Order 96-11-7

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

Served: November 19, 1996

Issued by the Department of Transportation
on the 13th day of November, 1996

U.S.-Philippines All-Cargo Service Proceeding	Docket OST-96-1074

ORDER TO SHOW CAUSE

By this order, we tentatively grant the applications of Polar Air Cargo, Inc. (Polar) and United Parcel Service Co. (UPS) to provide scheduled all-cargo services in the U.S.-Philippines market. Interested parties are directed to show cause why we should not make the grant of this authority final.

Background

Under the provisions of a Protocol to the U.S.-Philippine Air Transport Services Agreement signed November 20, 1995, the United States may now designate a total of three carriers to provide scheduled all-cargo services on Route 3 of the Agreement.[1] Federal Express Corporation is the only carrier currently designated on Route 3, and we therefore have the opportunity to designate two additional U.S. carriers for U.S.-Philippines scheduled all-cargo service.

By Order 96-2-19, we instituted the above-captioned proceeding to select two carriers to provide scheduled all-cargo service on Route 3. That order describes the major selection criteria as (1) which applicants will be most likely to offer and maintain the best service for the shipping public; (2) the effect of the applicants' service proposals on the overall market structure and level of competition in the U.S.-Philippines cargo market, and any other markets shown to be relevant, in order to promote an air transportation environment that will sustain the greatest public benefits; and (3) other factors historically used for carrier selection where they are relevant.

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[1] Route 3 reads "from the United States via intermediate points to the Philippines and beyond."

Five carriers have applied for the two available designations. The applicants, Evergreen, Northwest, Polar, United Parcel Service (UPS), and World, are each currently operating transpacific scheduled all-cargo services. Except for Northwest, which operates combination services on Route 2, each of the applicants would be a new entrant in the U.S.-Philippines market.

The U.S.-Philippines air cargo market is small but growing. Although the market grew 17.6 percent annually between 1993 and 1995, the U.S. carrier market share dropped from 41.3 to 27.7 percent, while third-country carrier market share grew from 41.6 to 57.9 percent. This trend gives renewed urgency to selecting two new U.S. carriers to provide all-cargo service in the market.

Summary of Applications

Evergreen

Evergreen proposes (1) twice weekly service between New York, Chicago, Los Angeles, and Honolulu, on the one hand, and Manila, on the other, via Sydney and beyond Manila to Hong Kong and Khabarovsk; (2) one flight per week between New York, Chicago, Los Angeles, and Honolulu, on the one hand, and Manila, on the other, via Auckland and Melbourne and beyond Manila to Hong Kong and Khabarovsk; (3) twice weekly service between San Francisco and Anchorage, on the one hand, and Manila via Khabarovsk. This would produce a total of five flights per week, with three flights on a South Pacific routing and two flights on a North Pacific routing. Two of the three Evergreen South Pacific flights are wet leased by Qantas, and much of the available capacity on those flights would be controlled by Qantas for its customers. Evergreen would use B-747-100 and B-747-200 aircraft for this five flight per week service.

Northwest

Northwest proposes once weekly service between Anchorage and Manila via Tokyo and also, an eastbound-only service between Singapore and Anchorage via Manila and Tokyo, effectively providing one and a half roundtrips per week in U.S.-Philippines service. The Northwest service would be operated with B747-200F aircraft. Northwest's Tokyo-Manila service would be tag-end entry from existing U.S.-Japan service, while the Singapore service would add Manila as an intermediate point to an existing flight.

Polar

Polar proposes three weekly westbound-only services between New York, Chicago and Anchorage, on the one hand, and Manila, on the other hand, via Khabarovsk, Russia, and beyond Manila to Taipei. Polar also proposes two weekly westbound-only services between New York, Chicago, Los Angeles, and Honolulu, on the one hand, and Manila on the other hand, via Auckland, Sydney / Melbourne, and Singapore. Polar proposes four weekly eastbound-only services between Manila, on the one hand, and Anchorage, Chicago, and New York, on the other hand, via Khabarovsk, and one weekly eastbound-only flight between Manila, on the one hand, and Anchorage, Seattle, and Los Angeles on the other hand. Polar's total service proposal of five weekly frequencies would be provided with B-747F aircraft.

