

Posted: 8/31/2001

12:05 pm

137820

Order 2001-8-27



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

Issued by the Department of Transportation
on 31st day of August, 2001

Served: August 31, 2001

2001 Hong Kong Fifth-Freedom All-Cargo
Frequencies

Docket OST-95-764 - 191

ORDER TO SHOW CAUSE

Summary

By this order, we tentatively allocate three weekly frequencies to Polar Air Cargo to provide fifth-freedom all-cargo service between Hong Kong and Seoul, South Korea, in conjunction with its proposed U.S.-Hong Kong all-cargo services. In addition, we have tentatively decided to award backup authority to Northwest Airlines.

We will afford interested parties 10 calendar days to file objections and five calendar days to file any answers to such objections.

Background

Under the 1995 U.S.-Hong Kong Memorandum of Understanding, U.S. carriers may operate no more than eight weekly all-cargo frequencies with local fifth-freedom traffic rights for services between Hong Kong and a total of two third-country points chosen by the United States in conjunction with their U.S.-Hong Kong services. These two points may be in the Philippines, Thailand, and/or South Korea, with no more than five weekly frequencies allocated to any one point.¹ By Order 96-8-35, the Department allocated five weekly frequencies to Federal Express Corporation to serve the Hong Kong-Subic Bay market and three weekly frequencies to Air Micronesia to serve the Hong Kong-Manila market.² In connection with the Department's

¹One of the eight frequencies may be converted into two weekly flights to be operated by aircraft with a capacity of fewer than 50 tonnes (55.1 U.S. tons) if operated in conjunction with a U.S.-Hong Kong service where the U.S. gateway point is not in the continental United States.

²Since Air Micronesia proposed Boeing 727 service with a capacity of fewer than 50 tonnes (55.1 U.S. tons) from Guam, its allocation of three frequencies was converted to four under the terms of the MOU.

frequency allocations, the United States selected Subic Bay and Manila, Philippines, as the two third-country points.³

The awards to Federal Express and Air Micronesia were subject to the Department's standard 90-day dormancy condition, whereby unused frequencies would revert automatically to the Department for reallocation in the event a carrier ceased to use the frequencies for a period of 90 days. Subsequently, Air Micronesia ceased operating its three frequencies and they reverted to the Department.⁴ In November 2000, United Parcel Service filed an application for allocation of the three available frequencies. Polar Air Cargo, Northwest Airlines, Evergreen International Airlines, and Federal Express Corporation filed competing applications.

By Notice dated January 19, 2001, in this Docket, we requested applications from all other U.S. carriers interested in using the available fifth-freedom traffic rights. No other applications were filed. On March 12, 2001, the Department instituted a proceeding in this Docket to select which carrier(s) would be selected for the three frequencies at issue. Our instituting order set forth a procedural schedule and a set of evidentiary requirements for the submission of pleadings needed by the Department to make its decision in this case.

Applications and Responsive Pleadings

As indicated above, the applicants before us are Polar Air Cargo, Northwest Airlines, Evergreen International Airlines, United Parcel Service (UPS), and Federal Express Corporation (FedEx).⁵ Polar, Northwest, and Evergreen propose service via Seoul, South Korea. UPS and FedEx propose service via Manila, Philippines. Polar and UPS request all three frequencies and would not accept a lesser allocation.⁶ Northwest and Evergreen request all three frequencies but are prepared to accept an allocation of two. FedEx requests one frequency. (See Appendix A for a summary of the carriers' applications.) Each of the applicants filed direct exhibits, rebuttals, and briefs.⁷

Position of the Parties

Polar, Northwest, and Evergreen argue that the interdependence between third-, fourth-, and fifth-freedom services makes the U.S. third/fourth freedom markets relevant in this proceeding. In this connection, Polar, Northwest, and Evergreen argue that the U.S.-South Korea market is much larger and more valuable to U.S. shippers than the U.S.-Philippines market. They also argue that a U.S. carrier already serves the Hong Kong-Philippines market, whereas foreign carriers dominate the Hong Kong-South Korea market. Thus, these carriers contend that the Department should focus its attention on those applicants that have proposed South Korea (Polar, Northwest, and Evergreen)

³Under the terms of the MOU, third-country points selected by the United States may be changed with not less than 90 days notice to the Hong Kong aeronautical authorities.

⁴See Notice dated January 19, 2001, in this Docket.

⁵Gemini Air Cargo filed an application but subsequently withdrew from the case.

⁶UPS states that it will be able to use the three frequencies to operate four weekly flights under the flight conversion provisions of the U.S.-Hong Kong aviation agreement.

