

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

In the Matter of

2004 U.S.-CHINA CARGO DESIGNATION  
AND 2004/2005 ALL CARGO FREQUENCIES

Docket OST-2004-18468

CONSOLIDATED REPLY OF  
GEMINI AIR CARGO, INC.

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August 9, 2004

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Gemini Air Cargo, Inc. submits this Consolidated Reply to the respective submissions of additional information that the parties to this proceeding filed on August 2, 2004. Examination of the additional information provided by the four applicants for both certificate authority and a frequency allocation – Gemini, Polar Air Cargo, Inc., Evergreen International Airlines, Inc., and Arrow Air, Inc. – continues to demonstrate that Gemini's proposal satisfies the public interest far more than the competing proposals. The differences between the Gemini proposal, on the one hand, and the Polar, Evergreen, and Arrow proposals, on the other, are pronounced and undisputed in all material respects. Under its proposal Gemini will dedicate the entire capacity of its flights (except for marginal quantities of transfer traffic) to the transportation of U.S.-China Third and Fourth Freedom traffic. Polar and Evergreen are equally candid that their proposals will incorporate a substantial amount of cargo transportation between China and third countries at the expense of capacity that would otherwise be dedicated to the U.S.-China market.

The Department should reject the Arrow proposal for different reasons. As discussed below, Arrow lacks the resources to undertake the substantial expansion in its operations that would be necessary for its complex proposal, which, even if implemented, would have questionable sustainability.

The attached Rebuttal Statement from Mr. Rick Cashman, Senior Partner of Marketechs International, provides economic and commercial analysis of the most recent information submissions. The Rebuttal Statement supports the conclusion that Gemini's proposal serves the public interest far better than those from the other certificate applicants.

Reply to Frequency Requests by Incumbent Carriers

Before addressing the proposals of Polar, Evergreen, and Arrow in light of their submissions of August 2, Gemini restates its position that the Department should grant Gemini its full request of 12 frequencies. Approval of Gemini's request leaves a combined total of 27 frequencies from the August and March tranches available for distribution to the incumbent carriers -- FedEx, UPS, and Northwest. This number will still permit the incumbent carriers to introduce a massive increase over their existing service. While the expedited freight carriers, FedEx and UPS, do provide a worthwhile type of cargo service, Gemini agrees with Northwest (NW Submission, p.1) that the U.S.-China cargo market now has a vital need for a substantial expansion in the capacity of U.S. carriers to transport general freight. For that reason, the Department should give priority to Gemini's request for 12 frequencies that Gemini will use to carry general freight, and

allocate the remaining frequencies among the incumbents in a manner that also gives priority to the transportation of general freight.

1. Implementation of Polar's plan will result in the dedication of substantially less capacity to the U.S.-China market than the Gemini proposal. Although Polar touts the putative benefits of operating its proposed U.S.-China service via its hub in Incheon, Polar's service pattern will result in the transportation of less traffic between the United States and China than would direct U.S.-China service, even in periods when the demand for cargo air transportation between the United States and China is high. This conclusion is supported by the Rebuttal Statement of Mr. Cashman, Exhibit GR-RT-1.

(a) Lower yields from Polar's reliance upon consolidators will create economic pressures for Polar to assign a lower priority to U.S.-China traffic than higher yielding cargo in other markets. Consolidation forwarders contract with carriers to sell all or substantial portions of a carrier's capacity in return for specially discounted rates from the carrier. The consolidator will market the aircraft capacity to shippers and subcontract to other forwarders. As Mr. Cashman points out in his Rebuttal Statement, consolidation loads are "based on high volume tenders" and produce low net rates to airlines. GR-RT-1, page 4. This model can benefit the carrier by reducing its marketing costs. This approach can be counter-productive, however, because it can make the carrier captive to the demands of the consolidator and result in yields that are insufficient to support the service in question.

Polar has historically relied on consolidators and indicates on page 5 of Exhibit PO-1 that its U.S.-China schedules are designed to meet the demands of freight consolidation schedules. Elsewhere, Polar asserts the benefits of its hub at Incheon that, according to Polar, will allow it to diminish the effects of directionality and seasonality in the U.S.-China market by supplementing U.S.-China traffic with traffic between the United States and other South Asian markets. Exhibit PO-1, page 6; Exhibit PO-2, page 4.

