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Responsive Testimony of Ken Torok

President – UPS Asia Pacific Region

My name is Ken Torok, President of UPS in the Asia Pacific Region, and I am pleased to offer this rebuttal testimony in support of our company's application for 12 U.S.-China frequencies in this proceeding. With an award of these 12 frequencies, UPS will best use the important new access won by the Department to the China market and offer needed new services that no other applicant offers. I would like to speak first to the relative merits of the UPS proposal, then address specific arguments made by FedEx and Northwest, the other two incumbent carriers in this case.

An Award to UPS of 12 Frequencies Will Best Serve the Public Interest.

With the frequencies that recently became available for allocation, UPS proposes to satisfy the most immediate and critical need -- enhanced express service to China's preeminent commercial center at Shanghai. Currently, our single daily flight from China to the U.S. operates with a 90%-plus payload factor, and demand continues to accelerate. There can be no real debate, UPS respectfully submits, that the most immediate priority for use of the newly-available 2004 frequencies should be to enable UPS to enlarge and expand its U.S.-China service with a full double-daily operation that can accommodate both express and general air freight to Shanghai.

UPS has long and well-demonstrated its deep commitment to serving China and its world-class capability to provide the full range of all-cargo services for U.S. and other shippers. While other carriers may prefer to see themselves as the "chosen instrument"

of U.S.-China trade, UPS continues to grow its global network and to build its world-leading logistics and delivery services, and our company today serves as a critical competitive option for U.S. and foreign shippers and producers.

As discussed in our original submission, this UPS-proposed use of the new frequencies will also facilitate the first U.S. carrier cargo hub in China – a unique and important new opportunity made possible only by the recently-negotiated U.S.-China agreement. These new frequencies should be used to lay the foundation for a qualifying cargo hub in China – so invoking the keystone provision of the new agreement – and UPS is ready, willing, and able to be the first U.S. air carrier to build a hub in China.

Just as important as enabling the process of building a new hub to open in two years, the new frequencies will allow UPS immediately to enhance the speed and reliability of international cargo shipments to and from numerous large commercial centers within China, even beyond the key gateway airports of Shanghai, Guangzhou, and Beijing. To do so, UPS will utilize its unique partnership with Yangtze River Express to maximize the benefits of the U.S.-China frequencies. In this way, UPS can provide U.S. businesses access beyond its own three gateways in China.

The UPS proposal for use of the 2004 and 2005 frequencies would not only meet the immediate need for new service to Shanghai, and to numerous important markets within China, but it would also link the U.S. nonstop, for the first time, to the immensely important Pearl River Delta region surrounding Guangzhou. UPS proposes to utilize six frequencies available in 2005 to mount the first and only non-stop service between the

U.S. and Guangzhou. That service will provide far more convenient access to that key point than any proposed by competitors – more than three hours faster than the one-stop service over Japan proposed by Northwest.

Today, UPS has only six China frequencies, about half that of FedEx and a third of those which Northwest could convert to all-cargo operations. This alone does not “entitle” us to the new frequencies we request. But the relative value of our proposed use of the frequencies, in contrast to that proposed by our competitors, does. Ultimately, we respectfully submit, UPS offers a clearly better answer to the Department’s key inquiry -- how to maximize use of these scarce opportunities to serve the huge markets between China and the U.S., and China and the world.

UPS actually takes little issue with the bulk of the FedEx submission – especially its positions regarding the relative importance of express services to economic growth and the development of U.S. exports by carriers such as UPS. While UPS offers both extensive general freight and express services, the FedEx submission correctly demonstrates the pre-eminent need for added express capacity in the immediate term. We also agree wholeheartedly as to the importance of enhancing U.S. exports and global trade. UPS has been a leader specifically in developing U.S.-China and U.S.-Asia trade, and our Company’s Chairman serves as a member on the President’s Export Council and as Chair of the U.S.-China Business Council.

While it also has the important benefit of adding additional air cargo capacity to the U.S.-Shanghai market, the UPS Shanghai proposal possesses the very important

benefit of allowing a U.S. cargo carrier to move in a timely manner toward the creation of a qualifying U.S. cargo hub that takes full advantage of the newly-negotiated U.S.-China bilateral. While FedEx and Northwest suggest that UPS' hub-building plans are somehow premature, the fact is that the hub traffic rights provided for in the new bilateral will become available in little more than two years after the frequencies to be allocated in this proceeding are operated.

