Statement of

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before the

Committee on Transportation and Infrastructure

United States House of Representatives

concerning

Effects of proposed arrangement between DHL and UPS on competition, customer service, and employment

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Mr. Chairman and Members of the Committee:

My name is Gary Hammes, Senior Vice President and Chief Operating Officer of ASTAR Air Cargo, Inc. I am pleased to present this statement to the Committee on behalf of the 1000 ASTAR employees who are frightened and concerned that their livelihoods, homes and communities will be destroyed should the announced DHL-UPS joint venture become a reality.

It is crucial that this Committee carefully review the anti-competitive implications of the proposed transaction. Although the welfare of ASTAR and its employees is foremost in the minds of ASTAR's senior management team, the negative ramifications go far beyond our company to include the entire industry and its many millions of parcel customers. If DHL is permitted to outsource its primary and most important business and operational functions to UPS, its fierce rival in the overnight express package business, it will result in the functional elimination of DHL as an independent competitor in the market, creating a UPS-FedEx two company market, giving those companies the incentive and power to raise prices above competitive levels. This is something that every American should be very concerned about in this age of rising transportation costs and the emergence of overnight express as a cornerstone of the "just in time" business model for the United States.

I. ASTAR Air Cargo.

ASTAR Air Cargo previously was known as DHL Airways. It commenced operations in 1979 as a wholly owned subsidiary of DHL Express, an air freight forwarder founded in 1969 by three young American entrepreneurs – Adrian Dalsey, Larry Hillbloom and Robert Lynn. The first

initials of their last names now are emblazoned on thousands of DHL trucks and planes around the world.

DHL created DHL Airways to transport overnight express packages and freight within the United States and between the United States and Europe. In 1998, Deutsche Post made an initial investment in DHL, purchasing a minority stake in the company, and in 2002, Deutsche Post acquired the remaining DHL shares. U.S. aviation laws prohibit a foreign entity such as Deutsche Post from owning or controlling a U.S. air carrier, thus requiring DHL to spin off its controlling interest in DHL Airways to a U.S. investor, who subsequently arranged for the sale of DHL Airways' to its present majority ownership group led by John Dasburg, the former President and CEO of Northwest Airlines. Mr. Dasburg became Chairman, President and CEO and, upon completing the 2003 acquisition, renamed the company ASTAR Air Cargo.

ASTAR has a contract to provide DHL with aircraft, crew, maintenance and insurance ("ACMI") airline services. This contract, most recently modified and reaffirmed in May 2007, extends through 2019. The contract is the source of 90% of ASTAR's revenues.

Today, ASTAR operates a fleet of 44 aircraft, including Boeing 727s, Douglas DC-8s and Airbus A300s. As of May 28 of this year, the date DHL announced its intention to establish a joint venture with UPS, ASTAR employed 1007 employees. Our airline has provided air cargo transport for DHL's packages in the United States for 29 years and has structured its organization to provide highly reliable and safe services for DHL. ASTAR's work force averages 46 years old with 11 years' seniority. Most ASTAR employees were hired at a time when DHL and the airline were part of an integrated business entity. Because of their long association with DHL, ASTAR's employees understand what DHL requires in the way of all

cargo services, and they have dedicated their lives to providing DHL with superior service. Last year, ASTAR completed on-time 98.7% of its flights for DHL, a performance that the large passenger airlines can only dream of.

ASTAR has excellent employee relations, as exemplified by the fact that ASTAR and ALPA were able to agree this past February to a new four year collective bargaining agreement, pursuant to which ASTAR was able to maintain lower crew costs than UPS. ASTAR's pilots made this agreement to help ASTAR and DHL maintain an advantageous cost structure in a highly competitive environment. At the time the contract was signed, neither ASTAR nor ALPA was aware that DHL had been negotiating with UPS to move its business from ASTAR to UPS.

