WRITTEN TESTIMONY OF JOHN MULLEN
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HOUSE COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

"EFFECTS OF THE PROPOSED ARRANGEMENT BETWEEN DHL AND UPS ON COMPETITION, CUSTOMER SERVICE, AND EMPLOYMENT"

SEPTEMBER 16, 2008

INTRODUCTION

Mr. Chairman, Ranking Member and distinguished members of the Committee, thank you for providing me the opportunity to discuss the topic of competition in the package delivery industry and the potential services agreement between DHL and UPS.

On May 28th, DHL announced a major restructuring of our express business in the United States, including the widely publicized vendor services agreement with UPS that the companies are considering. This restructuring, if completed, would address significant on-going losses in the U.S market, and, hopefully, allow DHL to remain a viable competitor in the U.S. air express business and to continue providing future employment opportunities in the United States.

I welcome this opportunity to explain the reasons why this restructuring is necessary, but first want to stress that we have not taken this action lightly. Since 2003, DHL has invested over $5 billion building our presence in the U.S. market. This investment consists of $3 billion in operating losses, $0.9 billion in capital expenditures (including substantial improvements and expansion of our main U.S. air cargo and hub sorting facilities at Wilmington, Ohio), and $1.1 billion in strategic investments, including the acquisition of Airborne Express in 2003. With

projected operating losses of $1.3 billion in 2008, DHL's total expenditure for U.S. operations from 2003 through 2008 will exceed $6 billion.

Despite our heavy investment and determined efforts to build credibility in the U.S. market, our air express volumes have declined over this period, due in part to the generally deteriorating market conditions in the U.S. overnight air sector. Meanwhile, our operating costs, especially jet fuel expenses, have increased dramatically. Losses of this magnitude are unsustainable, and with our volumes continuing to decline, we have no choice but to undertake the significant steps I am describing today to address the on-going losses.

If the vendor services agreement with UPS is consummated, DHL will lose some of the benefit of the large investments we have made in the U.S. market, particularly our investments at the Wilmington facility. DHL would not be pursuing this course unless it was necessary.

We are sensitive to the impact this decision will have on our employees, on the employees of our current air services vendors ABX Air. Inc. ("ABX") and ASTAR Air Cargo, Inc. ("ASTAR") and on the southwest Ohio communities in the Wilmington area. We are committed to working with state and community officials there to assist employees and their families who will be affected by this necessary restructuring. DHL already has committed to provide in excess of $260 million in severance, retention, and health benefits for the workforce in Wilmington, including funding the severance and benefits programs of the ABX and ASTAR employees who will be affected by the proposed plan. According to the testimony of Wilmington's Mayor last week, this is more than the $257 million annual payroll for all the

workers in Clinton County for DHL, ASTAR, ABX and the other eighteen companies at the Air Park. A portion of this commitment (approximately $35 million) is being made pursuant to contractual or benefit plan obligations of DHL, while the balance (approximately $225 million) represents our effort to go beyond what would otherwise be required. The fact that the majority of these expenditures will benefit individuals who are not even employed by DHL indicates DHL's commitment to helping the Wilmington community through this transition.

Finally, DHL has commenced initial discussions with local officials regarding disposition of the Wilmington Air Park in the event a vendor services agreement with UPS is consummated. DHL will work to consider transition plans for the Air Park which could reduce the impact of our terminating operations at that location.

BRIEF HISTORY OF DHL IN THE U.S.

DHL's current structure and business model are the products, in part, of regulatory constraints on non-U.S. companies engaged in air transport services in the United States. DHL was founded in the United States in 1969 by three entrepreneurs. We expanded over time to become a global air express service provider. DHL's operations inside the United States were conducted by one company, DHL Airways (which was owned and controlled by U.S. citizens), while our operations outside the United States were conducted by a different company, DHL International (which for more than a decade has been owned and controlled by foreign entities). Because U.S. law limits foreign ownership of U.S. air carriers to a 49% equity interest and a 25% voting interest, DHL International could not operate the U.S. domestic airlift component of its integrated air express delivery service. The two companies, however, were able to provide

integrated, global air express service through a variety of contractual arrangements, though with higher costs than a single company would have. In 1998, Deutsche Post World Net ("DPWN"), a publicly traded company, became an investor in DHL International. DPWN acquired all of the company in 2002.

