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Order 2000-3-2

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

Issued by the Department of Transportation
on the 7th day of March, 2000

Joint Application of

**UNITED PARCEL SERVICE CO.
and
CHALLENGE AIR CARGO, INC.**

for approval of a transfer of route authority
under 49 U.S.C. § 41105 (U.S.-Latin America
all-cargo service) and related authorities

Served: March 9, 2000

Docket OST-99-6345 - 14

In the Matter of the Applications of

CHALLENGE AIR CARGO, INC.

for an exemption pursuant to 49 U.S.C.
§40109 and allocation of frequencies (U.S.-
Latin America all-cargo service)

Dockets OST-96-1379 - 6

OST-98-4277 - 3

OST-99-5046 - 4

ORDER TO SHOW CAUSE

SUMMARY

By this order we tentatively approve the Joint Application of United Parcel Service Co. (UPS) and Challenge Air Cargo (Challenge) for the transfer to UPS of Challenge's certificate and exemption authorities to provide scheduled all-cargo foreign air transportation between the United States and various countries in the Caribbean, Central America and South America area (Latin America). We also tentatively grant Challenge temporary exemption authority to permit Challenge to continue its operations in these markets until UPS is able to begin its own service.

APPLICATION

On October 12, 1999, UPS and Challenge filed a joint application for transfer of Challenge's U.S.-Latin America all-cargo route authority to UPS.¹ The Joint Applicants also requested that UPS be granted authority to integrate this Latin America authority with its existing certificate and exemption authority. In conjunction with their application, the Joint Applicants requested that Challenge be granted interim exemption authority to keep serving the markets until UPS can inaugurate its own service.

In support of their application, the Joint Applicants state that following approval of the transfer UPS will commence scheduled all-cargo service in all thirteen markets now served by Challenge, significantly increasing its U.S.-Latin American operations. UPS states that its operations will benefit shippers in the U.S.-Latin America market by offering more service options and broader geographic coverage, including its extensive U.S. system. UPS further states that this transfer will fill an important gap in UPS' worldwide distribution network and will increase competition in the U.S.-Latin America market by replacing a smaller competitor with a much larger competitor. Of all the markets at issue, the carriers state that the only overlap in the existing services of the two carriers involves service to Costa Rica and the Dominican Republic, both of which are open-entry countries.

With respect to Challenge, the applicants state that during the transition period Challenge will continue to operate the routes included in the route transfer using three DC-10F aircraft it will retain and/or other aircraft it will wet-lease. While Challenge notes that the DC-10F aircraft it will retain are better suited for any possible future wet-lease cargo operations it may undertake, Challenge states that upon consummation of the route transfer and UPS' commencement of services, it will reconsider at that time the scope of operations that it will conduct. In this regard, Challenge states that it will advise the Department 30 days before the end of the transition period, and prior to making any substantial change that would affect the carrier's operations, ownership, and control.

The Joint Applicants further state that the transfer will have an overall positive impact on labor. They acknowledge that Challenge will be conducting reduced operations after the transaction and therefore, will have fewer employees. However, they state that UPS, as a result of its expansion, will employ a substantial number of new employees, including most of Challenge's current employees.

¹ The certificate authority at issue involves scheduled all-cargo routes between various points in the United States and Barbados, Belize, Bolivia, Brazil (Miami), Colombia, Ecuador, El Salvador, Guadeloupe, Guatemala, Guyana, Haiti, Honduras, Jamaica, Martinique, Netherlands Antilles, Grenada, Paraguay, Peru, Surinam, and Trinidad and Tobago. The exemption authority at issue involves scheduled all-cargo routes between various points in the United States and Brazil (from Dallas/Ft. Worth) and Venezuela.

The Joint Applicants also argue that the transaction warrants approval under the criteria required of the Department to report to Congress, namely, the effects of the transfer on (1) the viability of each carrier, (2) competition in the domestic airline industry, and (3) the trade position of the United States in the international air transportation market.

