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Order 2001-10-15



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

Issued by the Department of Transportation  
on the 29th day of October, 2001

Served: October 29, 2001

2001 Hong Kong Fifth-Freedom All-Cargo  
Frequencies

Docket OST-95-764 - 198

**FINAL ORDER**

**Summary**

By this order, we make final our tentative decision in Order 2001-8-27 and 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 Polar's U.S.-Hong Kong all-cargo services. In addition, we make final our tentative decision to award backup authority to Northwest Airlines.

**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. By Order 96-8-35, the Department allocated five weekly frequencies to Federal Express Corporation to serve the Hong Kong-Subic Bay, Philippines market and three weekly frequencies to Air Micronesia to serve the Hong Kong-Manila, Philippines market, subject to our standard dormancy conditions.

Subsequently, Air Micronesia ceased operating its awarded three frequencies and they reverted to the Department.<sup>1</sup> Five U.S. carriers--Polar Air Cargo, Northwest Airlines, United Parcel Service (UPS), Evergreen International Airlines, and Federal Express Corporation filed competing applications for reallocation of the frequencies. On March 12, 2001, the Department instituted a proceeding in this Docket to determine which carrier(s) would be selected for the three frequencies at issue.

<sup>1</sup>See Notice dated January 19, 2001, in this Docket.

By Order 2001-8-27, the Department tentatively selected Polar for allocation of the three frequencies, and the Department tentatively awarded backup authority to Northwest. Objections to the show-cause order were due by September 10, 2001; answers to objections were due September 17, 2001.

### **Responsive Pleadings**

Northwest, UPS, and Evergreen filed objections to the Department's show-cause order. Northwest and Polar filed answers.

Northwest urges the Department to reconsider its tentative decision and to award the three available frequencies to it rather than Polar. In this connection, Northwest argues that it would make better use of the frequencies due its existing strong hub and network operations, which would allow Northwest to carry more traffic, and to serve more U.S. points and U.S. shippers than Polar. In addition, Northwest claims that, unlike Polar, it has demonstrated a strong commitment to the Asia-Pacific market.<sup>2</sup> In this regard, Northwest also maintains that the previous 1996 Hong Kong fifth-freedom case emphasized the importance of a strong carrier presence in Asia and the ability to compete with foreign-flag carriers, factors that Northwest contends favor its proposal. According to Northwest, the Department has abandoned these historical factors in making its tentative decision in this case. Northwest states that Polar has reduced its Asia-Pacific services within the past few months, and reiterates its earlier arguments that Polar's service history casts doubt on Polar's ability and commitment to use the three frequencies.

If the Department nevertheless finalizes its tentative decision, Northwest requests that the Department's final order clarify exactly how the back-up award to Northwest would be triggered. Specifically, Northwest states that the Department should make clear that the frequencies will automatically revert to the Department and be reallocated to Northwest if Polar fails to satisfy the dormancy condition at any time, including a delayed start-up or a suspended service after start-up; and that the dormancy condition cannot be satisfied if Polar operates one or two frequencies but only all three. Northwest objects to an exception for "seasonal" services pursuant to the dormancy condition. In this regard, Northwest maintains that Polar's proposal clearly indicates a year-round (non-seasonal) service, and that abuse and disputes could arise from the imprecise nature of what constitutes "seasonal" services.

UPS argues that the Department's tentative selection of Polar followed an "old school" regulatory approach, focused on only one fifth-freedom market (Hong Kong-Seoul) and one segment of the all-cargo air services market (general air freight). UPS argues that this approach should yield to a broader, global perspective that emphasizes highly efficient air carrier networks competing globally in open markets. UPS argues that its own proposal would provide greater benefits. Specifically, UPS contends that it would serve all segments of the cargo market; its new hub operation would compete directly with the network operations of Federal Express; and that it has a greater commitment to the Asia-Pacific region and more staying power than Polar.

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<sup>2</sup>Northwest also contends that the Department's show-cause order incorrectly states that Polar would be the only carrier to introduce a "totally new transpacific service (Order 2001-8-27 at 6)." Northwest maintains that it also proposed a "totally new transpacific service." Moreover, Northwest states that, despite the fact that the Department had not yet acted in this case, it began new U.S. points-Anchorage-Seoul and return service in July 2001, and that it hopes to add the Hong Kong frequencies at issue here to that new service.