A China cargo hub simply cannot be built overnight. FedEx itself acknowledged this fact in the testimony of Mr. Michael Ducker who recognized that "constructing a major hub facility depends on practical and time-consuming steps." UPS began those steps once the new agreement was signed. Upon the signing, I met separately with Mr. Wu Nianzu, Chairman of the Pudong Airport Authority, Mr. Yang Xiang, the Vice Mayor of Shanghai, and the CAAC Transport Minister, Mr. Yang Yuanyuan, to discuss the development of our cargo hub in Shanghai. We have committed to creating a working team of UPS staff and the appropriate government officials to develop together a world-class air cargo and logistics hub for UPS in Shanghai.

UPS requires the frequencies it seeks in this case to ensure that its planned Shanghai hub is fully operational by 2007. Waiting until 2006 or 2007 to receive the necessary frequencies, as Northwest seems to suggest, is simply not realistic. We respectfully urge the DOT to consider the testimony of the two air express carriers in this proceeding as to the factual issue of what it takes in practice to establish such a cargo hub.

Our determination to build a Shanghai hub is not only to utilize the important new traffic rights afforded to hubbing carriers in the new bilateral agreement, but also to meet a competitive business need for a northern Asia regional hub. While FedEx and Northwest already enjoy such a hub in Tokyo (where they enjoy unique traffic rights), UPS lacks such an essential facility, which Shanghai will provide. Contrary to the FedEx supposition, or its professed unique determination to “invest in the Chinese people,” UPS intends to build a meaningful operation in Shanghai.

There can be little dispute that international air express services represent the future of U.S.-China and U.S.-Asia trade. The evolution and growth of international trade throughout the world has profoundly changed the needs and priorities of international shippers from bulk carriage (*e.g.*, by ocean-going vessels), to general air freight, to express air services to, ultimately, the fully-integrated, high technology supply chains on which global businesses now depend. Despite the Northwest view, it would hardly make sense, or serve the public interest, to allocate new service opportunities in one of the world’s greatest future markets predominantly to serve the demand to move heavy freight.

An Award to FedEx Fails to Maximize the Public Benefits of the Frequencies.

Particularly questionable in this case is the request of FedEx for nearly half (18) of all the available new all-cargo frequencies – 50% more than UPS requests. The FedEx proposal to use 12 of these frequencies for a “round-the-world” service does precious little to address the core goal of enhancing all-cargo service in the U.S.-China market.

Even if this globe-circling service required 12 frequencies rather than six, shipping packages from the U.S. to Europe, and only then on to China, does not optimize the use of U.S.-China frequencies. Simply put, UPS will offer more new U.S.-China capacity with the 12 frequencies it is requesting than FedEx will offer with the 18 frequencies it seeks.

The FedEx proposed use of scarce U.S.-China frequencies is hardly designed to improve and enhance speedy, reliable service for U.S. importers bringing goods from China, or businesses bringing U.S. shipments to major Chinese cities. Compared to the proposed FedEx round-the-world service, the UPS proposal to serve Shanghai with a new daily service will cut more than a full day from the FedEx time in transit between Shanghai and the U.S. Indeed, a close examination of the UPS and FedEx proposals shows that UPS will provide almost four times more weekly capacity than FedEx from Shanghai to the U.S. – a point that FedEx touts as its “most critical gateway in China” – and almost five times as much China-to-U.S. capacity per frequency as FedEx.

Given the extraordinarily inefficient use of the frequencies proposed by FedEx, one can only assume that FedEx’s most pressing interest is not in adding incremental China-U.S. capacity, but rather using these new U.S.-China frequencies principally to serve the Japan-China and Europe-China markets—which FedEx otherwise could do under the liberal change of gauge provisions in the new bilateral agreement.

FedEx’s use of its proposed round-the-world flight as the rationale for additional China frequencies in this proceeding is much the same strategy it offered to request

additional “beyond” frequencies in last year’s Hong Kong frequency allocation case. Yet there is an obvious distinction between these two cases, arising from the differing nature of their bilateral restrictions. In Hong Kong, the bilateral agreement restricted beyond rights, but allowed unrestricted opportunities for flights to and from Hong Kong and the United States.

In contrast, the China bilateral restricts flights to and from China and the U.S., but allows for liberal flights to markets beyond China once the gateway is reached. As a consequence, while the FedEx round-the-world proposal may make sense in Hong Kong as a way of maximizing the use of rights under a bilateral construct in which beyond rights are limited, the same round-the-world flight actually wastes frequencies in bilateral constructs – like China’s – where the chief obstacle is a limitation on country-to-country flights, and yet the beyond rights are relatively open. In such a case, global circumnavigation leads to doubling the number of frequencies needed to afford similar service levels.