In this regard the Joint Applicants state that the transfer will have a positive effect on the viability of UPS by enabling UPS to operate its own aircraft in the U.S.-Latin America market, instead of having to place its cargo on other carriers, thereby filling an important gap in the scope of UPS' services. They also state that the agreement will provide substantial new capital to Challenge and improve its financial health. They further state that the transfer should have a positive impact on the domestic airline industry as UPS with its more extensive domestic network will offer more convenient international service to almost the entire United States, thereby increasing competition domestically. Finally, the Joint Applicants state that the trade position of the United States will be improved significantly because UPS provides more service options and has the ability to carry more traffic than Challenge.

RESPONSIVE PLEADINGS

A number of Challenge pilots filed objections to the proposed transfer.² The Joint Applicants filed replies.³

The pilots state that Challenge has engaged in an unfair labor practice because it failed to negotiate a labor agreement in good faith by not informing the employees about the intended plans for the transaction between UPS and Challenge. The pilots also state that the transaction will be adverse to competition, and that serious safety risks will be created by the transaction because the pilots now employed by Challenge are experienced in serving these routes while UPS pilots are not. Finally, the pilots state that the Department should require UPS to accept Labor Protective Provisions (LPPs) as a condition of the transfer because the hiring of Challenge pilots by UPS would enhance safety.⁴ In addition, the pilots argue that LPPs may be the only way to protect their employment rights, since their collective bargaining agreement with Challenge could be extinguished when the transfer is consummated.

² The requests were accompanied by motions for leave to file otherwise unauthorized documents and requests for leave to intervene and make oral presentation. Under Department rules, requests to intervene and oral presentation are not necessary to comment on the subject application. The Joint Applicants opposed the motions of the pilots because they were filed more than a month after the normal answer period and they state that the transaction has been common knowledge, especially among Challenge employees, for many months. We will grant the requests for leave to file otherwise unauthorized documents and accept the late answers to the joint application in the interest of a complete record.

³ These pleadings were accompanied by motions for leave to file otherwise unauthorized documents. We will grant the motions.

⁴ See, Allegheny-Mohawk Merger Case, 59 C.A.B. 22 (1972)

In their reply, the Joint Applicants state that their transaction demonstrates the market forces that the Department relies on to maximize the benefits of commercial aviation and that contrary to the pilots' statements, the transaction has been common knowledge for many months. They state that this transaction will give UPS a larger presence in Latin America, enhance competition and stimulate employment since UPS is a much larger carrier. They strongly object to arguments that the transfer will have negative safety implications, maintaining that UPS is experienced in serving markets around the world. The Joint Applicants also state that the Department has not imposed LPPs for almost two decades because after deregulation the Department has limited its authority over the carriers' managerial decision making. Moreover, they state that the pilots should abide by the collective bargaining agreement that specifically addresses their rights in these circumstances.

TENTATIVE DECISION

We have tentatively decided to approve the transfer of Challenge's U.S.-Latin America route authority to UPS and also to grant Challenge an interim exemption to permit it to continue operating its existing services until UPS is prepared to begin service.

The statute authorizing certificate transfers, 49 U.S.C. §41105, provides that no certificate may be transferred unless the Department approves the transfer as being consistent with the public interest. The Department has adopted as its public interest standard in such cases a policy of allowing proposed transfers provided that they do not conflict with important international aviation policy objectives and are not otherwise inconsistent with the public interest.⁵ In determining whether a transfer of route authority is consistent with the public interest, we must also consider three additional criteria: the effect of the transfer on the viability of each carrier; on competition in the domestic airline industry; and on the trade position of the United States in the international air transportation market.⁶ Also, the Department has stated that it will carefully consider the impact of any proposed sale of route authority on airline workers.⁷

In this case, we tentatively find that the route transfer meets our standards for approval. Specifically, the introduction of UPS' service will provide new service options to the shipping public, more fully use our bilateral route opportunities and enhance competition in the U.S.-Latin America all-cargo market. In these circumstances, we tentatively conclude that approval of the transfer will benefit the public and will not conflict with our international aviation objectives.

We also tentatively find that both carriers will remain fit to provide their authorized services and that the transfer of Challenge's Latin America route authority to UPS will have a positive impact

⁵ See, e.g., Joint Application of Northwest Airlines and Delta Air Lines, Order 95-4-41, p.3, Joint Application of Federal Express Corporation and Evergreen Airlines, Order 95-8-9, p. 4, and Joint Application of Federal Express Corporation and Florida West International, Order 97-10-23, p.4.