As to the proposed backup award, UPS urges the Department not to select a carrier for backup authority in order to preserve the Department's flexibility should the need arise to replace Polar with another carrier. In this regard, UPS argues that no one can predict future market conditions. If and when Polar ceases its proposed services, UPS maintains that its intra-Asia hub in the Philippines may have developed to such an extent that the Department may wish to reexamine whether the frequencies should be allocated to Northwest, UPS, or another carrier. According to UPS, Polar has already begun to reduce its Hong Kong services this year. If Polar ceases its proposed Hong Kong fifth-freedom services, UPS argues that Northwest would operate under the same economics as Polar since both carriers focus on general air freight services rather than fully integrated cargo operations.

In addition, UPS argues that not selecting a backup carrier is consistent with prior Department precedent and sound public policy. In support of its position, UPS cites numerous prior Department decisions in comparative selection proceedings similar to this case here. In the event the Department does finalize its tentative decision, UPS states that the Department should limit any backup award to no more than one year, consistent with prior Department policy statements regarding the purpose of backup authority.

Evergreen argues that its proposal would do more to level the competitive playing field among U.S. carriers in Asia, facilitate the growth of Evergreen's Hong Kong hub, enhance network efficiency and offer truly competitive services in the fifth-freedom market than the selection of Polar. Evergreen maintains that it, unlike Polar, fashioned its proposal around the fifth-freedom, rather than the third/fourth freedom market. In this connection, Evergreen argues that it would carry more cargo than Polar in the fifth-freedom market due to Evergreen's hub operation at Hong Kong. Evergreen also reiterates its argument that, unlike Polar, it does not currently possess limited-entry fifth-freedom rights to operate beyond Japan. Thus, Evergreen maintains that it is a "have not" carrier and that selection of its proposal would help to remedy this imbalance.

Evergreen also argues that it has a record of consistent market development in Asia compared to Polar, which Evergreen maintains has exited several important Asia markets (including South Korea) in recent years. In addition, Evergreen contends that whether an applicant would be a new competitor in an open-skies third/fourth freedom market (*i.e.*, U.S.-South Korea) should not have been the deciding factor in a limited-entry fifth-freedom case such as this one. Evergreen maintains that Polar's proposal is for "restored" rather than "new" service. However, to the extent that Polar's service could be called "new," Evergreen argues that Polar is not the only carrier proposing new service. Evergreen states that its proposal would also be a "new" U.S.-South Korea service, and that Polar was going to restore U.S.-South Korea service regardless of the outcome of this case.

Evergreen further argues that the Department's tentative decision does not address the issue that the frequencies would fit perfectly into Evergreen's strategic plan to develop its Hong Kong hub, whereas an award to Polar would not facilitate significant new intra-Asia competitive opportunities or network efficiencies. With regard to domestic feed services, Evergreen argues that the Department's tentative decision overlooks evidence that Evergreen would offer a more extensive road feeder service than Polar, and maintains that Polar did not respond to competing applicants' arguments that Polar's domestic feed services are inadequate. In addition, Evergreen states that Polar, unlike Evergreen, would not offer any West Coast flights. Finally, Evergreen states that the

show-cause order provided no explanation as to why the Department tentatively decided to select a backup carrier (Northwest) when the instituting order stated that the Department would not place at issue the selection of a backup carrier. In any event, Evergreen maintains that its proposal ranks ahead of Northwest in terms of promoting new transpacific competition.

Northwest, UPS, and Evergreen all argue that Polar's recent acquisition by Atlas Air raises questions, which need to be addressed by the Department. In particular, UPS and Northwest indicate that the combined Polar/Atlas would use the frequencies to conduct wet-lease operations for non-U.S. carriers, rather than operating the proposal offered by Polar in this case.

In response to the objections, Polar states that Northwest, UPS, and Evergreen reiterate arguments they used before, and that no party has raised any new substantive issues not already considered and rejected by the Department in its tentative selection of Polar for three frequencies.<sup>3</sup> Polar maintains that the Department's tentative decision was based on a fundamental structural benefit unique to Polar's proposal. Specifically, Polar states that it alone would introduce a new choice of carrier service in the U.S.-South Korea market. In this regard, Polar emphasizes that Northwest and Evergreen already operate in the U.S.-South Korea market whereas Polar does not. With regard to Evergreen's argument that Polar would have introduced South Korea service without an award in this case, Polar states that the service referred to by Evergreen would have operated over a South Pacific routing to Seoul in the eastbound direction only. Polar states that it has waited for the outcome of this case before starting this eastbound service, which it now intends to begin on October 7, 2001.

