign Trade Transportation Group Corporation, which controls nearly 50% of the China portion of the U.S.-China air express/cargo market. Designating UPS to fly oversized B747s into Beijing and Shanghai would make UPS even more dependent upon Sinotrans to serve other markets in China, and it would increase Sinotrans' dominance over U.S.-China air express/cargo services.

In contrast to the benefits derived from FedEx's proposal, UPS's proposal will not offer U.S. shippers and exporters significant new price and service options. Certainly UPS's customers might receive a small, but unquantifiable, improvement in the reliability of its service; however, this improvement is on its face marginal because UPS concedes that its existing service already is sufficiently reliable.[63] Overall, UPS's proposal merely duplicates services it offers its customers via Hong Kong and that FedEx currently offers. Due to the duplicative nature of UPS's proposed air express/cargo services and errors in generating its traffic forecast, UPS can support at most four of the ten frequencies it seeks. FX-RT-2 at 1. Indeed, Delta contends that UPS can only justify two or three frequencies. DL-R-T-1 at 5.

[63] As noted above, UPS is engaged in an agency partnership with Sinotrans, whose "network in China is unparalleled, offering quality service and direct timely access across the country" according to Ron Wallace, president, UPS International. FX-R-106 at 2. Needless to say, if UPS thought its service was unreliable, it would not offer it to its customers.

UPS's alleged inability to compete thus stems primarily from its own errors and poor decision-making, not from FedEx's current modest position in the U.S.-China market. Further, UPS's claim of an inability to compete is spurious in light of its statement in January 1999 that "with this [UPS-Sinotrans] agreement we intend, by the end of the year, to make UPS uniformed drivers and brown trucks a common sight on the streets of major business centers in China."[64] For a company that claims it cannot compete in the U.S.-China air express/cargo market, UPS's plan for last year was quite ambitious.

5. The Department Must Also Consider Route Integration Benefits.

When the Department analyzes the benefits to connecting traffic, it considers the long-standing factor of route integration.[65] In so doing, the Department compares the benefits to each prospective gateway's immediate catchment area in large measure based on the availability of on-line connections and the traffic to be carried over them.[66] In other words, the Department "assesses each applicant's ability to flow traffic to and from points behind the U.S. gateway and beyond the foreign gateway."[67] This factor has "figured significantly in carrier selection" cases

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[64] FX-R-106 at 2. In the press release announcing UPS's agreement with Sinotrans, the China National Foreign Trade Transportation Corporation, UPS states that Sinotrans offers "quality service and direct timely access across the country." *Id*.

[65] DOT Policy Statement on Procedures and Criteria for Selecting Carriers for Limited-Entry Markets, 51 Fed. Reg. 43181, 43187 (1986).

[66] *U.S.-London Route Proceeding (1993)*, Order 93-12-27 at 38.

[67] DOT Policy Statement on Procedures and Criteria for Selecting Carriers for Limited-Entry Markets, 51 Fed. Reg. 43181, 43187 (1986).

because it directly relates to the economic viability of a carrier's proposal. *Id.* For the all-cargo carriers in this case, this necessarily entails the degree to which each carrier would integrate the U.S.-China frequencies with its domestic, Asian, and global networks.

In terms of route integration, FedEx is a fully integrated carrier that offers on-line connections for cargo throughout the United States, Asia, and the rest of the world. In the United States, FedEx serves virtually every business and residential address. In Asia, FedEx provides shippers with the most comprehensive service through its AsiaOne network, which serves 17 cities directly from its hub at Subic Bay, Philippines. Around the world, FedEx connects 366 airports in 210 countries to offer air express/cargo services to all ends of the Earth. FX-204 at 1. Therefore, FedEx can flow general air freight and time-sensitive, express freight to and from points behind its U.S. and China gateways. Due to its unsurpassed connectivity and operational capabilities, the overall number of potential customers who will benefit from FedEx's proposed service is greater than that of any other applicant in this case.

No other all-cargo carrier offers the superior level of connectivity FedEx describes in its U.S.-China proposal. Although UPS possesses a comparable domestic network, its international network is poorly conceived for serving China markets, because UPS decided to establish its hub in Taiwan and, therefore, cannot connect with China directly. Without integrating its Asia network with its proposed China operations, UPS cannot connect traffic from Southeast Asia, Korea, or Japan to China. FX-RT-2 at 17. Instead, UPS will continue to serve Southern Asia via Hong Kong and will not derive any traffic benefits from network stimulation. *Id*. Even if UPS had chosen an appropriate hub for China service, its Asia network would still be inferior because it only serves 12 Asian cities from Taiwan. UPS-303. Therefore, the relative value of UPS's services to the beyond-gateway regions is substantially less than those of FedEx.