II. Adverse Effects of UPS-DHL Transaction.

A. Adverse Effects on Competition.

I come before this Committee, not as an antitrust scholar or even a lawyer. My background exclusively is in airline operations. Prior to becoming Chief Operating Officer of ASTAR Air Cargo in 2003, I served as ASTAR's Senior Director of aircraft maintenance and engineering. In my 16 years in the industry prior to joining ASTAR in 2002, I held management positions with Northwest Airlines, where I was the Director of Component Maintenance, United Air Lines, where I was 737 Fleet Operations Manager, and Evergreen International Aviation, where I was Director of Maintenance/Business Services. I am here today to offer my opinion, based on my long experience of how airlines operate, that: (1) DHL will lose its operational and commercial independence if it hires UPS to transport and sort its packages; and (2) as a direct result of DHL losing its operational and commercial independence, the overnight express business will become a FedEx-UPS a two-company market.

Before discussing the specific operational factors that form the basis for my opinion, I would like to take a few minutes to provide a broad overview of what it takes to move a package from A to B on DHL while providing the high quality of services demanded by its customers. Understanding the operational specifics of package movement is critical to a realistic assessment of whether DHL will retain the ability to compete in the United States if its proposed joint venture agreement with UPS is consummated.

A shipment begins with the customer creating a unique DHL bar coded label, and arranging for pick up with a DHL van or dropping the package at a DHL drop location. The pick-up driver scans the bar code, creating the first of several real-time records that customers can access to track their package. The driver takes the package to its first sort facility, where it is scanned and put in a container for loading on an ASTAR (or ABX Air) aircraft. ASTAR flies the package to Wilmington, Ohio where DHL employees unload the package, scan it, and enter it into the DHL owned and managed sort facility. An information system uniquely designed for the DHL worldwide network reads the bar codes and directs the sorted packages to waiting ASTAR and ABX Air aircraft destined for the destination cities. ASTAR and ABX Air pilots fly the packages to the destination city, where DHL employees off load the aircraft, scan the bar codes, and place the shipments on DHL vans for delivery to their final address. When delivered, the driver once again scans the bar code creating the final record of a real time transit and delivery process.

As is clear from this brief description, the entire transportation process, from pick-up to delivery is a tightly integrated system that relies on proprietary systems that are unique to DHL. The real-time tracking of packages and providing the tracking data to customers is a critical business function and point of differentiation between companies. DHL cannot hire UPS to do its air transport and hub sorting without inserting a major competitor in the middle of its tracking

system. By turning over this key differentiating activity to a competitor, DHL will have eliminated itself as an independent company and an effective competitor.

1. DHL's scheduling will be compromised.

Currently, DHL and ASTAR collaborate daily on flight schedules, flight plans, flight loads and anticipated volumes of packages to ensure that the right aircraft are assigned to the proper routes. Such collaboration is critical for DHL because DHL depends on knowing precisely how much capacity it has available to serve its existing customers and to seek new customers. Such collaboration will be difficult if not impossible for DHL if it contracts with UPS to carry its packages.

Under the current arrangement between DHL and ASTAR, DHL is free to seek new business from large shippers, knowing that if it needs additional capacity to service the new account, ASTAR will be able to supply the additional lift. DHL seeks such business on a variety of bases, including better price, earlier delivery, later pick up and guaranteed capacity. DHL, in particular, has been very aggressive at using these competitive tools to attract large new accounts.

If linked to UPS, however, DHL will no longer be able to compete effectively for major customers. DHL will not be able to offer later pick-ups or earlier deliveries than UPS unless it can convince UPS to adjust its flight schedules to accommodate DHL's business requirements. And, UPS is not likely to be willing or able to do so. Nor is UPS likely to be willing or able to add capacity to accommodate a new DHL customer – particularly if DHL's intent is to take the business from UPS. Finally, FedEx, UPS and DHL all recognize the importance of understanding their competitors' sales strategies. It will not only become simpler for UPS to discern DHL's sales strategies, such sales strategies will become transparent to UPS because

DHL will not be able to offer customized service or capacity to a new customer without pre-arranging flight operations with UPS thus making its sales strategy totally clear to UPS. When DHL approaches UPS to add capacity to a particular city, it will tip-off UPS to its new business opportunity, giving UPS the opportunity to solicit DHL's prospective customer while DHL remains mired in negotiations with UPS to increase capacity.