UPS

UPS proposes to operate document / small package express and general air freight service between its hub facility in Anchorage and Manila via Seoul, and Taipei, and beyond Manila to Singapore and Kuala Lumpur six days a week with B-767 aircraft.

World

World proposes to operate a total of three weekly flights between the U.S. and the Philippines over the following routings: (1) one flight per week between New York, and Anchorage, on the one hand, and Manila, on the other, via Seoul; (2) two flights per week between Los Angeles and San Francisco, and Anchorage on the one hand, and Manila, on the other hand, via Seoul and beyond Manila to Penang and Kuala Lumpur. World would operate its service with DC-10-30 and MD-11 aircraft under a block-space arrangement with Asiana wherein Asiana remarkets the capacity to its customers, as well as under a code-share arrangement with Malaysian Airlines.

Position of the Parties

Evergreen

Evergreen argues that it would offer and maintain the best service for the shipping public, given its major operations in Asia where it has a strong reputation as a top-quality cargo airline. Adding the Philippines to Evergreen's existing U.S.-Asia / Pacific network, it argues, would significantly enhance the competitive structure of the market and substantially strengthen Evergreen's Far East operations. Proposing to offer return B-747 widebody service along with Polar, Evergreen argues that it provides significantly higher quality service,[2] and that, if

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[2] In this context, Evergreen made allegations regarding the quality of Polar's service and commitment of resources to maintenance. Polar filed a motion to strike what they assert are improper factual misrepresentations by Evergreen. Evergreen answered in opposition to Polar's motion, essentially reasserting the original allegations. Polar subsequently filed a reply and motion for leave to file.

Although Evergreen's serious charges against the conduct of Polar's operations were not supported by objective evidence, given the fact that Polar responded to the allegations on the record and the issues raised were fully aired in two rounds of pleadings, we have determined to deny Polar's motion to strike, but to grant its motion for leave to file.

selected, it would maintain its proposed level of service, based as it is on a reasonable traffic forecast.

Other applicants argue that the commitment of Evergreen to operate scheduled all-cargo services in its own behalf is questionable, and that Evergreen has an established history of inability to honor its scheduled service proposals. They argue further that two of Evergreen's five west-bound flights are wet-leased to Qantas, and that these flights will therefore not offer any significant capacity. Evergreen, the other applicants maintain, is essentially a wet-lease/charter operator rather than a scheduled all-cargo operator, which is evidenced by the fact that it has not entered U.S.-Asia open entry markets or taken advantage of fifth freedom opportunities available from Australia and New Zealand.

Polar

Polar argues that it would provide more overall capacity between the U.S. and Manila than any other applicant, and that it would provide a level of service more responsive to the needs of the market, unrestrained by wet lease commitments over any sector of its routing. In addition, it argues that its selection would do the most to stimulate competition in the U.S.-Philippines and U.S.-Asia cargo markets, and that it can be relied on to operate the service it proposes.

Other applicants argue that Polar's proposal offers no new transpacific capacity to the shipping public, and that Polar proposes only to add a stop in Manila to its existing Pacific services. They argue further that Polar's forecast is not credible and would result in unrealistically high load factors over many of its proposed segments. Polar's weak financial position, the other applicants also argue, render it unable to successfully develop the service it proposes.

Northwest

Northwest argues that its proposed service would provide the first U.S.-Philippines heavy-payload cargo service, thus complementing FedEx's current package service and Northwest's own container service carried on combination aircraft. In addition, Northwest argues that its service can be integrated smoothly into its current network of Pacific all-cargo operations, allowing the U.S. to take full advantage of valuable fifth-freedom rights to provide all-cargo service between the Philippines and Japan.

The other applicants argue that Northwest already holds authority to serve the Philippines cargo market through its combination service on Route 2, which is even convertible to all-cargo service if Northwest desires, and that its selection would be a waste of a limited-entry opportunity. They argue further that Northwest proposes the fewest frequencies of any applicant and that selecting Northwest, which already holds more transpacific authority than any other applicant, would not enhance competition.