⁶ The Department must also examine certificate transfer transactions to determine whether the parties to the transfer are U.S. citizens and are fit to hold their authority. See Federal Express, Order 89-3-21 at 7.

⁷ See *Initiative to Promote a Strong Competitive Aviation Industry*, January 1994.

on the viability of both carriers. Challenge will benefit from the infusion of new capital to support its future plans.⁸ UPS will benefit from the ability to expand its operations to new markets, improving its competitive posture.⁹ The improvement in each carrier's viability will enable each carrier to compete more effectively and thereby enhances competition in the airline industry.¹⁰

Furthermore, we tentatively find that there will be a positive impact on the U.S. trade position in the international air transportation market as a result of this transfer. Since UPS has a much more extensive route network and worldwide infrastructure than Challenge, UPS will be able to provide more effective competition to both foreign carriers and other U.S. carriers in the U.S.-Latin America market. In these circumstances, air commerce between the United States and Latin America should increase, improving the U.S. trade position.

Finally, we tentatively find that the route transfer should have an overall positive impact on airline employees. The expansion of services at UPS will result in an increase of airline jobs at UPS to conduct the increased service.¹¹ Moreover with respect to Challenge employees, the Joint Applicants stated that even if Challenge initially might have fewer employees as a result of its reduced operations, UPS will hire additional employees, including some of those previously employed by Challenge. Furthermore, the route transfer and the resulting capital infusion will

⁸ Challenge states that it has current assets of \$19.7 million, current liabilities of \$35.5 million (for negative working capital of \$15.8 million, and a current ratio of 0.55:1), negative retained earnings of \$15.8 million and negative stockholder's equity of \$6.3 million, as of June 30, 1999. After completion of the transaction, certain funds received will be used by Challenge to repay advances made by its owner, Mr. Peter Ullrich. The remainder of funds will be retained by the company, together with certain assets, primarily three DC-10 all-cargo aircraft and other assets associated with its Dallas operations, and approximately \$2.0 million in liabilities. As a result, Challenge forecasts that, upon completion of the transaction, it will have current assets of \$17.2 million, current liabilities of \$2.0 million (for positive working capital of \$15.2 million and a current ratio of 8.6:1), positive retained earnings of \$7.7 million, and total stockholder's equity of \$17.2 million. Thus, while initially the carrier will be a much smaller entity with reduced operations, it will be stronger financially.

⁹ UPS currently operates a fleet of 224 all-cargo large jets, as well as other equipment, to provide complete package shipment services. Transfer of the Challenge route authority to UPS, together with associated assets, will broaden UPS' geographic coverage. UPS' overall financial condition is strong with current assets of \$239.2 million, current liabilities of \$227.4 million (for positive working capital of \$11.8 million and a current ratio of 1.05:1), positive retained earnings of \$937.5 million, and positive net stockholders' equity of \$930.3 million, as of June 30, 1999.

¹⁰ The proposed transaction will have no impact on either carrier's senior management and key technical personnel team, or compliance disposition. Moreover, we find that the proposed transfer will have no impact on the citizenship of UPS or Challenge. Both UPS and Challenge are currently owned and controlled by U.S. citizens. Mr. Peter Ullrich, a U.S. citizen, holds 100 percent of Challenge's issued and outstanding stock. At the time of our last review of its fitness, UPS was wholly owned by its parent, United Parcel Service of America (*see* Order 96-7-24). In mid-November 1999, UPS' parent undertook its first public stock offering. Under this offering, it offered for sale shares totaling ten percent of its total stock and representing one percent of its total voting power. Hence, UPS continues to be owned and controlled by U.S. citizens.

¹¹ Application at 14, and motion of UPS dated December 15, 1999 at 4.

afford Challenge the opportunity to concentrate the scope of its operations, thus serving the overall interests of the carrier and its employees. Against this background, we tentatively believe that notwithstanding the various concerns raised by the commenting Challenge pilots, on balance, the significant positive public benefits cited above warrant approval of the joint application.