Given the favorable treatment that the Department has traditionally accorded to applications that propose to offer the most capacity in limited entry markets, (see NW Submission, page 6 n. 8), Polar's marketing approach runs counter to the public interest objective of maximizing U.S.-China capacity. This inconsistency would arise when low yields from consolidators in the U.S.-China market creates an incentive for Polar to use its hub to give preference to the transportation of non-China cargo with a higher yield.

Gemini will not succumb to excessive reliance on consolidators to its own detriment and to the detriment of the U.S.-China market. While consolidators are a part of the air transportation industry, Gemini will market its U.S.-China capacity over as broad a range of rate types as possible.

(b) Polar's reliance on its hub in Incheon to offset asserted directionality and seasonality in the U.S.-China market comes at the expense of capacity that would otherwise be dedicated to transporting U.S.-China cargo traffic. Polar would obviously be able to offer more U.S.-China capacity if it did not propose to operate its service via its

hub at Incheon. Polar attributes its decision to operate via Incheon as designed to alleviate problems arising (a) from the directional imbalance in favor of eastbound over westbound traffic and (b) from seasonality in the market. Gemini, in contrast, would dedicate 95% of the capacity of its aircraft in both directions year-round to the transportation of cargo between the United States and China.

The directional and seasonal nature of the U.S.-China cargo market is changing. “The imbalance of traffic demand is eroding, however, as the markets move toward maturity, with the weaker westbound direction growing faster than the eastbound,” Exhibit GR-RT-1, page 2, and this trend obviates the need foreseen by Polar for extensive traffic supplementation. Furthermore, the introduction of cargo service directly to more points within the People’s Republic of China will decrease the amount of westbound cargo traffic that is now shipped via Hong Kong and increase the amount that is shipped directly to its destination. This trend will vastly decrease the directional and seasonal fluctuations of the U.S.-China market. The rapid growth and increasing maturation of the U.S.-China air cargo market will enable Gemini to operate its proposed U.S.-China service successfully in both directions.

2. The Polar and the Evergreen proposals provide inadequate service to the U.S. West Coast. Los Angeles is the largest single U.S. point for U.S.-China trade although Chicago and New York are comparable.<sup>1</sup> Notwithstanding the essential role

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<sup>1</sup> Per Exhibit NW-28, the Los Angeles Customs District accounted for 23.9% of U.S.-China air trade in 2003, Chicago 20.6%, and New York 22.1%. Similarly, according to Exhibit PO-14, LA accounted for 26% of U.S. exports to China by value, versus 18% for Chicago and 14% for NY; LA

played by Los Angeles in the U.S.-China air cargo market, neither Polar nor Evergreen dedicates a substantial amount of capacity to the Los Angeles market on the flights that each would operate pursuant to their proposals. Gemini, however, would offer a substantial portion of its service via Los Angeles and San Francisco.

Gemini noted this imbalance in its submission of August 2. (Additional Information of Gemini, pages 7-8) Polar's proposed schedules indicate, for example, that of the nine flights that Polar seeks to operate following the second tranche allocation, Polar will operate only one westbound and one eastbound flight via Los Angeles. Exhibit PO-3, pages 3-4. Evergreen would not operate any of the seven flights that it has requested via Los Angeles.

In comparison Gemini's proposed flights provide service that is balanced among New York, Chicago, and Los Angeles. Of the 12 weekly flights that Gemini would operate after March 25, 2005, six would serve Los Angeles -- three would originate and terminate in Los Angeles (GR 007/008), and three would serve Los Angeles as an intermediate point (GR 011/012). Exhibit GR-1. In addition, the three flights that would originate and terminate in Los Angeles would also serve San Francisco in the outbound direction. (GR 007) Exhibit GR-1. Lastly, not only will Gemini operate substantially more frequencies at Los Angeles than Evergreen or Polar, Gemini will still operate more flights to the U.S. East Coast and Midwest than either Polar or Evergreen. Exhibit GR-5.