FedEx simply does not need the large tranche of frequencies it requests here to achieve even this beyond-China service objective. FedEx can serve those markets by using its existing beyond rights, together with the new change of gauge authorities obtained by U.S. negotiators in the new U.S.-China agreement. UPS is proposing to do so in this proceeding by connecting Shanghai to four points (Beijing, Clark, Osaka and Tokyo) with just two six-days-per week frequencies. For example, FedEx does not need six frequencies to serve Qingdao from the U.S., but rather could serve that market via

Shanghai using the change of gauge authority provided in the recent bilateral agreement. FedEx cannot reasonably demand the award of six scarce frequencies to serve Qingdao, particularly where its existing authority is sufficient to provide that service.

Especially obvious utilization questions are raised by the FedEx proposal to use six new frequencies to append to its existing U.S.-Korea service a short flight from Korea to the relatively small city of Qingdao, using the smallest aircraft proposed in this case. With this small-capacity flight factored into the FedEx proposal, the result is that UPS offers three times the weekly air cargo service capacity proposed by FedEx (1.7 million lbs. vs. 600,000 lbs.) even though UPS will use 50% fewer scarce frequencies to do so.

While numerous points in China will support new all-cargo service in the future, the undisputed fact remains that Shanghai is the commercial center of China, with more than five times the international trade demand of such regional points as Qingdao, the 24th largest city in China in terms of population. Indeed, FedEx frankly admits that Shanghai, where UPS seeks the needed frequencies to build a cargo hub, remains “the most important market” in China.

Even the purported benefits of new FedEx service to Qingdao are questionable. UPS already serves that city with its Chinese partner, Yangtze River Express, and does so with much shorter transit times and later departure times for shippers than FedEx proposes by using six new frequencies to fly there via Korea. UPS now offers shippers a three hour later departure time from Qingdao to the U.S. than FedEx proposes to offer, and a transit time nearly four hours shorter. In contrast to the inferior service FedEx

would add to this still-developing Qingdao market, UPS proposes to add important new service to the preeminent Shanghai market to meet a real and immediate shipper need.

An Award to Northwest Fails to Maximize the Public Benefits of the Frequencies.

The application of the other incumbent, Northwest, is no more compelling than that of FedEx. Northwest seeks an additional 10 frequencies – even as it has just obtained seven new China combination frequencies that it could, at its option, convert to all cargo use. The fact that Northwest prefers to use these convertible frequencies for combination services to compete with United Airlines is their business choice. And fulfilling Northwest’s inflated desires here would leave it with a cache of some 33 weekly frequencies, more than twice what UPS proposes to operate.

Moreover, on a relative benefits basis, the Northwest proposal to use five new frequencies to serve Guangzhou with a less-than-daily, one-stop flight over Japan is inferior to UPS’ plans for a daily nonstop using a high-capacity MD-11. And the UPS service would address the needs of all segments of the freight market—including regular cargo, expedited cargo, and express delivery—while Northwest operates only as a general air freight carrier. In light of Northwest’s extended argument about the relative value of general air freight transportation to express services, the Department should understand that UPS actually carries more general air freight globally than Northwest Cargo. Moreover, UPS proposes to dedicate almost 40% more total aircraft capacity for U.S. exports to China.

Northwest's response predictably argues that general air freight, rather than express services, represents the greatest underserved need. The facts are to the contrary; FedEx's economic testimony confirms this. One source of confusion may be that Northwest's argument is based on a potentially misleading demand metric – measuring demand by shipment weight, rather than value, number of shipments and product yield. It is impossible to dispute that the air transport demands for a shipment of cement moved from the U.S. to China are greater than the air transport demands for a shipment of computer hard drives from Silicon Valley that requires the same aircraft capacity, but does that really mean that U.S. trade and economic interests are equally advanced by the two air services? Does not the public interest favor the use of valuable China market access for the latter use? Indeed, an award to UPS will address the demands of both express and general air freight shippers.

In any event, one must question Northwest's stated commitment to the general freight market when much of its current business is actually linked to express package delivery service on behalf of DHL. Northwest already provides DHL capacity between the US and Shanghai three days per week, and Northwest therefore needs only two additional frequencies for a five-per-week Shanghai service—the same frequency of service that it has requested for Guangzhou. DHL has itself made clear that Northwest needs only three new Shanghai frequencies, not the five requested by Northwest, in order to provide the necessary service for it.