We are unpersuaded by arguments that LPPs are necessary to ensure safe operations by UPS in the transferred markets. UPS is authorized to operate scheduled cargo operations on nearly a worldwide basis. There is no evidence on the record that would lead us to question UPS' ability to operate these Latin America operations, which are comparable in scope to operations now conducted by UPS in other markets. Moreover, any new operations by UPS can be inaugurated only after completing all necessary requirements of the Federal Aviation Administration. In these circumstances, we tentatively find no basis to conclude that such services will not be conducted in a safe manner after full compliance with all FAA safety requirements.¹²

EXEMPTION

We have tentatively decided to grant Challenge Air Cargo interim exemption authority to continue its authorized U.S.-Latin America services for a period of up to six months after the effective date of the transfer of its foreign route authority to UPS.¹³ We find that grant of the exemption is in the public interest and will ensure that valuable bilateral aviation rights are fully used by maintaining U.S.-flag all-cargo service in these markets pending approval of UPS' services by the various foreign governments in this region.

ACCORDINGLY,

1. We tentatively grant the application to the extent consistent with this order;

¹² We have also tentatively decided not to impose mandatory labor protective provisions on UPS for reasons other than safety as requested by the Challenge pilots. It has been the Department's policy not to impose LPPs unless they are necessary to prevent labor strife that would disrupt the national air transportation system, or unless, due to special circumstances, they are necessary to encourage fair wages and equitable working conditions. We tentatively find that the pilots have not presented any special circumstances that would warrant a departure from this policy in this case. There is no evidence on the record that the transfer will result in a significant impact on the national transportation system. Moreover, the record indicates that collective bargaining provisions are in place to address employment issues. The Department has consistently found that labor matters should normally be resolved through that process without government interference.

¹³ While the Joint Applicants did not request a specific term for this authority, we believe that six months is a reasonable period for UPS to obtain the necessary authority from the foreign governments involved, especially since it already has a business presence in these markets. Should UPS need more time to implement its service, we will entertain an application to extend this interim arrangement at that time.

2. We tentatively issue in the specimen form attached, a certificate of public convenience and necessity to United Parcel Service Co. to reflect the transfer of the requested certificate authorities;
3. We tentatively cancel the certificates of public convenience and necessity issued to Challenge Air Cargo, Inc., for Routes 353, 626 and 711;
4. We tentatively transfer to United Parcel Service Co. the exemption authority and frequency allocations previously granted to Challenge Air Cargo by the Notice dated June 7, 1994, as amended by Order 97-8-20 (Ecuador frequency allocation) and the following Notices of Action Taken: June 24, 1998, Docket OST-96-1379 (Miami/San Juan-Caracas, Miami-Valencia/Maracaibo), August 14, 1998, Docket OST-98-4277 (Brazil frequency allocation), and May 5, 1999, Docket OST-99-5046 (Dallas/Ft. Worth-Venezuela/Brazil);¹⁴
5. We tentatively grant United Parcel Service Co. authority to integrate the above certificate and exemption authorities with its other certificate and exemption authority;
6. We tentatively grant Challenge Air Cargo interim exemption authority under U.S.C. § 40109 to continue to provide all-cargo scheduled service between Miami, Florida, on the one hand, and Bolivia, Brazil, Colombia, Dominican Republic, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Peru, and Venezuela, on the other, to the extent consistent with this order;
7. We tentatively allocate on an interim basis 4.5 weekly widebody frequencies and 7 weekly narrowbody frequencies to Challenge Air Cargo to operate U.S.-Brazil and U.S.-Ecuador all-cargo flights, respectively, to the extent consistent with this order;
8. The authority tentatively granted in ordering paragraph 5 shall be subject to the terms, conditions and limitations in United Parcel Service's certificate of public convenience and necessity, including the route integration condition, and the authority tentatively granted in ordering paragraph 6 shall be subject to the attached Standard Exemption Conditions;
9. We direct all persons to show cause why we should not issue an order making final our tentative findings and conclusions;
10. We direct interested persons wishing to comment on our findings and conclusions, or objecting to the issuance of the order described above, to file their comments or objections with the Department, Dockets, Docket OST-99-6345, U.S. Department of Transportation, 400 Seventh Street, SW, Room PL-401, Washington, D.C. 20590, no later than 10 calendar days