⁷Evergreen and Polar filed corrections to their direct exhibits and Evergreen filed a correction to its rebuttal. By Notice dated March 26, 2001, the Department extended the deadline for filing direct exhibits, rebuttals, and briefs by ten days to accommodate scheduling conflicts related to U.S.-Hong Kong bilateral aviation negotiations that were planned around the time of the initial filing dates in this case.

rather than the Philippines (UPS and FedEx) as the local fifth-freedom traffic point. Northwest and Evergreen now serve the U.S.-South Korea market and proposed additional transpacific flights in conjunction with their proposed fifth-freedom Hong Kong-Seoul flights. Polar, which does not now serve South Korea, proposed to institute a new transpacific service.

Polar states that its proposal best meets the objective of using the available fifth-freedom rights to strengthen the ability of U.S. carriers to mount and sustain underlying third and fourth-freedom services in Asia. In this regard, Polar argues that it, rather than Northwest or Evergreen, would introduce and maintain “new” transpacific all-cargo services with an award in this proceeding. Polar maintains that its new U.S.-South Korea service is wholly dependent on an award of Hong Kong fifth-freedom frequencies here. Polar states that Northwest and Evergreen, in contrast, already offer U.S.-South Korea services.

Polar further argues that, unlike Northwest or FedEx, it cannot depend on a massive hub or liberal operating rights in Japan in order to serve the Asian market. Moreover, unlike other carriers in this proceeding (Northwest, Federal Express, and UPS), Polar contends that it cannot combine traffic flows from China. Thus, Polar maintains that it would offer the greatest service and competitive benefits.

The competing applicants argue that Polar lacks commitment to Asia as evidenced by its history of dropping services in the region and the fact that Polar now operates few Asia flights, casting doubt as to whether it would mount and sustain the proposed services, and whether Polar has the network strength and the management wherewithal to compete with Asian carriers in the intra-Asia market. The competing applicants also criticize Polar for having inadequate domestic feed services. In this connection, the competing applicants argue that Polar’s domestic road service is inadequate and not comparable to a domestic air system. Northwest and Evergreen further state that Polar projects the lowest traffic and load factors of the South Korea applicants, reducing the public benefits of its proposal.

Northwest emphasizes that, in addition to serving the larger Hong Kong-South Korea fifth-freedom market, its proposal would benefit U.S. shippers by adding a new third/fourth freedom service to South Korea. Of those applicants proposing Hong Kong-South Korea services, Northwest argues that it alone can establish and maintain over the long term a “new” single-plane U.S.-South Korea-Hong Kong service with an extensive U.S. feed network via its hub operation in Anchorage, an advantage it contends is not available from either Polar or Evergreen.

The competing applicants argue that Northwest already has access to Hong Kong from Tokyo/Narita on combination services and already has a strong presence in Asia even without an award in this case. They also argue that an award to Northwest, given its strong position in Asia, would not improve inter-carrier competition in the region.

Evergreen argues that it would offer more fifth-freedom capacity and carry more fifth-freedom cargo than any other applicant from three geographically dispersed U.S. gateways (San Francisco, Columbus, Ohio, and New York). In addition, Evergreen states that it could use the available frequencies to further enhance its hub in Hong Kong, where it currently enjoys no limited-entry route rights. Every other applicant in this proceeding, according to Evergreen, has some form of fifth-freedom operating rights in Asia. Thus, Evergreen maintains that it is the only true “have not” carrier that needs to be strengthened in the region.

The competing applicants argue that Evergreen is primarily engaged in wet-lease operations and, thus, that its service proposal here would be used to benefit foreign carriers in Asia; that Evergreen's Hong Kong hub arguments are untenable since its Hong Kong services are minimal; that without a more established network, three frequencies provided by Evergreen would have little competitive impact; and that its traffic forecast, which is based on a flat load factor rather than traffic in the market, is not credible and is inconsistent with the Department's directives in this case.

UPS argues that the principal benefit of its service proposal is that the fifth-freedom frequencies would provide the incremental traffic necessary to enable UPS to establish a fully competitive intra-Asia hub in the Philippines, which UPS intends to develop at Clark Air Force Base. UPS contends that such a hub would connect Hong Kong with the major commercial and financial centers in Asia, connect those important centers with each other and, in addition, improve connections between Hong Kong and Europe. UPS states that no other applicant would have the same competitive impact (*i.e.*, a new intra-Asia network) with head-to-head competition for FedEx and Asian carriers as UPS. UPS maintains that it needs to gain custodial control of its cargo by operating its own flights beyond Hong Kong (UPS currently tenders cargo to third-party carriers for beyond-Hong Kong services). Without custodial control, UPS argues that its services suffer from extended transit times, limited drop-off options available to shippers, increased costs, reduced reliability, and reduced shipper confidence.