The New Entrant General Air Freight Carrier Requires 4 or Fewer Frequencies.

Finally, with regard to frequencies for a new all-cargo designee, it is clear that traditional cargo service – in contrast to the express cargo business -- simply does not require six or seven weekly flights to begin operation. At least initially, for this coming fall season, the new designee should be able to operate effectively with four or even fewer weekly operations. Both the general air freight carriers and the Department in past cases agree that four frequencies are sufficient to begin service to the China market.

Conclusion.

UPS urges the Department to maintain its determination to award and allocate these valuable new frequencies without delay. Regrettably, some applicants in this proceeding, whether or not motivated by a desire to preserve a favorable market *status quo*, have chosen to burden the record with much extraneous or marginally relevant material, from marketing brochures to a presentation entitled “a day in the life of a FedEx package.” Such submissions add little to the process, and should not be allowed to delay the Department’s prompt decision in this matter

UPS applauds Secretary Mineta, Minister Yang, and their delegations, for their efforts and cooperation with industry to achieve the new U.S.-China bilateral agreement. It is a visionary deal that will accelerate the flow of goods into and out of China, providing substantial benefits to workers, businesses and consumers in both countries.

With our global air network and capacity to provide total supply chain solutions, UPS will take this opportunity to better connect all of the world's major markets to China. As businesses continue to streamline their supply chains, the seamless and efficient movement of goods becomes ever more critical. The U.S.-China agreement, with its open rights for air-cargo carriers that establish hubs, recognizes that air express services bring great benefits to cities and regions. We respectfully urge the Department to award UPS the frequencies it seeks to enable these hub benefits to be realized at Shanghai, and to enable us to provide the first and only non-stop service between the U.S. and Guangzhou.

Narrative to Consolidated Reply of UPS

In light of the applications and the cumulative supplemental information provided by the other applicants in this proceeding, it is clear that the Department should award UPS the twelve frequencies it has requested in this proceeding. As a foundational matter, UPS maintains a world-class, global transportation network, capable of providing consumers a full spectrum of cargo products—from next-day express packages to oversized general air freight. UPS has already begun to extend this network into China and its initial successes are uncontroverted. UPS is ready, willing and able to continue to bring those benefits to the U.S.-China market when awarded the requested frequencies.

Compared to all others, UPS is the applicant best positioned to take maximum advantage of the many benefits of the new U.S.-China Protocol. Specifically, UPS has proposed to use its requested frequencies to most fully employ the change of gauge provisions of the amended bilateral and to position itself at Shanghai to maximize the many benefits of the newly-defined “cargo hub.” Further, in terms of service quality, UPS has presented a mix of improved transit times and vastly increased U.S.-China air cargo capacity that will be of greater value to shippers and consumers than would be the frequency use by any of the other applicants.

Exhibit UPS-R-101 provides a consolidated listing of the benefits provided by the UPS proposals.

I. U.S.-China Shippers and Consumers Require the Benefits Afforded by UPS' World-Wide Network.

UPS is only one of two applicants in this proceeding with a truly global cargo network. Exhibit UPS-R-102 is a graphical representation of this network and the global market that it serves. UPS has the world-wide transportation infrastructure, financial strength, aircraft fleet, business partners and personnel that, when viewed in light of its current proposal, offers U.S.-China shippers and consumers the most public benefits and also offers meaningful competition to foreign cargo carriers.

The Department has long acknowledged the benefits afforded to the shipping public by robust air cargo networks. Most recently, in the *2002/2003 Hong Kong Fifth Freedom All-Cargo Frequency Proceeding*,¹ in selecting UPS over Evergreen for a particular market the DOT noted "the important objectives UPS' use of these frequencies would serve, *i.e.*, 'the ability for U.S. carriers to link services to their regional hubs, thus enabling U.S. carriers to provide effective global operations and strengthening their networks and consequently providing greater shipping and competitive options for shippers worldwide.'"²

The Department has been clear and consistent in recognizing the importance of hub and spoke networks to the air transportation industry – both cargo and passenger – and in supporting network development through route awards. In 1995, in the *Statement*

¹ Docket OST-2002-14049.