¹⁴ Challenge was granted 4.5 weekly widebody frequencies for U.S.-Brazil service (Notice of Action Taken dated August 14, 1998, Docket OST-98-4277). It was also granted 7 weekly narrowbody frequencies for U.S.-Ecuador service (Notice signed by the Director, Office of International Aviation, dated June 7, 1994 and Order 97-8-20).

from the date of service of this order; answers thereto shall be filed no later than 5 calendar days thereafter;¹⁵

11. 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;¹⁶ if no objections are filed, we shall deem all further procedural steps to have been waived, and will proceed to enter a final order;

12. We grant all motions for leave to file otherwise unauthorized documents in the captioned docket;

13. To the extent not tentatively granted, we tentatively deny all requests in the captioned dockets; and

14. We will serve this order on all parties to the captioned dockets, the Ambassadors of Belize, Bolivia, Barbados, Brazil, Colombia, Ecuador, El Salvador, Guadeloupe, Guatemala, Guyana, Haiti, Honduras, Jamaica, France (Martinique), Netherlands Antilles, Grenada, Paraguay, Peru, Surinam, Trinidad and Tobago, and Venezuela in Washington, D.C.; the United States Department of State (Office of Aviation Negotiations); and the Federal Aviation Administration (AFS-200).

By:

A. BRADLEY MIMS
Deputy Assistant Secretary for
Aviation and International Affairs

(SEAL)

*An electronic version of this notice is available on the World Wide Web at
http://dms.dot.gov/reports/reports_aviation.asp*

¹⁵ The original submission is to be unbound and without tabs on 8½" x 11" white paper using dark ink (not green) to facilitate use of the Department's docket imaging system. Submissions may also be sent using the electronic submission capability through the Dockets DMS Internet site, (<http://dms.dot.gov>) by following the instructions at the web site.

¹⁶ As we are providing for the filing of objections to this tentative decision, we will not entertain petitions for reconsideration of this order.

SPECIMEN



**Certificate
of Public Convenience and Necessity**

For Route

This Certifies That

United Parcel Service Co

is authorized, subject to the provisions of Subtitle VII of Title 49 of United States Code, the orders, rules, and regulations issued thereunder, and the attached Terms, Conditions, and Limitations, to engage in foreign air transportation of property and mail.

This Certificate is not transferable without the approval of the Department of Transportation.

By Direction of the Secretary

Issued by Order

On

Effective on

A. Bradley Mims

Deputy Assistant Secretary for

Aviation and International Affairs

*Specimen

Terms, Conditions and Limitations

United Parcel Service Co., for **Route**

is authorized to engage in scheduled foreign air transportation of property and mail:

1. Between a point or points in the United States and:

Barbados	Guyana
Belize	Haiti
Bolivia	Honduras
Chile	Jamaica
Colombia	Martinique
Costa Rica	The Netherlands Antilles
Dominican Republic	Nicaragua
Ecuador	Panama
El Salvador	Paraguay
Grenada	Suriname
Guadeloupe	Trinidad and Tobago
Guatemala	

2. Between the coterminal points Miami, Florida, and Los Angeles, California; via intermediate points in Colombia, Ecuador, and Panama; and the coterminal points Manaus, Brasilia, Rio de Janeiro, Sao Paulo, Recife, Porto Alegre, Belem, Belo Horizonte, and Salvador, Brazil.

3. Between the coterminal points Houston, Texas, and Miami, Florida, and the coterminal points Lima and Iquitos, Peru.

This authority is subject to the following conditions:

(1) The holder shall at all times conduct its operations in accordance with the regulations prescribed by the Department of Transportation for the services authorized by this certificate, and with such other reasonable terms, conditions, and limitations as the Department of Transportation may prescribe in the public interest.

*This certificate is issued to reflect the transfer of various U.S.-Latin America route authorities on routes 353, 626, and 711 from Challenge Air Cargo to United Parcel Service.