With full acquisition, however, came new hurdles. U.S. law prohibits non-U.S. citizens from fully owning and controlling a U.S. air carrier. Prior to 2001, DHL Airways operated an integrated air and ground network in the United States, much as UPS and FedEx do today. Because of the restrictions on DHL's ownership of an air carrier, DHL could not maintain the same efficiencies that our competitors enjoy. Consequently, in May 2001, DHL underwent a major restructuring that separated DHL's air and ground operations. This strategic decision was made in the hope that it would allow the company to expand its presence and improve its operating platform in the United States, the largest and most vital market in the world for the air express industry. DHL's objective was to offer to the business customer an alternative shipping option to the extensive domestic services offered by UPS and FedEx, which are the leaders in the U.S. domestic air express business.

Three U.S. investors ultimately acquired the air operation and changed its name to ASTAR, while the ground operations were conducted by a company called DHL Express, which was acquired by DHL International as part of the restructuring. A prime motivation for the restructuring was to facilitate investment in the ground service operator – DHL Express – consistent with U.S. legal limitations on foreign investment in U.S. air carriers. The objective was to make DHL a more meaningful participant in the domestic air express sector.

In 2002, Airborne Express, which operated an integrated air and ground express delivery network in the United States, expressed an interest in possibly being acquired by DHL. Airborne had the converse of DHL's strategic problem; it operated its own services only in the United States and relied on third parties to deliver its few international shipments. When it approached DHL about a possible acquisition, Airborne was facing a rapid decline in its operating results – it had reported either operating losses or breakeven operations starting in the 2nd quarter of 2000 through the 3rd quarter of 2001 – and was losing business. Airborne lacked the financial resources to expand its network and keep pace with the competitive challenges it was facing from its larger rivals. Absent an acquisition by DHL, it faced a difficult and very uncertain future. At the same time, DHL saw in Airborne an opportunity to expand its domestic network and customer base significantly. In August 2003, DHL acquired Airborne and began the arduous task of integrating the ground operations of the two companies. Again in order to comply with U.S. law, DHL was required to divest Airborne's air operations (ABX), leaving DHL Express to operate ground operations only in the United States.

In order to provide an integrated express delivery service in the U.S., DHL Express needed airlift providers, so we entered into ACMI agreements (**A**irplane, **C**rew, **M**aintenance, **I**nsurance) with ASTAR and ABX. These ACMI arrangements, which require DHL to pay the full cost of the services these carriers operate for it, including both companies' allocated overhead, and an operating margin ensuring that both companies' services for DHL are highly profitable – have put DHL at a substantial competitive disadvantage, because they afford the company no operational control over the airlift component of our overall service and materially increase operating costs for DHL relative to the costs of operating our own airline, as FedEx and

UPS do. In large part because of these "cost plus" arrangements, ABX and ASTAR have been profitable during their relationship with DHL Express, while we have continued to lose money.

Unfortunately, the existing ACMI structure has serious limitations. Under our "cost plus" agreements with ASTAR and ABX, we have to pay for the entire flight operation unless we can sell some of the unutilized space. This means that DHL has to fill the aircraft or take the financial loss for flying it only partially full. Under the proposed agreement with UPS, by contrast, we would place our shipments into the UPS network and would not be responsible for the entire cost of the flight. In the current operating environment, continuing to maintain "cost plus" ACMI agreements with two different U.S. air carriers – which cannot match the economies of scale or scope and accompanying cost efficiencies achievable by combining DHL's volumes with UPS's – would place DHL at a severe and untenable competitive disadvantage.

In the five years since acquiring Airborne, DHL has made a prodigious effort to integrate the massive ground operations of former DHL and Airborne, including complex IT networks and workforces, into a single air express provider. Through 2004 and 2005, DHL completely re-branded these operations with our new trademark and launched an aggressive sales plan and a national marketing and advertising campaign to win customers from long-time incumbents including FedEx and UPS. DHL's massive investment in infrastructure paid off with marked improvements in domestic overnight and ground delivery services. But DHL's efforts have been severely hampered by an unsustainable cost structure. DHL's inability to grow our volume has led to underutilized aircraft capacity and other underutilized fixed-cost infrastructure. The resulting inefficiencies and increasing cost structure have severely impeded DHL's ability to

compete. Deteriorating revenues exacerbated by cost increases have resulted in devastating losses that DHL cannot continue to incur.

This is a particularly difficult time in the history of the aviation industry overall, including the air express delivery sector. In recent years, many major U.S. passenger and cargo airlines have sought the protections of bankruptcy, reduced their overall operations, including reduced flights and suspended service to entire airports, and shed thousands of jobs in the process. From 2001 to 2005, US airlines lost 100,000 jobs and $30 billion, and this trend continues today. Some carriers have ceased operations entirely.