UPS's strangle hold on the capacity DHL will have available to sell directly will impact its ability to compete. One of the most frequently used bases for price discounting is offering quantity discounts, especially for large volume shippers. Using UPS, however, DHL will not be able confidently to offer volume discounts, because it will be unable to assure prospective customers that it will have sufficient capacity to handle substantial increases in volume.

Scheduling flexibility on a routine daily basis also is critical to providing quality service. Today, ASTAR maintains an agreed number of spare aircraft to insure that ASTAR is in a position, at a moment's notice, to add capacity to a particular route to meet unusually heavy demand by DHL customers. The spares also serve a back-up function in case of a cancellation for mechanical or other reasons. The result is that ASTAR rarely leaves behind a package it cannot accommodate for weight or volume reasons. DHL's customers are assured that the packages that DHL asks us to fly will get where they belong on time because ASTAR and DHL work as a unified team with the uncompromised mission of getting DHL's customers their packages on time, every time. DHL and ASTAR have created a seamless cooperative working environment that insures maximum flexibility and reliability. We can do this because we are business partners, not business rivals. The opposite would be true if DHL were to move its air transportation and sort functions from ASTAR and Wilmington to UPS and Louisville.

Finally, ASTAR coordinates closely with DHL regarding a host of other scheduling matters. For example, like all airlines, ASTAR performs heavy maintenance "C" and "D" checks on its aircraft in accordance with FAA maintenance guidelines and standards. ASTAR discusses and coordinates these out of service maintenance issues with DHL to ensure that ASTAR and DHL can make alternative arrangements for providing capacity during heavy maintenance down time. It is not likely that UPS would be willing or able to similarly coordinate with DHL.

UPS will not be able or willing to provide DHL with the flexibility and reliability provided by ASTAR. DHL is ASTAR's most important customer. We actively collaborate with DHL to ensure that we meet its needs. That is our corporate mission. UPS will have no such corporate mission. In fact, DHL's success directly works against UPS' self-interest. UPS has a powerful commercial incentive to undermine DHL's commercial success, not to advance it. UPS' first and controlling responsibility is to get its own packages to their destinations on time, and to out-perform its rivals, one of whom is DHL. UPS can hardly be expected to make adjustments to its schedule to meet DHL's needs if such adjustment would compromise UPS' ability to meet its own needs.

Thus, if DHL contracts with UPS to transport its packages, UPS will have an inherent and unavoidable conflict of interest between meeting DHL's legitimate business requirements and meeting its own business requirements, which include out-performing DHL, out-earning DHL and beating DHL competitively any way it can. Given the operational complexity of the express overnight package business, there will be innumerable ways for UPS employees to disadvantage DHL customers, virtually all of which would be beyond DHL contractual oversight.

2. DHL's tracking and sorting will be compromised.

The proposed joint venture between DHL and UPS will dramatically degrade the quality of its service and make it difficult for DHL to be an effective competitor in the express overnight package business. That is because switching its sort function from its own facilities and organization to that of UPS will undermine DHL's ability efficiently and accurately to sort its customers' packages.

The central nervous system of the overnight express package business is the sort process that occurs at the hub. Every night at the Wilmington Air Park hub, ASTAR aircraft arrive within 90 minutes of each other, and take off 2 to 3 hours later. In that five hour period, a million packages are removed from their in-bound flights, funneled through a computerized sort process and then placed on outbound aircraft for final flight and delivery. Managing the "sort" is a delicate, complex and competitively sensitive process that must be done perfectly every day to insure that when customers' packages are removed from incoming aircraft, they are transferred to the proper outbound aircraft.

DHL cannot continue to compete against FedEx and UPS if its sort capability degrades, since that would compromise DHL's ability to provide its core service: prompt and reliable overnight package delivery.

To ensure that DHL maintains a high quality sort, DHL has established at the Wilmington Air Park its Network Control Group that manages, supervises and controls the operation of the DHL sort. The sort is totally dependent on DHL's proprietary bar code system which allows DHL to identify which packages are destined for which cities and efficiently facilitates the transfer and loading of each and every package onto the correct aircraft.