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accounted for 19% of imports by value, versus 15% for Chicago and 13% for NY. By volume LA represented 17% of exports versus 25% for Chicago and 22% for NY; LA represented 25% of imports by volume versus 12% for Chicago and 18% for NY.

3. Evergreen did not respond to the Department's request to disclose plans to operate its service via any "cooperative arrangements" with any other U.S. or foreign carrier.<sup>2</sup> All of the applicants in this proceeding, except Evergreen, responded to this DOT request. The twice-weekly round-the-world itinerary for EIA Route 1 (IAH-JFK-LUX-TAS-BJS-PVG-CTS-ANC-ORD) seems to be a roundabout way to introduce U.S.-China cargo service, especially with respect to the outbound sectors from the U.S. to China. This unconventionality raises the question whether this unique routing might arise out of a relationship between Evergreen and another airline or airline affiliate. Evergreen's failure to respond to the Department leaves this issue unresolved. Although the omission may have been an oversight, Evergreen should promptly supplement the record with its response.

4. The public interest benefits of Gemini's proposal are unrefuted by the additional information submitted by the competing certificate applicants.

(a) Gemini will transport offer more capacity dedicated to the transportation of U.S.-China Third and Fourth Freedom Cargo than either Polar or Evergreen. In Exhibit GR-8, Gemini showed that it would offer 32% more dedicated U.S-China Third/Fourth Freedom ATMs over critical legs each week than Polar, and 99% more ATMs than

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<sup>2</sup> In the Appendix to DOT Order 2004-7-13, DOT requested the parties to

Specify whether the applicant's service will be operated in conjunction with any cooperative arrangement (*e.g.*, wet lease, code share) with any other U.S. air carrier and/or any foreign air carrier. If such services will be operated, provide a detailed description regarding such operations, as well as a copy of the cooperative agreement, if not already on file with the Department.

Evergreen. Gemini used very conservative assumptions with respect to the amount of third country traffic that either Polar or Evergreen would carry. See Note to Exhibit GR-8.

Furthermore, using both Polar's and Evergreen's own data on the cargo capacity that each would make available over critical sectors still produces figures that are favorable to Gemini, even when Gemini uses unfavorable assumptions. In the case of Polar, the data in Exhibit PO-8 reveals that Polar's aircraft would have capacity of up to 3,564,838 pounds in both directions on the ANC-ICN critical leg sector.<sup>3</sup> This information means that the 4,296,000 pounds of critical sector capacity that Gemini would offer is 20.5% more than the foregoing figure for Polar.<sup>4</sup> These calculations do not, of course, reflect the fact that Polar has never asserted that it would fully utilize the ANC-ICN critical sector payload for U.S.-China traffic. Polar's much lower traffic estimates are set forth in Exhibit PO-8.

Using Evergreen's data and the very broad assumption that the maximum structural payload for Evergreen's B-747 aircraft is equivalent to the critical leg capacity for Evergreen's proposed routes, Evergreen's poundage over critical sectors would be

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<sup>3</sup> The total of the "Critical Sector Payload" column on page 1 of Exhibit PO-8 is 685,000 kgs. The total of the same column on page 2 of PO-8 is 932,000 kgs. The total for both directions is 1,617,000 kgs., or 3,564,383 pounds.

<sup>4</sup> The revised Polar figure of 3,564,838 pounds is less than the 3,814,650 pounds that Gemini estimated as Polar's critical leg capacity in Exhibit GR-3. The 20.5% greater critical leg capacity that Gemini offers in comparison to Polar contrasts with the prior margin of 12.6% in favor of Gemini.

3,227,900 pounds.<sup>5</sup> This figure represents an increase over Gemini's initial calculation for Evergreen, but is still far less -- by one-third -- than Gemini's substantially greater critical sector capacity of 4,296,000 pounds. Furthermore, Gemini's initial calculation of Evergreen's critical leg capacity in Exhibit GR-3 is probably far more accurate than a calculation that assumes that the maximum structural payload for Evergreen's B-747 aircraft is equivalent to its critical leg capacity, an assumption that would never stand up in the real world.