At the same time, the air cargo market has experienced increasing levels of excess air lift capacity, the impact of which has been substantially exacerbated by record increases in fuel prices. These record fuel prices, combined with a significant slowdown in the U.S. economy have hit the domestic air express sector particularly hard. For example, FedEx recently stated in its annual report that its U.S. domestic express shipping volumes fell to pre-2000 levels in its fiscal fourth quarter. UPS likewise recently reported a 6.1% decline in domestic next-day air express shipments for is fiscal second quarter. DHL has similarly experienced a steady decline in overnight air volumes since 2000.

During this time, DHL's (including former Airborne) total overnight air shipments, which included a greater percentage of documents as opposed to parcels shipments than our main U.S. competitors, shrunk at an even faster rate than the overall market. Furthermore, as overnight air costs have increased, shippers have moved increasingly to less expensive ground

delivery products, a segment in which DHL and former Airborne were not nearly as well equipped to compete with larger U.S. rivals FedEx, UPS and the U.S. Postal Service. So, the combination of declining air volumes, including even sharper declines in documents compared to parcels, rapidly increasing costs and the shift from air to ground products has created a triple threat to DHL Express in the U.S.

To be sure, DHL made strategic and operating mistakes in the integration of the DHL and Airborne businesses. The 2005 integration of our two main U.S. air cargo and hub sorting operations (of former Airborne and DHL) into a single facility at Wilmington, Ohio did not go well, impacting service to our customers and costing us a number of accounts. Other aspects of the integration of Airborne and DHL gave rise to unanticipated service issues, which also eroded our customer base and market share.

In addition, DHL has not been as successful as we had contemplated at reducing our substantial airlift costs, in particular the high fixed-cost structure of our two current providers, ABX and ASTAR. In an effort to reduce costs through a possible merger of ABX and ASTAR, DHL acquired a minority stake in ASTAR in 2007 and agreed to support the acquisition of ABX by ASTAR financially by offering a long-term operating contract to the surviving carrier. Such a transaction would have created a single carrier vendor for DHL in the United States and would have reduced redundant overhead and multiple fleet costs which DHL fully bore through our ACMI agreements. However, ABX rejected ASTAR's offer to purchase ABX. Other options, including ABX proposals to reduce costs to DHL for services provided by ABX, were

thoroughly analyzed by DHL. Unfortunately, ABX's proposals simply would not have delivered enough cost reductions to the DHL Express operations in the United States.

Subsequently, DHL was approached by UPS regarding the airlift services contract currently under negotiation. This agreement, if consummated, has the potential to provide greater long-term costs savings and efficiencies than the combination of ABX and ASTAR that DHL had tried to promote earlier or other proposals by ABX.

For some years now, financial analysts on Wall Street and elsewhere have criticized us for "not stopping the bleeding" in the United States. The stock value of DPWN has remained flat, and the pressure of the financial markets to "fix" our problem in the United States has increased.

In this context, some have asserted that DPWN is government-controlled. It is not. We are a publicly traded company that must be responsible to our shareholders and consider how best to respond to their calls for change. Nearly 70 percent of our stock is owned by retail and institutional investors, and US institutional investors constitute roughly 25 percent of the total ownership of the company. KfW Banking Group, a trustee of German funds, owns the remaining 31 percent of our stock, but it has no special voting interest.

Even though we have taken a long-term view of our U.S. business, we cannot ignore the fact that these operating losses – about $5 million per day - are simply unsustainable for the company, our shareholders, and our employees. Decisive action is now required.

On May 28, therefore, we announced a restructuring plan for DHL Express in the United States, consisting of two main elements: (1) the reorganization and consolidation of our domestic (ground) network; and (2) a possible shift of our domestic airlift and attendant sorting activity from our two current providers (ABX and ASTAR) to one single provider, UPS. Our ground network restructuring is well underway; and our contract negotiations with UPS are ongoing.

Finally, and though certainly not a motivation for the agreement with UPS, one other result of our plans is that by eliminating duplicate air systems, the contract with UPS would reduce carbon emissions (since there would be 50,000 fewer aircraft take-off and landing operations per year) and contribute to energy conservation by saving over 150,000,000 gallons of jet fuel annually.