The quality and efficiency of DHL's sort will be compromised if it surrenders its direct management and control of this function and turns it over to its competitor, UPS. Moreover, DHL and UPS have their own unique bar code software programs. DHL's bar code system operates on DHL's worldwide network, not just in North America. Shippers in North America use DHL's bar code system to ship packages regardless of whether they are shipping to Asia, South America or Europe. Since the DHL-UPS joint venture does not include using UPS aircraft in international markets, it seems clear that DHL must retain its own bar code system to retain seamless transfer compatibility between North America and the rest of the world.

The UPS and DHL bar code systems do not communicate with each other. This lack of compatibility presents a staggering logistical and operational hurdle to the integration of DHL and UPS operations. To put it simply, DHL will not be able to enter DHL bar-coded packages into the UPS sort system. It would take years, enormous expense and great risk for UPS to attempt to reconfigure its current sort system to accommodate DHL's packages. We have no idea how DHL intends to address this hurdle, but I am confident that any "work around" that DHL might elect to employ will leave it with an inferior sorting capability, one that would be far less efficient than the one it has today in Wilmington, and one that inevitably will degrade significantly DHL's product.

The sort function presents other challenges for DHL operating at UPS' sort facility. Every night, there are hundreds of operational decisions that must be made by DHL employees to insure that it provides the highest level of service to the largest number of customers.

For example, one of the toughest decisions faced every night is when to commence the sort. To be sure, the sort is scheduled to start at a pre-arranged time, but it is frequently the case that an

arriving aircraft is behind schedule due to unavoidable weather or ATC events. In such events, DHL must carefully consider whether to delay the sort until the delayed aircraft arrives or whether to commence the sort without the delayed aircraft's packages. Only DHL's operations' managers have in their possession the myriad of facts necessary to make decisions that maximize customer satisfaction. How many packages are on the delayed aircraft? How late will it be? How long of a delay will be required? To what extent will a delay degrade deliveries and in which markets? How many packages will be delayed on the outbound legs? DHL will be placing these critical decisions into UPS's hands, but UPS will conduct the sort to accommodate its own packages, not DHL's. UPS will not be able or willing to make real time adjustments to its enormous – and enormously complicated – sorting operation merely to accommodate DHL's packages or the special needs of DHL's key high volume customers.

Sometimes, after completion of the sort and load functions, packages must be left behind due to insufficient capacity on the out bound aircraft. When such events occur, as they inevitably will, one has to assume that UPS will make sure that its own packages make it onto the aircraft first, and if there are any packages to be left behind, they will be DHL's. To make matters worse for DHL, UPS now will be in possession of names and addresses of disappointed DHL customers, providing UPS with a golden opportunity to poach DHL's customers. It is not hard to imagine UPS sort personnel turning over this highly sensitive information to UPS salespeople for solicitation.

In fact, we already have seen concrete evidence that UPS has embarked on an aggressive campaign to steal DHL's customers based on the announced DHL-UPS joint venture. A UPS salesperson recently made a sales call on ASTAR (in its capacity as a customer of DHL's overnight express services) trying to convince ASTAR to switch its business from DHL to UPS.

In this call, the UPS salesperson argued that once integrated into UPS' operation, DHL's service would be substandard. We have seen other evidence that UPS is aggressively making such calls on other DHL customers. It is our belief that these sales calls are working and that DHL's package volumes have fallen significantly since the May 28 joint venture announcement.

This last point highlights one of the most puzzling aspects of DHL's decision to substitute a competitor for a dedicated vendor to transport, track and sort its packages. ASTAR believes that the fundamental cause for DHL's poor business performance in North America has not been costs that are higher than UPS' (and FedEx's) costs, both of which actually are higher than those of ASTAR. The largest controllable expense of any airline is labor (we all pay about the same for jet fuel and aircraft) and as I mentioned before, ASTAR's flight crew labor rates are superior to those of UPS. We are hard pressed to reconcile DHL's statements that the DHL-UPS joint venture is designed to lower its costs, when UPS' labor costs are higher than ASTAR's. Presumably, UPS is negotiating a contract price with DHL that will allow it to recover its costs and earn a profit, which means that DHL's costs are likely to increase if it moves from ASTAR to UPS.