UPS urges the Department to decide this case from a broad, global perspective, consistent with the 1995 U.S. international aviation policy framework. This approach, according to UPS, seeks to facilitate highly efficient air carrier networks, including time-sensitive/high-value cargo services, competing globally in open markets.

The competing applicants argue that UPS proposes to add no new transpacific service, and thus no new benefits to U.S. shippers, and that UPS is already established in Asia, so the competitive impact of its proposal would be minimal. They also argue that UPS does not need an award here to develop its Clark hub since UPS could operate an intra-Asia hub by continuing to fly Hong Kong-Manila on a blind-sector basis and by using existing route freedoms from other countries in the region. Finally, the competing applicants argue that UPS' proposal is based on the ability to operate flights under the flight conversion provisions in the U.S.-Hong Kong aviation agreement, but that UPS' proposal does not meet the requirements for such conversion.

Federal Express maintains that U.S. third- and fourth- freedom services are largely irrelevant here because the proposed points in this case--Seoul, Manila, and Hong Kong--already allow U.S. carriers unlimited access to third-, fourth-, and sixth-freedom traffic. Thus, FedEx states that the primary focus in this proceeding should be which combination of carriers would carry the most fifth-freedom traffic, serve the greatest number of fifth-freedom markets, and achieve the highest level of route integration.

FedEx states that it needs one more frequency to provide the "daily" express service demanded by shippers. If selected, FedEx maintains that it would be better able to compete against foreign carriers in the Asian market and that it is in the best position among the applicants to provide that competition. In this regard, FedEx contends that it would provide superior connectivity through its Philippines hub and that it would carry more cargo per frequency than any other applicant.

All of the competing applicants oppose a further award to FedEx, arguing that FedEx already has five of the eight available Hong Kong fifth-freedom frequencies and, thus, that awarding the frequencies to another carrier would best enhance competition in this case.

Tentative Decision

We have tentatively decided to select Polar for allocation of the three weekly fifth-freedom frequencies for services in the Hong Kong-South Korea market. We also have tentatively decided to make a backup award of the frequencies to Northwest.

When we instituted this proceeding, we stated that our primary objective would be to maximize the public benefits that would result from award of the authority in this case. In making that decision we stated that we would consider which applicants would be most likely to offer and maintain the best service for the shipping public. We also stated that we would consider the effects of the applicants' service proposals on the overall competitive environment, including the market structure and the level of competition in the U.S.-Asia market, and on any other market shown to be relevant, including the positive effect on each applicant's operations in Asia.

U.S. carriers have the right to operate a total of eight all-cargo frequencies for Hong Kong fifth-freedom services. Five of these frequencies have been allocated to FedEx, which uses the frequencies in the Hong Kong-Philippines market. The remaining three frequencies are at issue here. Three of the five applicants propose to offer service in the Hong Kong-South Korea market, and the remaining two applicants propose to add service in the Hong Kong-Philippines market.

The record shows that in the year 2000 the Hong Kong-South Korea market generated a substantially greater amount of all-cargo traffic (over 125,000 tons) than the Hong Kong-Philippines market (fewer than 75,000 tons).⁸ Currently, the Hong Kong-Philippines market receives service from three carriers, with the majority of that service provided by FedEx (10 weekly one-way flights vs. seven for Air France and two for China Airlines).⁹ On the other hand, the considerably larger Hong Kong-Seoul market has no U.S. carrier service at all. The 26 weekly one-way flights are divided among four foreign airlines.¹⁰

In these combined circumstances, and given the limited number of frequencies available to us, we tentatively find that the public interest is best served by selecting a proposal that would use the three frequencies to foster service in a fifth-freedom market that does not now have U.S. carrier service, thereby expanding the fifth-freedom markets receiving U.S.-flag service and the range of competitive U.S. carrier services in the intra-Asia market.

As FedEx and UPS propose service in the Hong Kong-Philippines market, which already has U.S.-flag service, we have tentatively decided not to allocate the frequencies to either carrier. FedEx already has five of the eight frequencies, which it uses in the Hong Kong-Philippines market and, thus, any further award to FedEx would not serve our goal to promote competition in the U.S.-Asia and intra-Asia markets. While UPS would be a new competitor in the Hong Kong-Philippines

⁸UPS-301, p. 3; NW-R-101. The exact figures were 126,011 tons for the Hong Kong-South Korea market and 74,657 tons for the Hong Kong-Philippines market.