THE PENDING DHL-UPS SERVICES AGREEMENT

Although discussions between DHL and UPS are ongoing and details about the proposed arrangements and the timing of a final agreement are still subject to negotiation and confidentiality requirements, the proposed vendor services agreement, as announced by DPWN Chairman and CEO, Dr. Frank Appel, and myself, calls for UPS to provide air lift services for nearly all of DHL U.S. package volumes and for UPS to provide main hub package sorting services at UPS's hub in Louisville, Kentucky. DHL would retain complete control over the rest of our business and remain an independent competitor in the U.S. air express delivery sector. We would continue to provide all pick-up and delivery and certain sorting services under the proposed arrangement, retain and manage our own sales force, develop and pursue our own

commercial strategies, maintain our own back office services, set our own pricing and product offerings, etc. DHL would retain full control over our ground operations and maintain our own IT systems, as we do today. There would be no sharing of sensitive or proprietary customer information beyond the operational data necessary for transportation between the appropriate airports. In sum, the proposed contract is essentially the substitution of a single vendor – UPS – for our two existing vendors – ABX and ASTAR – in the provision of airlift and package sorting services. The proposed contract contemplates no greater outsourcing of services by DHL than our current operating model.

The proposed agreement, if consummated, would not involve any merger, acquisition, alliance, or transfer of assets between DHL and UPS. It would be a commercial vendor contract for services negotiated at arm's length between two independent companies, limited to the air transport of DHL's packages and certain sorting services in North America. The proposed agreement, in connection with the other cost savings and operating efficiency initiatives announced by DHL on May 28, 2008, could make DHL a more viable long-term competitor in the United States. It would provide DHL with greater stability and align the costs that DHL pays for the airlift component of our U.S. operating platform much more closely with the variable costs involved in providing those services.

Similar vendor arrangements involving competitors are common in the transportation industry. FedEx and UPS provide airlift for the U.S. Postal Service. Most commercial airlines carry packages for express delivery companies, freight forwarders and other businesses. In the maritime world, the mutual utilization of cargo space has been common among competing

shipping lines for many years. Additionally, passenger airlines have code-share arrangements with each other for carrying passengers. This has been common practice in the airline industry for years. Such arrangements are common in the transportation sector, which is characterized by very high fixed costs of transport networks, because they bring very substantial efficiencies to participating companies. Those efficiencies in turn enhance competition and benefit consumers through lower prices and better service. Carriers cannot efficiently bear the long-term expense of operating their networks at partial capacity. Our proposed agreement would be designed to provide DHL (as well as UPS) just the sort of pro-competitive efficiencies that companies in the transportation sector have long enjoyed from similar arrangements. This is particularly important given the dramatic fuel price increases already mentioned.

For these reasons, among others, we believe the agreement would be fully consistent with U.S. antitrust laws. If and when the agreement is concluded, we will provide a copy to the Department of Justice and will cooperate fully with any review of the contract that the Department chooses to undertake.

IMPACTS ON THE STATE OF OHIO

As I said at the outset, we are most mindful of the impact that our proposed transfer of services from Ohio-based companies ABX and ASTAR to Kentucky-based UPS will have on the local Ohio economy and the many dedicated DHL, ABX, and ASTAR employees who work in Wilmington. As indicated above, DHL has already agreed to fund an estimated $260 million or more in severance, retention, and health-benefit arrangements for the workforce in Wilmington – including approximately $225 million over and above what our contractual or legal obligations

would otherwise require. This includes agreements with ABX and ASTAR to fund certain severance and benefits programs being provided to ABX and ASTAR employees who would be affected by the proposed agreement, if consummated. DHL has gone beyond our mere contractual obligations and industry benchmarks in agreeing to fund these benefit programs. Under the plans funded by DHL, all pilots, mechanics, sort employees and non-executive personnel will be eligible for one or more of the benefits programs of DHL, ABX and ASTAR.

Until an agreement is consummated, we cannot put in place other measures to address its impact, but we are mindful of the need to address such concerns. Immediately following the announcement on May 28, DHL held discussions with key officials to address the potential impact of our announcement on the local community. On June 4, I met with Ohio Governor Ted Strickland, Ohio Lieutenant Governor Lee Fisher, and several State legislators to explain our decision. I have also been in touch with concerned Members of Congress, and I have very much appreciated hearing their views.

On June 25, Dr. Appel personally committed to Lieutenant Governor Fisher that DHL would consider measures to mitigate the economic impact on the employees and the community of Wilmington. Indeed, we have selected a dedicated team of senior executives of the company to review all options regarding mitigation efforts and have engaged with community leaders in respect of the potential disposition of the Wilmington Air Park and other potential avenues of mitigation. As noted, the potential agreement with UPS is not finalized, and the timing and extent of impacts of our future actions is not presently known. In the event DHL and UPS reach agreement, DHL will work with state and local officials on mitigation plans.