² DOT Order 2003-9-9, p. 4 (Sept. 12, 2003) (citing DOT Order 2003-7-17, p. 6).

of the *United States International Air Transportation Policy*,³ the Department emphasized the “globalization of the world economy” and stated that, “to meet demand and to improve their efficiency, many carriers are developing international hub and spoke systems that permit them to combine traffic flows from many routes (the ‘spokes’) at a central point (the ‘hub’) and transport them to another point.”⁴ The *Policy Statement* further recognized that “carriers are developing worldwide hub and spoke systems to tap the substantial pool of international city-pairs . . . carriers wishing to establish global networks require higher quality and quantity of supporting route authority than they have sought in the past.”⁵ The *Policy Statement* recognized that carriers were beginning to “adjust their focus to bargain for the bundles of rights that will permit airlines to develop global networks.”⁶ “At a minimum,” the DOT said, “we must increase our focus on emerging markets and their contribution to global networks”⁷

The Department has applied this pro-network, pro-development thesis in numerous route cases, including the first *2001 Hong Kong Fifth-Freedom* proceeding.⁸ In the Order to Show Cause in that case, the Department based its award to FedEx principally upon the ability of FedEx to “serve different markets and provide more

³ Docket 49844, 60 Fed. Reg. 21841 (May 3, 1995) (“*Policy Statement*”).

⁴ *Id.*, p. 21841-42.

⁵ *Id.*, p. 21842.

⁶ *Id.*, p. 21841.

⁷ *Id.*, p. 21844.

⁸ Docket OST-95-764.

gateway connecting cities than any of the carriers” through its Subic Bay hub.⁹ In that Order, the Department emphasized that “hub strength in competition with foreign carriers [was] an important criterion in the circumstances of this market” and that the applicants other than FedEx in that earlier proceeding would not be able to “realize any significant competitive strength against foreign carriers through hub presence.”¹⁰

II. UPS Serves the Public with the Entire Spectrum of Air Cargo Products.

Serving all segments of the product market is essential to meeting the needs of shippers. UPS offers the full range of air cargo price/service options the shippers require, from fully integrated, time sensitive, high yield, high value, door to door express service to low yield, low value, less time sensitive airport-to-airport general air freight service. For a complete listing of UPS’ air cargo service products, please see Exhibit UPS-R-103. This unmatched portfolio of services was created by striking a balance between the value of the goods and the shipper’s schedule and allowing the shipper to choose a service that best meets its needs.

⁹ DOT Order 96-7-36, p. 6 (decision made final in DOT Order 96-8-35).

¹⁰ *Id.*, p. 8. More recently, the Department recognized the importance of network benefits in the *U.S.-U.K. Alliance* case, DOT Order 2002-11-12 (Jan. 25, 2002). In this case, the U.S. Justice Department also noted the importance of networks (*id.*, p. 13) as did the DOT (*id.*, p. 45). *See also* Application of Continental Airlines, Inc., DOT Order 2001-5-1, p. 5 (May 3, 2001); *1999 U.S.-Argentina Combination Service* Case, DOT Order 2002-12-13, December 19, 2000, p. 8; Application of Northwest Airlines, Inc., DOT Order 2000-10-12, p. 3 (Oct. 13, 2000) (noting the “important public benefits” of and its “policy of facilitating ... international airline networks as a response to the underlying network economics of the airline industry”).

The DOT has long recognized the superior public benefits which flow from a selection of a carrier offering this broad spectrum of service options. Indeed, the Department selected FedEx in the 1995 *Hong Kong Fifth-Freedom All-Cargo Proceeding* because it could serve both the express/small package market and the general air freight market, judging that the resulting mix of traffic “support[s] and sustain[s] the overall service offering.”¹¹ This is also consistent with the emphasis in DOT’s Policy Statement regarding the need to increase “the variety of price and service options available to consumers.”¹²

The same considerations were applied in the *U.S.-Philippines All-Cargo Service Proceeding*, where the Department chose UPS over other carriers that did not serve the fully-integrated/express segment of the all-cargo market.

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 . . . [and] UPS offers the greatest range of services over the largest transportation network with the greatest geographic coverage of any of the applicants¹³

The Department voiced the same concern for ensuring a full range of services in the *U.S.-China Air Services (2001)* proceeding:

¹¹ DOT Order 96-7-36, p. 7.

¹² *Policy Statement*, 60 Fed. Reg. at 21844.

¹³ Docket OST-96-1074, DOT Order 97-1-17, p. 7 (emphasis added).