With regard to Northwest's and Polar's proposed general freight services, neither carrier's proposal offers significant route integration benefits. Although both carriers have domestic and international networks, the scope of each carrier's cargo network is minimal compared to FedEx's worldwide on-line network. Moreover, unlike Northwest and Polar, FedEx developed its worldwide on-line network to meet the needs of air express/cargo shippers. In light of the increasing reliance on supply chain management and growing trade in high-technology products between the United States and China, integrated air express/cargo services are more important than ever. However, Northwest and Polar cannot meet the needs of all U.S. air express/cargo shippers located outside of their respective limited networks. Nor do they provide comprehensive door-to-door services. Similarly, the cargo services provided by the combination carriers pale in comparison to FedEx's ability to serve every U.S. address and 144 cities in China with a variety of price and service options. Combination carriers, using the belly capacity of their planes, are essentially restricted to airport-to-airport general air cargo service provided on behalf of forwarders and consolidators. Those carriers would not provide any route integration benefits in the cargo context.

6. The Department Should Also Consider Other Factors Important to the Development of U.S.-China Economic Relations.

In route cases, the Department also considers "other factors historically used for carrier selection where they are relevant." Order 2000-1-21 at 3. Prior precedent shows a concern with balancing long-term and short-term competitive considerations.[68] In this regard, the Department must be mindful of the history of Western trade relations with China, which dates back to the thirteenth century when Marco Polo ventured forth into China to strike up a trading relationship with the Chinese. In so doing, he understood that the long-term benefits of opening China were more important than the short-term benefits he would derive from the goods he could carry back to Italy.

The Department should evoke his entrepreneurial spirit and look beyond the limited and short-term contributions to the U.S. economy the other applicants would make. Instead, the Department must realize that its decision will influence the development of the U.S.-China market for goods and services for many years to come. In conjunction with the Clinton Administration's efforts to pave the way for China's entry into the WTO, reaping the benefits of increased trade with China will require the United States to place itself and its air carriers in a position to take advantage of China's emerging marketplace.

[68] *Dallas/Fort Worth-London Case*, Order 83-3-42 at 8 (Jan. 12, 1983) (deciding to choose "the carrier that can improve the competitive picture over the long term, rather than responding to short-term considerations").

In this regard, the Department should focus on ensuring that U.S. carriers establish strong competitive positions throughout China. Serving only Shanghai and Beijing would be a major mistake, because huge commercial opportunities elsewhere in China may be lost forever. For example, service to those cities alone ignores the high-technology markets in southern China and the industrial northeast. FX-209. This omission is akin to serving only New York and Washington in the United States while ignoring Silicon Valley and Chicago. The Department should choose FedEx, which is the leader among all U.S. carriers in promoting export opportunities for U.S. businesses, and which recognizes the need to develop emerging markets such as Shenzhen and Dalian. Opening these new opportunities will create new jobs for workers in the United States, not flying "empty boxes."

Further, some factors are not relevant to carrier selection proceedings, such as the domestic political support claimed by a particular applicant. Before transferring the Civil Aeronautics Board's decision-making authority in carrier selection cases to the Department, **Congress sought assurances that the Department would not be swayed by political influence when reaching a decision**.[69] In several hearings before Congress, the Department assuaged Congress' concerns that political considerations would not play any role in carrier selection cases.[70]

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69 *USAir, Inc. v. DOT*, 969 F.2d 1256, 1261 (D.C. Cir. 1992). *Cf.* Brief for Appellee at 4, *Delta Air Lines v. DOT*, 51 F.3d 1065 (D.C. Cir. 1995).

70 *Review Of Airline Deregulation And Sunset Of The Civil Aeronautics Board: Hearings Before The Subcomm. on Aviation of the House Comm. On Public Works And Transportation*, 98th Cong., 2d. Sess.

Therefore, UPS's claims of its political support in this proceeding should be recognized for what they really are — attempts to introduce irrelevant considerations into the selection process. They should have no effect on the Department's decision here.[71] If anything, UPS's reliance on claims of political support suggests that UPS is concerned that the merits of its case are inadequate. The Department should resist UPS's attempt to turn this case into a political contest. Instead, the Department should look to its mandate to maximize the economic benefits to the United States and award FedEx the eight frequencies it requests.

IV. CONCLUSION

A grant of eight frequencies to FedEx will generate the greatest overall economic benefits to the United States. It will also maximize the public benefits because FedEx is the applicant most likely to offer and maintain the best service for the shipping public in the U.S.-China market. By making the greatest use of the frequencies at stake in this proceeding, FedEx will play an integral role in generating billions of dollars in exports from the United States. What is at stake in this proceeding is the selection of the applicant that can provide the greatest opportunities for the United States to compete in

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3, 79 (Feb. 29, 1984) (testimony of Secretary Dole regarding the CAB Sunset Plan). *See also*, H.R. REP. No. 98-793 at 9 (1984), *reprinted in* 1984 U.S.C.C.A.N. at 2857, 2865.

[71] Further, UPS's political support is not as formidable as it claims. Nearly 50 of the elected representatives UPS claims as supporters in its direct exhibits are on record as supporting another carrier in this proceeding. FX-R-108. These elected representatives may also be supporting UPS; however, the support for UPS's claims are generally not available in the docket. *See* UPS-2000.

this important emerging segment of the global marketplace. As the record shows, FedEx is that applicant.

Respectfully submitted,

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