Finally, I want to say a word about the misinformation that has been widely publicized concerning the incentives DHL received from the State of Ohio and local jurisdictions in relation to the 2004-2005 consolidation of our air cargo and hub sorting operations at the Wilmington Air Park. DHL was induced to consolidate those operations at the Air Park, rather than in Northern Kentucky, in part by the offer of incentives that the State has valued in excess of $400 million. As shown in attached Exhibit I, however, DHL has received less than $6 million in incentives.

To put this in perspective, we lose in a day and a half the entire amount of benefits DHL has realized from the State of Ohio's incentives. The vast majority of the $400 million -- the Volume Cap Allocation for Tax Exempt Financing for improvements at the Air Park, valued by the State at up to $300 million -- was of no value whatsoever to DHL because it was not required for the type of tax-exempt financing available to DHL. Moreover, DHL is fully liable for all principle and interest related to the $270 million in bonds issued for the Air Park improvements. No governmental entity is liable for payment of any amount of the $270 million because it is solely DHL's obligation. Thus, the notion that DHL is abandoning the Wilmington Air Park facility after accepting more than $400 million in incentive benefits from the State is false.

CONCLUSION

In conclusion, I want to emphasize that the DPWN Board has not taken lightly the decision to reorganize DHL Express in the U.S. We deeply regret the resulting economic hardship, and we will work conscientiously to mitigate adverse effects. As CEO, I am

responsible for protecting the viability of our business in the United States, and I firmly believe that the decision to restructure DHL's U.S. operations was necessary to achieve that objective.

Mr. Chairman and distinguished Members of this Committee, I thank you very much for your attention. I look forward to your questions.

Exhibit I

DHL EXPRESS (USA), INC.: WILMINGTON AIR PARK EXPANSION AND IMPROVEMENT: STATE OF OHIO AND LOCAL INCENTIVES

Incentive	Offered by the State	Realized by DHL	Comments
Ohio Job Creation Tax Credit	$ 13,000,000*	$ -0-	Agreement has not been executed. If the vendor services contract is consummated, DHL is not expected to realize any benefit.
Ohio Job Retention Tax Credit	66,000,000*	-0-	Agreement is understood to have been submitted to ABX; status is unknown. If the vendor services contract is consummated, DHL is not expected to realize any benefit.
Business Development (412) Grant	2,000,000	2,000,000	
Volume Cap Allocation for Tax-Exempt Financing	300,000,000*	-0-	Volume Cap was not required for the type of tax-exempt financing available to DHL, and neither the Dayton-Montgomery County Port Authority nor DHL applied for or received any volume cap for the bonds issued by the Dayton Port. DHL is obligated to pay rent sufficient to pay all of the debt charges on the bonds issued by the Dayton Port. No governmental entity is liable for payment of this debt from its own resources.
Ohio Investment in Training Program	2,000,000	2,000,000	
Employment Pre-screening Test and Recruitment Services	729,760		Such benefit, if any, that DHL received by virtue of the State's reimbursement to local government agencies for these costs was indirect and the value realized is not capable of precise measurement. The amount expended by the State for this purpose is not known.

* Estimated value per State of Ohio incentives offer letter dated June 15, 2004.

Community Reinvest-ment Area	17,000,000*	600,000	For tax year 2007, DHL received an estimated $600,000 abatement on real property taxes.
Ohio Enter-prise Zone Program	9,660,000*	1,000,000	For various reasons, including changes in State law, DHL does not expect to realize more than $1,000,000 in personal property tax savings.
Roadwork Develop-ment (629) Account	1,000,000	-0-	Received by the City of Wilmington for public improvements.
Runway Fee Savings	7,000,000		The savings on landing fees that DHL realized by choosing in 2004 to consolidate operations at the Wilmington Air Park, rather than at the Cincinnati/Northern Kentucky Airport in Covington, Kentucky, was a function of DHL's acquisition, expansion and improvement of, and consolidation of operations at, the Air Park. The State of Ohio did not provide to DHL either cash or any credit against any payments that would otherwise be owing to the State.
OWDA Local Econom-ic Develop-ment Loan	4,000,000	-0-	Received by the City of Wilmington for public improvements.
TOTAL	$422,389,760**	$5,600,000	

* Estimated value per State of Ohio incentives offer letter dated June 15, 2004.

** The State also offered to DHL in the letter setting forth the incentives package that it would expedite commencement and completion of construction of a bypass around the City of Wilmington. Planning for and scheduling of construction of the bypass is understood to have commenced before DHL ever became involved with the Air Park. Further, the bypass is a public improvement that should be of benefit generally to the traveling public and Wilmington area residents.