Moreover, because DHL purchased 49% of the economic interest in ASTAR last year, it shares in 49% of ASTAR's profits, which is a further cost benefit from continuing to use ASTAR that DHL will lose if it moves from ASTAR to UPS. We are sure that UPS has no intention of sharing with DHL half the profit it expects to earn from DHL's business.

Thus, we believe that DHL's fundamental problem is not high costs, but rather poor unit revenue arising from the fact that when it purchased Airborne in 2003, Airborne was a distant third in the marketplace, unable to provide the same high levels of service that FedEx and UPS provided.

Thus Airborne was forced to heavily discount its rates and concentrate on a relatively small number of large bulk shippers.

For DHL to improve on Airborne's market position, it needed to invest in product quality rather than concentrate on cost cutting, which actually tends to degrade quality, rather than enhance it.

DHL has had only modest success in improving its quality and now is embarking on a misguided venture that is sure to destroy the quality of its product completely.

B. Adverse Effects on the Military and the CRAF Program.

ASTAR is a proud and specialized participant in the Civil Reserve Air Fleet (CRAF) program pursuant to which US certificated air carriers commit to supply the Department of Defense with aircraft capacity in times of national emergency. Of the 44 total aircraft in ASTAR's fleet, ASTAR has committed 17 aircraft to the CRAF program, which at 38% of its entire fleet makes ASTAR one of the largest (by percentage) participants in the program.

Of greatest importance is the percentage of certain mission critical aircraft that ASTAR contributes to the CRAF program. The DOD requires a wide variety of aircraft, both in terms of payload and range, to fulfill its worldwide responsibilities. The DC-8-71/73F series aircraft, eight of which ASTAR provides to the CRAF program, fills a unique role in DOD's airlift requirements. Indeed, ASTAR provides almost 50% of CRAF Stage III DC-8-71/73F aircraft. DOD's access to these mission critical aircraft types could be severely degraded as a result of the proposed DHL-UPS joint venture.

CRAF is not the only way in which ASTAR and its employees contribute, and have contributed to our national defense. One-third of ASTAR's employees are veterans. ASTAR and its pilots

and other staff have volunteered to fly into hostile zones and other hazardous locations in the service of our nation and American troops. They have received more than 100 DOD awards in recognition of their dedicated work.

C. Adverse effects on ASTAR and its employees.

As of May 28 of this year, the date DHL announced its intention to create a joint venture with UPS, ASTAR had a total of 1007 employees, including 506 pilots represented by the Air Line Pilots Association, 208 mechanics, and 12 dispatchers (represented by the International Brotherhood of Teamsters. Many uprooted their lives and families to move to the Wilmington area three years ago at the request of DHL which decided to shutter its former operational hub at Cincinnati's airport and combine ASTAR's hub with ABX's hub at Wilmington. The employees made this move, and the sacrifices that come with relocation, in reliance on the promise of stable jobs that were a by-product of the long term ACMI contract between ASTAR and DHL.

If DHL completes its joint venture with UPS, all ASTAR employees will lose their jobs. Their work skills are not readily transferable outside of the airline industry, especially if they are pilots and mechanics. Few airlines are hiring today. Indeed, most airlines are completing a round of lay-offs resulting from high jet fuel prices. The employees who moved to, and live in the Wilmington area will find themselves trapped by collapsing house prices, resulting from so many people being thrown out of work in the same community at the same time.

In short, the proposed DHL-UPS joint venture will inflict enormous damage on ASTAR's employees, decimate the community, and negatively impact the high quality and low-cost services provided to millions of customers by an industry that currently benefits from vigorous three-firm competition.

Thank you for giving me the opportunity to present the views of ASTAR Air Cargo. I would be pleased to answer any questions.