The award to UPS will provide consumers the benefit of carrier choice and a full range of competitive all-cargo services now offered . . . as well as enhanced competition with the serviced offered by [foreign]-flag carriers. This new airline service will serve [the Department's] objective to increase the number of competitors in this market and to expand the range of price/service options available to consumers.¹⁴

Significantly, the Department specifically identified Polar's inability to serve the important express segment of the market as a basis for denying its application in China.¹⁵

III. Express Traffic Has Value That Cannot Be Judged By Weight Alone.

Certain applicants in this proceeding would have the Department believe that the categories of air cargo products should be evaluated solely by weight or the square footage that such cargo requires in the hold of an aircraft. Specifically, it has been argued that since small package express represents a smaller percentage of the traffic mix by weight, it needs less attention, and thus is less important, to the frequency allocation analysis in this proceeding. This is a near-sighted view and wholly ignores the importance of express traffic to shippers, consumers and the overall economies of the U.S. and China.

Express package traffic is very important to the markets to which UPS proposes service in this proceeding. First, express traffic comprises high-value products and items of significant importance to the shippers and receivers of these packages. Aside from the immediate, tangible value of the contents of these packages, it is important to recognize

¹⁴ *U.S.-China Air Services (2001)*, Docket OST-1999-6323, Order 2001-1-6, p. 5.

the high yield of such express services and the economic stimulus that such services bring to a growing economy and its supporting industries. Express traffic facilitates the rapid flow of goods, funds and information that are the life-blood of all economies. Currently, 12% of the global cargo market is express traffic and this market share is expected to increase vis-à-vis the worldwide share of general air freight. Exhibit UPS-R-104 describes this growth in detail. In China, the growth rate of express traffic is increasing at four and a half times the global rate for express traffic, and, as such, the China express growth rate is expected to near 30% in the immediate future. Accordingly, by its proposal, UPS is positioning itself to meet this rising and important demand.

As a key piece of the infrastructure of the global economy, air express service is revolutionizing the component and finished product supply-chain, allowing producers to access the world's key markets with new 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 Chinese productivity and optimized supply-chain management. The kind of all-encompassing services proposed by UPS will become even more critical in the increasingly competitive global marketplace—particularly as that marketplace continues to move rapidly toward a high-value, time-definite and high-technology paradigm.

¹⁵ DOT Order 2000-11-24, p. 13.

IV. UPS' Proposal Brings Air Cargo Shippers in the U.S.-China Market the Greatest Benefits Because UPS Makes Best Use of New Bilateral Provisions.

UPS' proposal takes better advantage of the liberalized bilateral provisions than do the proposals of the other applicants. Most importantly, UPS is the only applicant which will use the award in this case to commence building a "cargo hub" as that term is defined in the bilateral. Once this hub, which will be at Shanghai, is established, UPS will enjoy extraordinary operating flexibility--including unlimited frequencies to the hub and seventh freedom rights. The DOT should encourage carriers to take full advantage of these liberal rights, and, to that end, award UPS its requested 6 frequencies in 2004.

The other applicants criticize UPS, saying that UPS does not need the frequencies now because the hub rights are not available under the bilateral until 2007. The other applicants are short-sighted. As explained in Exhibit UPS-R-105, page 1, a cargo hub cannot be created overnight, but must be developed over time. This common sense approach to network construction was reinforced by FedEx Vice President Michael Ducker in his testimony in this proceeding. Air rights are a critical component of the hub-building process.

Additionally, UPS is the only applicant which will make maximum use of the existing and new change of gauge provisions of the bilateral. By awarding UPS its six 2004 requested Shanghai frequencies, the DOT will be, in reality, awarding UPS the ability to operate in 24 additional traffic lanes because UPS, utilizing the change of gauge provisions, will serve its all-points Asian hub at Clark, as well as Japan. See Exhibit

UPS-R-105, page 2. This is another reason why an award to UPS maximizes the valuable rights obtained under the bilateral. It shows that for every 2004 U.S.-Shanghai frequency UPS does not receive, it will lose connectivity and increased air cargo capacity with four markets: Shanghai, Beijing, Tokyo and Osaka.

UPS' selection of Shanghai for its first cargo hub in China was not based solely upon the exceptional market demands and opportunities of this city, but also upon its geographic location in the Asia Pacific region. Shanghai is ideally situated to serve as a much-needed regional hub for UPS. Unlike FedEx and Northwest who operate large regional hub facilities in Tokyo (facilitated by their decidedly superior amounts of international route authority to serve Japan), UPS has been operating at a disadvantage without a northern Asia regional hub. An award of the requested 2004 U.S.-Shanghai frequencies will help remedy that imbalance.