Thus, regardless of whether one compares the poundage that Gemini, Polar, and Evergreen would offer over critical sectors, or the capacity by ATMs that each would dedicate to 3rd/4th Freedom U.S.-China traffic, the Gemini proposal best meets the public interest by maximizing the capacity for serving the U.S.-China cargo market.

(b) None of the additional information submitted by Polar or Evergreen alters the benefits arising from the fact that Gemini will operate more frequencies to China than Polar or Evergreen or that it will operate direct single-plane service to more U.S. cities than Evergreen and to the same number as Polar.<sup>6</sup> These are major benefits to the

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<sup>5</sup> Evergreen states that its maximum structural payload for its B-747 aircraft is 248,300 pounds, Exhibit EIA-3. Using the very generous assumption that the maximum structural payload would be the same as its critical leg payload (which would never be the case unless the critical leg were very short), the poundage that Evergreen would carry each week over Route EIA-1 would be 2,483,000 pounds (248,300 pounds x 5 frequencies x 2 directions). For EIA Route 2, Evergreen estimates that half of its capacity would be available for U.S.-originating transportation. Using that assumption the total inbound critical sector poundage would be 248,300 pounds (50% of 248,300 x 2 frequencies). For the outbound sector the critical sector poundage would be 496,000 pounds (248,300 x 2 frequencies). The total for the inbound and outbound sectors for EIA Route 1 would be 744,900, and the overall total for Routes EIA 1 and 2 would be 3,227,900 pounds.

<sup>6</sup> Gemini's Additional Information, pages 6-7; Exhibits GR-3 & GR-4.

shipping public and to the U.S. economy, and the Department should carefully consider these benefits in addition to the other benefits of the Gemini proposal in making its determination. Shippers and consignees in more U.S. cities will have lower costs due to lower delay because they will have more days of the week on which to ship and receive cargo to and from China.

5. Arrow's proposal continues to present far fewer public benefits than Gemini's proposal. In its filing of August 2, Arrow provides more information regarding its proposed operations, but this additional information does little to surmount the inherent flaws in Arrow's proposal that Gemini and the other applicants have already pointed out.

Arrow, for example, provides information about its plan to initiate service using two B-747 aircraft that Miami Leasing will lease to Tradewinds Airlines, which in turn will operate the aircraft for Arrow under a wet lease arrangement. Given the importance of the new service to China, however, Arrow's interim arrangement does not incorporate the stability that should be an important element of new China service.

Furthermore, Arrow's proposal continues to be inferior to Gemini's proposal due to the expense and uncertain time that Arrow must incur to become qualified to operate B-747 aircraft and to add those operations to its FAA operations specifications.

Third, the Arrow proposal is complex in its routing. Service to so many points in China and in the United States will increase operating expenses and demand substantial management attention. These factors will make it more difficult for Arrow to operate the service profitably in comparison to carriers whose routings are more focused.

Lastly, notwithstanding Arrow's assurances, doubts remain regarding whether Arrow has the financial resources to mount such a major expansion in its operations so soon after financial reorganization.

The Department should reject the Arrow Application for the foregoing reasons.

CONCLUSION

The Department should select Gemini Air Cargo, Inc. for the award of a certificate of public convenience and necessity to operate scheduled foreign air transportation of property and mail from point or points in the United States; via intermediate points; to point or points in the People's Republic of China open to scheduled international operations; and beyond. The Department should also designate Gemini as the third U.S. scheduled all-cargo carrier to China and allocate to Gemini six all-cargo frequencies to operate to China in 2004 and six additional all-cargo frequencies to operate to China in March 2005.

Respectfully submitted,

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August 9, 2004

CERTIFICATE OF SERVICE

I hereby certify that on this 9<sup>TH</sup> day of August 2004, a copy of the foregoing CONSOLIDATED REPLY OF GEMINI AIR CARGO, INC. was served via email or fax upon the following parties. No indication was received that any transmission had failed.

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**REBUTTAL STATEMENT OF MR. RICK CASHMAN**

Gemini's service proposal best benefits U.S. aviation and the public interests. Throughout its Application and Additional Information filing, Gemini has emphasized direct service between the United States and China. Gemini has shown that its fleet aircraft, the MD-11F freighter, is well suited to this market and that its service proposal makes maximum use of the designation and frequencies.