⁹*OAG Cargo Guide*, April, May, and July 2001. In some months, such as July, FedEx publishes only seven flights.

¹⁰EZ-309. The four are Korean Airlines, Asiana Airlines, Cathay Pacific, and Air Hong Kong.

market, we tentatively conclude, given the relative sizes of the Hong Kong-Philippines and Hong Kong-South Korea markets, and the complete absence of U.S.-flag service in the Hong Kong-South Korea market, that authorizing an applicant that would serve the larger and unserved fifth-freedom market in this case would provide greater overall public benefits.

We have reached this tentative conclusion after careful consideration of the affirmative public interest arguments offered by UPS and FedEx. Regarding UPS' proposal, we particularly noted the potential benefits in its arguments in support of the global service benefits, and the competitive/structural improvements that would derive from its proposed services, if those services could be realized. FedEx's proposal of daily fifth-freedom cargo service also would bring a degree of benefit to the market. While we recognized that certain aspects of both proposals might indeed prove beneficial, we tentatively determined that, in the circumstances before us now and taking into consideration the limited opportunities available, those benefits did not outweigh the service and competitive/structural benefits that would result from introducing competition in a second Hong Kong fifth-freedom market and, for the reasons discussed below, the particular benefits associated with the introduction of Polar's service.

Three of the applicants in this case--Polar, Northwest, and Evergreen--would serve the Hong Kong-South Korea market. After reviewing all three proposals, we tentatively find that Polar's proposal would provide the greatest public benefits. In addition to providing shippers a first U.S.-flag service option in the fifth-freedom Hong Kong-South Korea market, Polar's new transpacific all-cargo service would provide shippers with a new choice of service in the third/fourth freedom U.S.-South Korea market. Also, Polar's proposed use of B747-200 freighter equipment should effectively serve the needs of shippers in these markets.

The selection of Polar would furthermore provide significant structural benefits. Polar is the only applicant in this proceeding proposing to institute a totally new transpacific service. Selecting Polar thus would promote the increase of U.S. carrier competition in the U.S.-South Korea all-cargo market. Currently, foreign carriers provide the majority of service in the U.S.-Seoul all-cargo market, operating approximately 60 percent of the total all-cargo frequencies.¹¹ Service by an additional U.S. carrier would enhance competition among U.S. carriers in the market as well as build on the competitive position of U.S. carriers vis-à-vis foreign carriers.

Finally, Polar's new services in the Asia-Pacific region together with its services in the U.S.-Japan, Hong Kong, Taipei, Kuala Lumpur, and Manila markets¹² would increase competition among U.S. carriers in the region (UPS, FedEx, and Northwest) as well as the U.S.-flag position vis-à-vis foreign carriers in the region.

We tentatively conclude that neither Northwest nor Evergreen would offer as great a combination of service and competitive benefits as Polar. Northwest and Evergreen now serve the U.S.-South Korea market. While both, if selected, would offer the same quantum of increased service as would Polar, neither would be a new participant in the market. Thus, neither Northwest nor Evergreen would offer shippers the advantage of an additional choice of carrier or the price and service advantages available from a new competitive service, all public benefit factors that we tentatively find weigh in Polar's favor.

¹¹*OAG Cargo Guide*, July 2001.

¹²PO-103.

Furthermore, Northwest is already a well-established carrier in the Pacific region with extensive third/fourth and fifth-freedom services. We tentatively view the competitive benefits of expanded services by another U.S. carrier in the region to be substantial and favoring Polar in this case. Evergreen, on the other hand, does not offer the benefit of a totally new transpacific service, a factor that we tentatively conclude affords Polar a decisive advantage in this case.

We have carefully considered the criticisms of Polar's proposal regarding its projected traffic levels and domestic feed service. We have tentatively concluded that these criticisms do not, on balance, argue persuasively against Polar's selection. We believe that Polar's forecast is conservative but not unreasonable, in light of the current economic conditions in Asia. In addition, long-haul all-cargo services are frequently provided with a combination of air and road feeder service. Therefore, in light of the service and competitive benefits that would be offered by Polar's proposal, we tentatively believe that Polar's proposal is the most attractive in this proceeding.

Backup Award

We have tentatively decided to award Northwest Airlines a backup allocation for the available frequencies. As a major established carrier in the Asia-Pacific region, Northwest is in the best position, with services already at Seoul and Hong Kong, to start and maintain a competitive service in the event that Polar does not start or maintain its new services. Northwest would expand its current transpacific service with immediate service benefits to U.S. shippers. In addition, Northwest, like Polar, would provide U.S. carrier competition in a fifth-freedom market now dominated by foreign carriers. Northwest also would be able to institute service quickly, ensuring prompt use of the available rights.