VI. UPS' Offers the Best Combination of Improved Shipping/Transit Times and Increased Capacity to Shippers and Consumer.

In terms of timing—a critical element in express service—Exhibit UPS-R-106 demonstrates that UPS will beat FedEx between the U.S. and Shanghai by one full day. From Qingdao to the U.S., UPS will continue to offer a three-hour later departure time than FedEx. *See* Exhibit UPS-R-112. Late departure times are critical for express customers, and important to all customers. There is no doubt which of these two applicants will do the most to increase U.S. exports and benefit U.S. businesses and

workers. With respect to Northwest, Exhibit UPS-R-115 shows that, between Guangzhou and Anchorage, UPS will beat Northwest by almost two and one-half hours.

In terms of capacity, UPS will provide almost four times more capacity than FedEx between Shanghai and the U.S. even though FedEx has stated that it considers Shanghai its "most critical gateway" (*see* Exhibit UPS-R-107). This is largely due to FedEx's circuitous, multi-stop round-the-world routing. As described in Exhibit UPS-R-109, taking the UPS and FedEx proposals as a whole, UPS will provide almost five times as much capacity per frequency as will FedEx. Additionally, FedEx is offering no new southern China capacity on its Shenzhen routing (*see* Exhibit UPS-R-108).

VII. On the Merits of the Proposals, UPS Is More Deserving of An Award Than Any of the Other Applicants.

A. FedEx is Undeserving of 18 Frequencies.

FedEx provided a great deal of information in its supplemental response—probably a bit more than necessary—but it still did not carry the burden of showing why it should be awarded 18 new frequencies. UPS appreciates the effort FedEx expended on explaining the virtue of world-wide networks. UPS also believes that such networks are imminently important. UPS also appreciates FedEx' explanation of how it, like UPS, actively promotes exports. UPS believes that we all agree that the use of these frequencies ultimately will be a good thing for the U.S. economy. The question is—

which carrier can do the most—and the answer to this is where UPS disagrees with FedEx.

Most notably, FedEx would have the Department embrace the long-forgotten “chosen instrument” theory of frequency allocation. By its argument, FedEx would have the Department give new authority only to the carrier that possesses the most authority. While this might have been a good and necessary practice with regard to Pan American Airlines half a century ago, it is an absurd idea today. FedEx should recognize that such a policy gave way long ago to “carrier strengthening” and then ultimately to today’s fair and equitable allocation of new authority based on the public interest benefits derived from a carrier’s service proposal.

FedEx does not require 12 frequencies for its bi-directional round-the-world flight as it already offers such service. *See* Exhibit UPS-R-110. UPS requests that the Department consider that granting six frequencies for one-way service to be a waste of such valuable rights.

The Department should also pay close attention to the markets that FedEx has chosen to serve. The city of Qingdao may some day become a large commercial center like Shanghai and Guangzhou, but today, it is a minor commercial center where there is insufficient demand for U.S.-China air cargo services to warrant the dedication of this proceeding’s frequencies. *See* Exhibit UPS-R-111. Further, FedEx proposes to serve Qingdao with service that will not meet the needs of, and thus not be valuable to, U.S.-Qingdao shippers and consumers. *See* Exhibit UPS-R-112. Along the same lines, FedEx

clearly states that it does not bring anything new to the shippers and consumers in the Shenzhen market. *See* Exhibit UPS-R-108.

B. Northwest, With Its 33 U.S.-China Frequencies, is Undeserving of the Frequencies It Requested.

As explained in Sections II and III above, Northwest's claims that the U.S.-China express market is small, unimportant and overserved are without merit. Furthermore, its claim that only it can remedy what it terms to be a shortage in general air freight capacity is equally in error.

Northwest's application and supplemental information seem to indicate that it wants to be all things to all shippers. It cannot and will not serve in this capacity. As a threshold matter, it does not possess a network optimized for the carriage of time-sensitive express traffic. Equally important, when compared to UPS, Northwest carries less general air freight on its freighter aircraft than UPS. Recent history shows that UPS' general air freight traffic is increasing while Northwest's has remained relatively flat. Exhibit UPS-R-113 shows that UPS not only carries more general air freight than Northwest, but also that the market's demand for its general air freight services is increasing faster than that of Northwest. Further, although Northwest is proposing larger aircraft, it faces serious load restrictions over these stage lengths which it fails to make clear to the Department in its exhibits. *See* Exhibit UPS-R-114 Thus, because Northwest is dedicating only half of its capacity for U.S.-Guangzhou traffic, it is dedicating far less capacity than UPS.

Additionally, if Northwest wants to provide better service to the foreign integrator, DHL Worldwide Express, it can do so without an award of five frequencies. Currently, Northwest provides DHL capacity to Shanghai three days per week. For a viable express-like service, Northwest actually needs only three additional frequencies, then it can move DHL's express traffic daily. *See* Exhibit UPS-R-116.