Gemini and Polar have submitted the most relevant Additional Information in this proceeding. In addition, there is significant support for Gemini's proposal in the arguments and exhibits of Northwest and Federal Express in their Application and Additional Information filings. The key issue in comparing the Polar service proposal with that of Gemini is whether pure U.S.-China service or a significant mix of China with non-China demand services makes best use of the rights under the Protocol. Northwest correctly asks whether general cargo (heavy industrial freight over a range of weight-rate categories as opposed to express shipments of less than 70lbs) is being adequately addressed by the applicants and the Department in this proceeding.

Where priority is placed by the Department on maximizing the use of the new U.S.-China authority to be awarded in this proceeding, Polar suggests, and emphasizes, three key sub-issues: 1.) the directional imbalance, 2.) the seasonal variations, and, 3.) the predominance of "consolidation" market demand. While Gemini accepts the market characterization of Polar and Northwest with respect to directional imbalance and seasonal variations, we diverge on the best way to structure those services to make maximum use of the new authority.

Directionality The directional imbalance of demand in the U.S.-China market between eastbound and westbound is undeniable, as shown in Northwest's NW-3, with which Gemini concurs. The imbalance of traffic demand is eroding, however, as the markets move toward maturity, with the weaker westbound direction growing faster than the eastbound. Further, the the "bleeding" of traffic from the Peoples Republic of China over Hong Kong, as shown in NW-19, which is more directionally balanced to/from the U.S., will decrease rapidly as it finds new freighter capacity and thereby reduce the historical U.S.-PRC-U.S. imbalance in favor of westbound trade. Supporting the relative increase in westbound market demand is the ongoing and rapidly advancing "China Opening," which is facilitating increased entry of U.S. trade directly into China. In view of these facts, Gemini believes that Polar has failed to take into account that the structural change in the market will have a significant effect on the future of the market with regard to directional imbalance. Indeed, the new authority that the Department will award in this proceeding will hasten directional balance.

Seasonality The effects of seasonal fluctuations in traffic demand will become less significant as stronger base loads in both directions, particularly the weaker westbound direction, become available as new freighter services are introduced. The new designee in this proceeding, with sufficient frequencies per week, and serving both major industrial zones in China via Shanghai and Guangzhou, will tap both new growth and reclaim traffic that currently "bleeds" over Hong Kong between the U.S. and China. Gemini's service proposal takes full advantage of these market realities, contrary to Polar's service proposal that relies on significant volumes of non-U.S.-China traffic to justify its services.

Scope of Markets Gemini's proposal clearly focuses a great deal more on serving U.S.-China shippers than those of either Polar or Evergreen, both of which express equal or greater interest in other, non-U.S.-China foreign markets. With known directional imbalances in U.S.-China market demand, Gemini is puzzled as to why Polar and Evergreen have chosen to ignore two of the strongest marketing zones, the U.S. West Coast and the Southeast zone of China via Guangzhou.

Secondly, Gemini agrees with Polar and Northwest that LAX is a major and important gateway to and from China. Polar shows in PO-14 that Los Angeles represents 28% of volume in air trade (both directions added together), compared with 15% for Chicago and 19% for New York. Yet in Polar's PO-3, the proposed flight schedules and service proposal show only one trip available in each direction at LAX. Elsewhere in Polar's submission, Polar infers more frequencies at LAX (which no doubt would be split with ORD and JFK) (PO-1 and PO-2). These additional frequencies are not proposed in either Polar's Application nor its Additional Information schedule filings (PO-3). Regardless of these inconsistencies, Gemini has clearly and consistently shown full recognition of LAX as a major gateway with six full, single plane frequencies directly serving China to and from the U.S. West Coast marketing zone.

Northwest shows U.S. China air trade to be 24% at the LAX gateway, 24% at ORD and 22% at JFK, further supporting Gemini's service weight at LAX (NW-28). Evergreen simply ignores the U.S. West Coast market and, similar to Polar, ignores Guangzhou in China's industrial Southeast, in spite of their demonstrated importance in the U.S.-China market structure.