Terms, Conditions and Limitations

All of the carriers in this proceeding already hold the necessary underlying economic authority to operate their proposed services.

Consistent with our standard practice, we propose that the frequencies allocated in this proceeding will be subject to our standard 90-day dormancy condition, wherein any frequencies not operated for a period of 90 days would be deemed dormant, except where the service in the market is seasonal. Where seasonal services are at issue, however, a carrier must notify the Department that its operations are of a seasonal nature; otherwise, the dormancy condition would apply. Under the dormancy condition, if any of the flights allocated are not used for a period of 90 days, the frequency allocation with respect to each frequency would expire automatically and the frequency would revert to the Department for reallocation. The dormancy condition would begin upon the service date of the final order in this case.

ACCORDINGLY,

1. We tentatively select Polar Air Cargo, Inc. for allocation of three weekly frequencies for Hong Kong-Seoul, South Korea, fifth-freedom all-cargo services in conjunction with its U.S.-Hong Kong services, subject to our standard 90-day dormancy condition;

2. We tentatively select Northwest Airlines, Inc. for backup authority to use the three weekly frequencies for Hong Kong-Seoul, South Korea, fifth-freedom all-cargo services in conjunction with its U.S.-Hong Kong services, subject to our standard 90-day dormancy condition;
3. We direct any interested parties having objections to our tentative decisions set forth in this order and in ordering paragraphs 1 and 2 above, to file their objections with the Department, Dockets, Docket OST-95-764, U.S. Department of Transportation, 400 Seventh Street SW, Room PL-401, Washington, DC 20590, no later than 10 calendar days from the date of service of this order; answers thereto shall be filed no later than five calendar days thereafter.¹³
4. 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;¹⁴ if no objections are filed we will deem all further procedural steps to be waived and will proceed to enter a final order awarding the authority proposed in this order; and
5. We will serve this order on the parties to the captioned docket of this order, the Hong Kong Economic and Trade Office in Washington, DC, the U.S. Department of State (Office of Aviation Negotiations), and the Federal Aviation Administration.

By:

SUSAN McDERMOTT
Deputy Assistant Secretary for
Aviation and International Affairs

(SEAL)

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

¹³The original filing should be on 8½" x 11" white paper using dark ink and be unbound without tabs, which will expedite use of our docket imaging system. In the alternative, filers are encouraged to use the electronic filing submission capability available through the Dockets/DMS Internet site (<http://dms.dot.gov>) by following the instructions at the web site.

¹⁴As we are providing for the filing of objections to this tentative decision, we will not entertain petitions for reconsideration of this order.

SUMMARY OF ALL-CARGO APPLICANT FORECASTS							Appendix A
2001 HONG KONG FIFTH FREEDOM ALL-CARGO FREQUENCIES							
Docket OST 95-764			(Thousands of Lbs.)				
			Federal				
			<u>Express</u>	<u>UPS</u>	<u>Polar</u>	<u>Northwest</u>	<u>Evergreen</u>
			(1 freq.)	(4 freq.) *	(3 freq.)	(3 freq.)	(3 freq.)
			HKG-MNL	HKG-MNL	HKG-SEL	HKG-SEL	HKG-SEL
			MD-11	B767-2 freq.	B747-200	B747-200	B747-200
				B757-2 freq.		Freighter	
<u>Westbound</u>							
U.S. Originating Traffic							
				55,822	5,400	20,625	13,623
					10,000	13,847	22,544
Foreign Originating Traffic							
			6,467	18,202			
Third Country-Third Country							
			250	100	8,100	12,343	22,544
Hong Kong Fifth Freedom							
			6,717	74,124	23,500	46,815	58,711
Total							
<u>Eastbound</u>							
U.S. Destination Traffic							
				80,840	11,300	18,756	22,544
					17,700	18,077	13,623
Third Country-U.S.							
Foreign Destination Traffic							
			6,715	25,975			
Hong Kong-Third Country							
Third Country-Third Country							
			800	189	7,700	12,968	13,623
Hong Kong Fifth Freedom							
			7,515	107,004	36,700	49,801	49,790
Total							
			14,232	181,128	60,200	96,616	108,501
Grand Total (000's Lbs)							
			FX-301	UPS-324	PO-301	NW-301	EZ-300
			FX-302	UPS-332		NW-306	(Rev)
* UPS-332 is based on UPS operating five times a week rather than the four times a week shown in UPS's proposed service.							