UPS

UPS argues that its selection would connect the Philippines to every point in the United States and every other point on the UPS network, and thus provide the most and best service for shippers. In addition, it argues that only it has the resources necessary to provide a fully competitive service and the financial strength to ensure that it will be able to maintain that service. Furthermore, it argues that an award to UPS would reduce the disparity in limited entry route authority in the Pacific held by UPS on the one hand, and by FedEx and Northwest on the other, and thereby enhance competition.

The other applicants argue that UPS proposes to focus on the small package/express delivery market in competition with FedEx, but that it would not offer adequate heavy lift capacity in its general air freight service, the largest sector of the market. They argue further that UPS would offer the least capacity among the applicants, and that UPS already serves the Philippines as an indirect air carrier. Finally, the other applicants criticize UPS's proposal for its dependency on fifth freedom traffic.

World

World argues that it is the only applicant proposing competitive service to the three largest markets for U.S.-Philippines cargo, New York, Los Angeles, and San Francisco. In addition, World argues that its selection would significantly enhance competition among the transpacific all-cargo carriers due to the fact that it is an experienced operator of scheduled all-cargo services that would be able to build on its current services in the region and to expand its customer base.

The other applicants argue that World would offer relatively little capacity to the U.S.-Philippines cargo market, and much of that capacity would be operated for the benefit of Malaysian Air Systems. They argue further that World is not an experienced scheduled all-cargo carrier and that its equipment is incapable of handling large containers or outsized shipments.

Tentative Decision

Among the five applicants, UPS is the only carrier offering comprehensive, integrated express/small package service plus general air freight service. We have tentatively determined that UPS would therefore be most likely to offer and maintain the best service for the shipping public while having the most beneficial impact on overall market structure and level of competition in the U.S.-Philippines cargo market by providing the strongest and broadest competition to the incumbent FedEx, an integrated all-cargo carrier. We also believe that the selection of UPS with its emphasis on serving the express/small package market in combination with any of the other applicants stressing general air freight would provide the best and broadest range of service options for shippers in the market.

UPS is a good fit with any of the other applicants in other ways as well. UPS would provide the greatest number of frequencies with the smallest aircraft (B-767-300) consistent with its express/small package focus. This service pattern complements the proposals of the other applicants, which would operate larger, wide-body aircraft designed to accommodate the larger general air freight shipments with fewer frequencies. UPS can offer the greatest range of services over the largest transportation network with the greatest geographic coverage of any of the applicants. Since the Agreement has no restrictions on intermediate and beyond points, UPS will be able to integrate its Philippines service with any other point in Asia that it serves.

Because of its fleet flexibility, UPS can also add or delete capacity in small increments. For example, UPS proposes to add a B-767 for summer service, which will add 18 percent additional capacity in the market, without adding frequencies. In addition, UPS is the only applicant that can effectively compete with FedEx, a carrier that for many years has been the only U.S. flag all-cargo carrier in the Philippines market, thus furthering the goal of benefiting the overall market structure and level of competition.

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

UPS's carriage of some fifth freedom traffic over its proposed route also does not militate against an award in this proceeding, as Evergreen and Northwest argued. Given the relatively small size of the U.S.-Philippines cargo market, UPS's carriage of some fifth freedom traffic is likely to contribute to the overall success of its cargo service between the two countries. UPS's proposal to carry a relatively modest level of fifth freedom traffic is not viewed as excessive under the circumstances of this proceeding. Furthermore, any growth in the U.S.-Philippines cargo market may result in reducing the relative amount of fifth freedom traffic carried over the route.

Having tentatively determined to select UPS, we now look to which remaining carrier would most effectively satisfy the selection criteria in this case. Based upon a review of each of those proposals, we have tentatively determined that Polar would offer and maintain the best service for the shipping public while enhancing the overall U.S.-Philippines cargo market structure and maximizing competition. With five roundtrips per week, Polar offers significant new capacity in the U.S.-

Philippines cargo market through its B-747 wide-body service, giving U.S.-Philippines shippers the aircraft with the largest available lift.