Concerning the acquisition issue, Polar states that the Atlas Group intends to operate Polar and Atlas as separate subsidiaries and, thus, Polar will continue its own operation as a scheduled all-cargo airline. In addition, Polar states that the acquisition will have no impact on the route plans for its new U.S.-South Korea-Hong Kong services in this case, and that Polar/Atlas are fully committed to Polar's request in this docket.<sup>4</sup>

In response to UPS' arguments, Northwest states that the Department's responsibility in this case concerns the public interest rather than private interest of UPS, and, thus, that it is not the responsibility of the Department to strengthen the competitive position of UPS vis-à-vis Federal Express. With respect to UPS' arguments concerning back-up authority, Northwest contends that no amount of flexibility is likely to change the fundamental market conditions that underlie the Department's tentative decision. Moreover, Northwest maintains that the backup award to Northwest assures the promptest possible provision of service if Polar is unable to implement or maintain its service proposal. For these same reasons, Northwest argues that it is not necessary to limit the backup award to a one-year period.

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<sup>3</sup>According to Polar, the objections raised pursuant to the award of back-up authority to Northwest are the only issues that have not already been addressed by the Department. Polar states that it takes no position on those issues and urges the Department to issue a final order confirming its tentative selection of Polar as soon as possible so that it can start-up its U.S.-South Korea-Hong Kong services on October 7, 2001.

<sup>4</sup>As to any other concerns in this matter, Polar states that they are better addressed in the context of the joint application of Atlas and Polar for route transfer and related authority (Docket OST-2001-10239).

## **Decision**

We have decided to make final our tentative decision in Order 2001-8-27 and select Polar Air Cargo for allocation of three weekly frequencies to provide fifth-freedom all-cargo service between Hong Kong and Seoul, South Korea, in conjunction with its U.S.-Hong Kong all-cargo services. The authority will be subject to our standard 90-day dormancy condition, whereby any frequencies not operated for a period of 90 days will be deemed dormant and automatically revert to the Department for reallocation. In addition, we have decided to make final our tentative decision to award backup authority to Northwest Airlines, as discussed below.

In our show-cause order, we stated that the distinguishing factors favoring Polar in this case were (a) its proposal to offer service in the Hong Kong-South Korea market, which is not currently served by any U.S. carrier; and (b) the fact that Polar alone would offer a new choice of carrier service in the transpacific U.S.-South Korea market, which is now served primarily by foreign carriers. We tentatively found that Polar's new competition and service in the third/fourth/fifth-freedom and regional markets at issue would best enhance market structure and provide the most significant public benefits in this proceeding.

We have carefully reviewed the objections and comments to our tentative decision. We find that no party has presented any arguments or evidence that warrants changing our tentative findings and conclusions in this case.

Indeed, no one has disputed the tentative findings supporting our selection of Polar, namely, that the South Korea-Hong Kong market is larger than the Hong Kong-Philippines market; that the South Korea-Hong Kong market is 100 percent dominated by foreign carriers; that foreign carriers do not dominate the Philippines-Hong Kong market; that foreign carriers currently provide the majority of service in the U.S.-South Korea market; or that Northwest, UPS, Federal Express, and Evergreen currently provide service in their proposed transpacific market whereas Polar does not.

Rather, each of the objecting carriers has reiterated its earlier arguments that its own proposal offers the greatest public benefits and should be selected. Northwest emphasizes its strong position in the Asia market now and, thus, its ability to compete with foreign carriers, as well as the service benefits of its Anchorage cargo hub. UPS emphasizes the global benefits of its service and its ability to compete directly with Federal Express. We fully considered these arguments in reaching our tentative decision, and indeed, recognized that the proposed services of these carriers might prove beneficial. Similarly, Evergreen emphasizes its Hong Kong hub, its road feeder service, its proposed west coast flights, and its position as the only applicant without some limited-entry Asia rights and argues that we did not fully consider or address these advantages in making our tentative decision. We recognize that implementation of Evergreen's proposal might offer possible benefits, such as improved service quality to U.S. shippers.