"Consolidation" Freight Polar's proposal emphasizes "consolidation" air freight service. Gemini disagrees that this traditional market segment is, or will be, the key to U.S.-China success. While pursuing consolidation forwarders has been, and apparently will continue to be, Polar's main marketing strategy to fill their 747 freighters, this strategy poses a problem for the development of 3rd/4th freedom U.S.-China traffic, i.e., low yields from the use of consolidation forwarders will drive allocations of space to non-U.S.-China markets. It is well known in the industry that consolidation loads, based on high volume tenders, are the lowest rated in terms of net rates to the airline. Gemini agrees with Northwest that the lower end of the rate spectrum can amount to -30% below standard rates and is a "deferred" service in terms of movement of the shipments in the airline's system (NW-8). The likelihood that Polar or Evergreen would sustain operations in a primarily consolidation freight market with marginal yield markets is very low. Accordingly, both Polar and Evergreen have "hedged their bets" on the U.S.-China commitment by building into their proposals other readily accessible markets (Non-US-China). Gemini, by contrast, avoids this economic pitfall by marketing 95% of its capacity to pure U.S.-China shippers over a full spectrum of freight rate types. Gemini will not embark on an fatally flawed economic proposal that depends on high volume, low yielding consolidation freight forwarders in the U.S.-China market.. Polar's marketing strategy relegates the U.S.-China market to a secondary position to other foreign markets that Polar would serve on the same flights and results in less use of its flight capacity to serve U.S.-China shippers. Gemini's strategy, on the other hand, maximizes the use of its frequencies for U.S.-China-U.S. shippers and would be far more developmental of this market than the proposals of Polar or Evergreen.

One of the purposes of the Department's negotiating strategy to acquire rights for a new entrant in the U.S.-China market is to establish a vigorous competition in that market between air carriers, both foreign and U.S. Gemini agrees with Northwest, in NW-20, that foreign carriers, particularly China Cargo Airlines, which is based at Guangzhou, offer a significant amount of weekly capacity in the U.S.-China markets. Likewise, FedEx in FX-120 and 121, identifies a significant presence and new plans for development by foreign carriers. Gemini concurs with Northwest that vigorous competition in the U.S.-China market is an intended product of the Protocol.

Gemini also concurs with Northwest that there is an urgent need for increased direct, single plane all cargo services in the U.S.-China market. Industrial heavy freight is an under-served category of cargo service in comparison to the light express cargo transported by the integrator carriers, Federal Express and UPS. Northwest's exhibits show the current contradictory imbalance in market demand when comparing the frequency and capacity offered in the U.S.-China market (NW-4, 5, and 9). Northwest points out that while the market demand exhibits a 90% general freight to 10% express freight relationship in exports and 94% to 6% in imports, U.S. carrier frequency distribution is the opposite, i.e., 15% of the frequencies are dedicated to general freight (NW) and 85% are reserved to express carriers (FedEx/UPS). This imbalance is indicative of the urgent need to use the new award in this proceeding to establish healthy new U.S. competition in the U.S.-China market. Gemini concurs fully with this assessment and has proposed a fully competitive service that would go far to redressing the current imbalance.

As shown by FedEx, established carriers such as Lufthansa, China Cargo Airlines, and FedEx itself have chosen the MD-11F as a competitive aircraft for longhaul China services (FX-120 and 12). FedEx and China Cargo Airlines have made that choice for the U.S.-China route. The MD-11F is the aircraft proposed by Gemini in this proceeding, and due to its inherent superior efficiencies over the 747F, will well serve Gemini in its goal to maximize the 3rd/4th freedom U.S.-China designation and frequencies while providing a vigorous new competitive muscle for U.S. aviation interests.

In making best use of the valuable new award in the U.S.-China market, Gemini will capture emerging new market opportunities, weathering directional and seasonal imbalances, by serving the most important and productive U.S. and China markets on a direct, single plane flight basis. Utilizing the more efficient MD-11F aircraft and offering more U.S.-China capacity per week than either Polar or Evergreen, Gemini Air Cargo is the best choice for the third designation and the award of twelve frequencies.