Polar also offers most single-plane service to/from the U.S. points with the greatest amount of U.S.-Philippines traffic of any of the applicants. Three of the top five U.S.-Philippines markets (New York, Chicago, and Anchorage) would receive new U.S.-Philippines single-plane service with at least three flights per week in both directions under Polar's proposal.[3] In the eastbound direction, where a significant traffic imbalance exists, Polar offers the greatest amount of service; New York and Chicago would each receive four flights per week, and Anchorage would receive five flights per week. Los Angeles, the second largest U.S.-Philippines market, would receive two westbound flights and one eastbound flight. Seattle would also receive new U.S.-Philippines service with one eastbound flight.

No other proposal provides as much new single-plane service to as many U.S. points. Although Evergreen would offer new single plane service with three westbound flights per week from New York, Chicago, and Los Angeles, two of those flights are wet leased by another carrier, Qantas. This fact substantially limits the competitive benefit of Evergreen's proposed service because Evergreen would have only one of those flights under its control to market directly to shippers and other indirect air carriers. Although Evergreen proposes new single plane roundtrip service from San Francisco, that service would be offered only twice per week. Under Evergreen's proposal, in the eastbound direction, aside from San Francisco, only New York and Columbus are forecast to receive cargo traffic from the Philippines, with three flights per week in each market.[4]

World would offer even less service to the most important U.S.-Philippines markets. It would serve New York, Los Angeles, and San Francisco in both directions, but would serve New York, the largest U.S.-Philippines market, with only one roundtrip per week, and would serve Los Angeles and San Francisco with only two flights per week in each market.[5] World also faces potential preemption of its proposed capacity from its marketing partners, Malaysian and Asiana, due to the fact that those agreements prevent World from controlling all of the capacity on its flights. In addition, those agreements limit the competitive benefits of World's proposal due to the fact that World is prevented from marketing some of the capacity on those flights directly to shippers and indirect air carriers.

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[3] Although Polar's proposal shows five westbound flights per week, two of those flights forecast no traffic in the westbound direction.

[4] Although Evergreen proposes to serve Anchorage on its eastbound service, it did not forecast any traffic.

[5] Although World proposes to serve Anchorage on its roundtrip service, it did not forecast any traffic eastbound.

Northwest would serve only Chicago, the fourth largest U.S.-Philippines market, with a single roundtrip flight per week, and would serve Los Angeles and San Francisco in the eastbound direction only with a single flight per week.[6] As an incumbent carrier, Northwest already offers substantial belly cargo capacity with its existing B-747 combination service. Thus, its selection would offer relatively less marginal service benefits to the shipping public than the other applicants, and does not offer the competitive or market structure benefits of adding another carrier in the U.S.-Philippines cargo market.

Dormancy Provisions

We have tentatively decided to include a standard 90-day startup requirement and dormancy provision in the exemptions that will be issued pursuant to a final order in this case.

ACCORDINGLY,

1. We direct all interested persons to show cause why we should not issue an order making final our tentative findings and conclusions;

2. We direct interested persons wishing to comment on our tentative findings and conclusions, or objecting to the issuance of the order described in paragraph 1, to file an original and 5 copies in Docket OST-96-1074, and serve on all persons on the service list in that docket, a statement of such objections, together with any supporting evidence the objector wishes the Department to notice, not later than November 26, 1996. Answers to objections shall be due December 6, 1996;[7]

3. If timely and properly supported objections are filed, we will afford full consideration to the matters or issues raised by the objections before we take further action. If no objections are filed, we will deem all further procedural steps to have been waived, and proceed to enter a final order subject to Presidential review under 49 U.S.C. § 41307;

4. We deny Polar's Motion to Strike;

5. We grant Polar's Motion for Leave to File; and

6. We shall serve this order on all parties in Docket OST-96-1074.

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[6] Although Northwest proposes to serve Anchorage on its roundtrip service, it did not forecast any traffic in either direction.

[7] The original filing should be on 8 1/2" X 11" white paper using dark ink and be unbound without tabs, which will expedite use of our docket imaging system. We will authorize service by fax in this proceeding. All pleadings should include a fax number for service.

By:

PATRICK V. MURPHY
Deputy Assistant Secretary for Aviation
and International Affairs

(SEAL)

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