Polar, only, however, would offer another choice of transpacific carrier in the U.S.-Korea market, a benefit not provided by any other applicant's proposal.<sup>5</sup> While Northwest and Evergreen would expand their existing services in the U.S.-Korea market, only Polar would provide a new choice of

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<sup>5</sup>UPS proposed services in the Hong Kong-Philippines market and did not propose to introduce a new transpacific service.

competitive services to shippers, a benefit we find to be significant in this case. In these circumstances, we find that the new competition and choice of service to consumers from an award to Polar outweigh the service benefits noted by Northwest, UPS, and Evergreen in support of their proposals in this case.

Evergreen has argued that Polar would offer “restored” rather than “new” service. In either case, the fact remains that Evergreen now serves South Korea and Polar does not. Evergreen has also argued that Polar would have introduced South Korea service without an award here. However, we note that Evergreen failed to distinguish between Polar’s plans to start eastbound only (single-direction) service between South Korea and the U.S. (over a South Pacific routing) and Polar’s proposal at issue here, which would involve a North Pacific U.S.-South Korea-Hong Kong service in both directions which offers greater benefits to U.S. shippers.

We are also unpersuaded by arguments that Polar’s proposal would provide minimal structural benefits and; thus, do not warrant its selection in this case. Although each of the objecting parties would also provide new competition in its proposed fifth-freedom market, only Polar offers the benefit of new carrier competition in transpacific as well as the relevant fifth-freedom market, and, thus, we believe best improves the overall market structure in the U.S.-Korea as well as the broader regional market. Northwest has emphasized its ability to compete with foreign carriers because of its strong position in the region and cited the relevance attached to that factor in our previous decision in this docket, the 1996 *Hong Kong Fifth-Freedom All-Cargo Proceeding*. However, given the different applicants and different circumstances presented here, we do not see those earlier findings as dispositive in the case at hand.

We are similarly unpersuaded by Evergreen’s argument that it should be allocated the frequencies because Evergreen is the only applicant that does not now have some limited-entry route rights in Asia and UPS’ argument that its ability to compete with FedEx is most significant. While respectively these are factors in each carrier’s favor, they must be considered in conjunction with the other service and competitive considerations relevant to a decision in this case. In these circumstances, while recognizing the advantages offered by each proposal, we believe that the combined service and competitive benefits from Polar’s proposal, outweigh the benefits of any other applicant’s proposal in this case. None of the parties has presented any evidence that persuades us otherwise.

Northwest, Evergreen, and UPS have argued that Polar lacks commitment to the Asia-Pacific region, as evidenced by Polar’s recent service reductions, and its past history of dropping routes in the region. However, in a pleading filed on September 17, Polar has expressly affirmed its intentions to commence its proposed U.S.-South Korea-Hong Kong services and to do so on October 7, 2001.<sup>6</sup> In these circumstances, we find no basis to question Polar’s commitment to implementing its proposal or to alter our tentative selection.

Finally, the objecting parties have argued that the recent acquisition of Polar by Atlas could mean that the combined Polar/Atlas will use the frequencies for wet-lease rather than scheduled services. Polar has stated on the record that Atlas “intends to continue to operate Polar and its scheduled

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<sup>6</sup>See Polar answer at 9.

network services as a separate company under common ownership with Atlas Air.”<sup>7</sup> The parties have presented no basis for us to conclude that Polar will use the services awarded here in a manner inconsistent with its proposal in this case. Against this background, we are not swayed by arguments that we should modify our tentative decision based on Atlas Air’s intention to acquire Polar.

### **Backup Award**

We have decided to make final our tentative decision to grant Northwest a backup allocation of the available frequencies. Consistent with our standard practice, the backup authority will remain in effect for a period of one year.

As noted by some of the parties, we stated in our instituting order that we did not intend to select a backup carrier in this case. Such a decision, however, is necessarily based on the circumstances of each individual case and subject to change based on the record of the proceeding. Based on our review of the record in this particular case, we have concluded that a backup award is in the public interest. In the event that Polar does not commence or maintain its proposed service during the first year, the selection of a backup carrier would ensure prompt use of the available rights. Given these circumstances, we are unpersuaded by UPS’ arguments that we should not select a backup carrier here.

We are also unpersuaded that we should extend the duration of the backup award for longer than one year as Northwest suggests. It has been our standard practice to limit backup awards to a period of one year.<sup>8</sup> That is the standard period in which we have determined the record remains relevant for another carrier to assume a route without further evidentiary procedures. Northwest has presented no persuasive reason to deviate from that policy.