Northwest proposes service to Guangzhou that is inferior to the service proposed by UPS. First, Northwest proposes intermediate services to Japan in both directions while UPS will serve Guangzhou daily, non-stop. Accordingly, UPS' transit time is significantly less. *See* Exhibit UPS-R-115. Also, although on its face it would appear that Northwest is serving Guangzhou with a larger aircraft, Northwest is dedicating only 50% of this aircraft's capacity to the U.S.-China market. *See* Exhibit UPS-R-114, page 3 of 3. As designed, Northwest's proposal is not intended to maximize U.S.-Guangzhou service, but rather serve the U.S.-Japan markets with incidental U.S.-China capacity. *See id.*

C. The New Designee Needs 4 or Fewer Frequencies to Serve the General Air Freight Market.

Each of the applicants for the new U.S.-China designation have applied for far more frequencies than the needs of a newly implemented general air freight service can support. In fact, in previous frequency allocation proceedings at least three of the applicants stated that new cargo service requires a minimum of two and a maximum of four frequencies per week. In the recent *2002/2003 Hong Kong Fifth Freedom All-Cargo Frequency Proceeding*, Polar Air Cargo testified that only two weekly frequencies are

necessary to initiate general air freight all-cargo service and that three or four frequencies are sufficient to provide a competitive general air freight service.¹⁶ In the same proceeding, Evergreen testified that it could operate efficiently and profitably and serve as an effective competitive new entrant in the Asian markets with four frequencies.¹⁷ Evergreen also stated in the 2002 U.S.- Brazil All-Cargo service proceeding that it believed two weekly frequencies were the “minimum necessary to enable it to gain recognition in the market and provide service on an economic basis.”¹⁸ Finally, in the U.S.-Peru All-Cargo Service Proceeding, Arrow Air recognized three weekly frequencies would be all that they could support in a new market.¹⁹

The Department should consider these previous statements by the new applicants when allocating the valuable frequencies in this proceeding. UPS has no preference which carrier the Department selects, however, the Department should not ignore their

¹⁶ See Docket OST-2002-14049, PO-T-1, Page 2. (In its Consolidated Reply, Polar attempts to distinguish its testimony in the 2002/2003 Hong Kong proceeding, however, in at least two other Asian frequency proceedings Polar stated that it only needs two frequencies to introduce competitive service. See Docket OST-95-764, Answer of Polar Air Cargo to Applications for Allocation of Frequencies. “Polar Air is requesting the minimum number of frequencies it needs to offer a competitive general freight service – two.” See also Docket OST-96-1496 – U.S.- Thailand All-Cargo Frequency Allocation, Exhibit PO-401. “As Polar Air has explained, two frequencies are the minimum necessary to mount and sustain an efficient and competitive freight-of-all-kinds service over the routings described in its application.”)

¹⁷ See Docket OST-2002-14049, EZ-T3, Page 8.

¹⁸ See Docket OST-2002-12683, U.S. Brazil All-Cargo Service Proceeding, Application of Evergreen International Airlines, Inc., Page 5.

¹⁹ See Docket OST-95-317, U.S.-Peru All-Cargo Service Proceeding, Brief of Arrow Air, Inc., Page 8.

acknowledgements of the actual needs of general air freight carriers. Three of the new applicants have recognized previously that a newly designated general air freight carrier does not need and cannot support six weekly frequencies with its newly created service. *See* Exhibit UPS-R-117. An award of four frequencies to the newly designated carrier would allow the carrier to establish its presence in China. The carrier can apply for additional frequencies in future proceedings after it understands the needs of its general air freight service. The Department should remember the applicants' lack of experience with providing general air freight service in China and the actual needs for newly established general air freight service when allocating the frequencies.²⁰ UPS will offer fully-integrated, express service as well as a general air freight services on all of its proposed frequencies, and its services require allocations in 2004 and 2005 of no less than six weekly frequencies in each year.

²⁰ In fact, in the U.S.-Peru All-Cargo Service Proceeding, Arrow Air requested that the Department consider the inexperience and potential waste of the limited frequencies when awarding the frequencies. "It is significant that the three carriers with the least experience in providing scheduled all-cargo service have requested the greatest number of frequencies. Arrow submits that this fact reflects that very lack of experience and if their wishes were granted, these carriers would waste these limited rights." *See* Docket OST-95-317 U.S.-Peru All-Cargo Service Proceeding, Brief of Arrow Air, Inc., Page 8.