Specimen

- (2) The holder is not authorized to carry passengers (other than cargo attendants accompanying the freight shipments).
- (3) The holder shall at all times conduct its operations in accordance with all treaties and agreements between the United States and other countries, and the exercise of the privileges granted by this certificate is subject to compliance with such treaties and agreements and with any order of the Department of Transportation issued under them. To the extent that the holder has authority to serve more than one country or points in more than one country on the same route segment, that authority does not confer upon the holder any additional rights (including fifth-freedom intermediate and/or beyond rights) in limited-entry markets unless the Department has completed any necessary carrier selection procedures to determine which carrier(s) should be authorized to exercise such rights and has notified the foreign country(ies) involved that any such selected carrier(s) has the required authority. In such cases, the fact that the carrier may hold authority to serve the countries (points) at issue on the same segment will not be considered as providing any preference to the holder in a carrier selection proceeding.
- (4) The exercise of the authority granted here is subject to the holder's first obtaining from the appropriate foreign governments such operating rights as may be necessary.
- (5) The holder's authority is effective only to the extent that such operations are also authorized by the Federal Aviation Administration, and comply with all FAA requirements concerning security.
- (6) The holder shall at all times remain a "Citizen of the United States" as required by 49 U.S.C. 40102(a)(15).
- (7) The holder shall maintain in effect liability insurance coverage as required under 14 CFR Part 205. Failure to maintain such insurance coverage will render a certificate ineffective, and this or other failure to comply with the provisions of Subtitle VII of 49 U.S.C. or the Department's regulations shall be sufficient grounds to revoke this certificate.
- (8) Should the holder propose any substantial changes in its ownership, management, or operations (as that term is defined in 14 CFR 204.2(n)), it must first comply with the requirements of 14 CFR 204.5.
- (9) In the event that the holder ceases all operations for which it was found "fit, willing, and able," its authority under this certificate shall be suspended under the terms of 14 CFR 204.7 and the holder may neither recommence nor advertise such operations unless its fitness to do so has been redetermined by the Department. Moreover, if the holder does not resume

*Specimen

operations within one year of its cessation, its authority shall be revoked for dormancy.

(10) The holder may combine services on this certificate with all services authorized by other Department of Transportation certificates or exemptions, provided, that such operations are consistent with the applicable bilateral aviation agreements; and provided further, that (a) nothing in the award of the route integration authority requested should be construed as conferring upon the holder additional rights (including fifth-freedom intermediate and/or beyond rights) to serve markets where U.S. carrier entry is limited unless the holder first notifies the Department of its intent to serve such a market and unless and until the Department has completed any necessary carrier selection procedures to determine which carrier(s) should be authorized to exercise such rights; and (b) should there be a request by any carrier to use the limited-entry route rights that are included in the holder's authority by virtue of the route integration authority granted here, but not being used, the holding of such authority by route integration will not be considered as providing any preference for the holder in a competitive carrier selection proceeding to determine which carrier(s) should be entitled to use the authority at issue.

(11) The holder acknowledges that the authority granted in segment 2 and 3 above is granted to determine if the holder's projected services, efficiencies, methods, rates, fares, charges, and other projected results will, in fact, materialize and remain for a sustained period of time, and to determine whether the holder will provide the innovative and low-priced air transportation it proposed in its application for this authority.

(12) The holder's authority on segment 2 shall expire on December 8, 2002, unless the Department earlier suspends, modifies, or deletes the authority.

(13) The holder's authority on segment 3 shall expire on October 2, 2001, unless the Department earlier suspends, modifies, or deletes the authority.

This certificate shall become effective [date to be filled in]

APPENDIX A

U.S. CARRIER Standard Exemption Conditions

In the conduct of operations authorized by the attached order, the applicant(s) shall:

- (1) Hold at all times effective operating authority from the government of each country served;
- (2) Comply with applicable requirements concerning oversales contained in 14 CFR 250 (for scheduled operations, if authorized);
- (3) Comply with the requirements for reporting data contained in 14 CFR 241;
- (4) Comply with requirements for minimum insurance coverage, and for certifying that coverage to the Department, contained in 14 CFR 205;
- (5) Except as specifically exempted or otherwise provided for in a Department Order, comply with the requirements of 14 CFR 203, concerning waiver of Warsaw Convention liability limits and defenses;
- (6) Comply with the applicable requirements of the Federal Aviation Administration Regulations, including all FAA requirements concerning security; and
- (7) Comply with such other reasonable terms, conditions, and limitations required by the public interest as may be prescribed by the Department of Transportation, with all applicable orders and regulations of other U.S. agencies and courts, and with all applicable laws of the United States.

The authority granted shall be effective only during the period when the holder is in compliance with the conditions imposed above.