Evergreen argues that it should rank ahead of Northwest for a backup award because its proposal would offer more overall public benefits. As indicated above, we do not dispute that Evergreen’s proposal would benefit the public. However, our focus for a backup award is on ensuring that another carrier could step in quickly and make effective use of the available rights should Polar not commence service or ceases service in the first year. Northwest is a more established carrier in the Asia-Pacific region with strong existing network operations, which could be leveraged to support its proposed services. Thus, Northwest is in the best position to institute backup service quickly and make use of the frequencies in a timely manner. We therefore make final our selection of Northwest for a backup award in this case.

### **Terms, Conditions and Limitations**

Polar and Northwest already hold the necessary underlying economic authority to operate their proposed services.<sup>9</sup> Thus, each carrier requires only an allocation of the necessary frequencies to operate.

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<sup>7</sup>See Polar answer at 8.

<sup>8</sup>See, e.g., Order 97-4-13 in Docket OST-97-2016: *1997 U.S.-Brazil Combination Service Proceeding*.

<sup>9</sup>See Order 99-12-7 for Polar (Route 651) and Order 92-3-38 for Northwest (Route 129).

Consistent with our standard practice, the frequencies allocated in this proceeding will be subject to our standard 90-day 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 will expire automatically and revert to the Department for reallocation. The dormancy condition with respect to Polar's primary award will begin on the service date of this order.<sup>10</sup>

Northwest argues that the dormancy condition cannot be satisfied if Polar operates only one or two frequencies but only all three. Thus, Northwest maintains that if Polar does not use all three frequencies within 90 days, then it should forfeit all three frequencies and Northwest's backup award should be activated. We disagree. Consistent with prior Department practice, each individual frequency is subject to the dormancy condition. For example, if Polar operates two frequencies and not three, then the third frequency would revert to the Department. The other two frequencies would not revert to the Department as long as Polar continues to operate them without a 90-day interruption of service.

As we have done in other cases, we are prepared to activate Northwest's backup in circumstances where fewer than the three frequencies Northwest sought become available, should Northwest remain interested in such allocation during the term of the backup authority and seek activation of its backup award.<sup>11</sup> In the event that any of the frequencies revert to the Department after Northwest's one-year backup award has expired, then all interested U.S. carriers, including Northwest, would have the opportunity to apply for reallocation of the frequencies.

**ACCORDINGLY,**

1. We make final our tentative findings and conclusions set forth in Order 2001-8-27;
2. We allocate Polar Air Cargo, Inc. three weekly frequencies for Hong Kong-Seoul, South Korea, fifth-freedom all-cargo services in conjunction with its U.S.-Hong Kong services;
3. The authority granted in ordering paragraph 2 is effectively immediately, and will remain in effect indefinitely, *provided that* the holder continues to hold the necessary underlying authority to serve the markets authorized, and *provided further* that if any of the flights allocated are not used for a period of 90 days, the frequency allocation with respect to each frequency will expire automatically and the frequency will revert to the Department for reallocation. The 90-day dormancy period will begin upon the service date of this order;
4. We allocate to Northwest Airlines, Inc. three weekly frequencies for Hong Kong-Seoul, South Korea, fifth-freedom all-cargo services in conjunction with its U.S.-Hong Kong services, should its backup award be activated as set forth in this order;
5. Subject to the terms of the backup award, the allocation granted in ordering paragraph 4 is effective immediately, and will remain in effect for a period of one year from the service date of this order, *provided that* the holder continues to hold the necessary underlying authority to serve the markets authorized, and *provided further* that if the backup award is

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<sup>10</sup>The seasonal service exception is not applicable in this case since Polar proposed a year-round service.

<sup>11</sup>See, e.g., Order 97-4-13 at 10, in Docket OST-97-2016: *U.S.-Brazil Combination Service Proceeding*.

activated, the frequencies allocated will be subject to a 90-day dormancy condition wherein if any of the flights allocated are not used for a period of 90 days, the frequency allocation with respect to each frequency will expire automatically and the frequency will revert to the Department for reallocation. The 90-day dormancy period would begin upon the service date of an order or notice activating Northwest's backup award and reallocating the flights previously allocated in ordering paragraph 2 of this order; and

6. 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)

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