STATEMENT OF

CAPTAIN JOHN PRATER, PRESIDENT
AIR LINE PILOTS ASSOCIATION, INTERNATIONAL

BEFORE THE

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

UNITED STATES HOUSE OF REPRESENTATIVES

WASHINGTON, DC

September 16, 2008

"Effects of Proposed Arrangement Between DHL and UPS on Competition, Customer Service, and Employment"

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Good afternoon. I am Captain John Prater and I am President of the Air Line Pilots Association, International (ALPA) representing some 53,000 pilots in the United States and Canada. I am testifying today on behalf of the 500 pilots ALPA represents at ASTAR Air Cargo, a group of pilots which has flown packages and cargo for DHL for over twenty years, on the proposed arrangement between Deutsche Post (recently renamed DPWN) and United Parcel Service to provide all lift for DHL's air overnight service.

I am pleased that this panel has the assistance of a bipartisan group of legislators from the state of Ohio, as well as the Governor, in carefully examining both the origins and ramifications of this proposed transfer of lift and work. ALPA wishes to specifically thank Senators Voinovich and Brown, Representatives Turner, Sutton, and Kaptur, Governor Strickland, and Lieutenant Governor Fisher and all the members of the Ohio delegation who have participated in these Congressional hearings and for their leadership on this issue.

The officials from Ohio have made a number of significant points, but there is one matter they have brought up which we would like to stress from the outset -- DHL approached and fashioned the "solution" to its problems in North America unilaterally, and chose to bypass, not only the companies and employees who have supplied its lift with great effectiveness for many years, but also the state of Ohio. This process, which denied the parties most affected by the decision any opportunity to construct alternatives or protect themselves, has produced an extraordinarily flawed "solution" which will inevitably cause DHL to lose market share and further consolidate the express package industry in ways which unquestionably violate U.S. antitrust laws.

Aside from this, ALPA's distinct concern is well known and is directly related to the above. On May 28, 2008, Deutsche Post, the German-based parent Company of DHL, announced that it was negotiating to transfer all North American flying presently performed in its service by ASTAR -- as well as that performed by ABX -- to United Parcel Service. Despite the fact that Deutsche Post had, and continues to have, a 49% ownership stake in ASTAR and representatives on its Board of Directors -- as well as the fact that it had entered into a fourteen year agreement for supply of its lift with ASTAR in the summer of 2007-- it did not inform either ASTAR or its employees that it had been in negotiations with UPS for the previous six months until that press

conference. If the transaction announced on May 28th is consummated and the government chooses to ignore the obvious anticompetitive impact of the deal, ASTAR will cease to exist and every one of our members at this carrier will be on the street. However, ALPA represented pilots and other ASTAR employees will obviously not be the only affected group. The state of Ohio has estimated that the immediate impact of the transfer of all DHL flying from the ASTAR and ABX hub of operations in Wilmington, Ohio will be a loss of over 10,000 jobs and a dramatic reduction in economic activity in Southwestern Ohio. In short, the impact on both our membership and on their friends and neighbors in the region will be catastrophic, and for that reason alone it is important that Congress and the Department of Justice look carefully into this matter.

Background

Three U.S. entrepreneurs established DHL in the late 1970s as a provider of freight forwarding and courier services. It established air operations to support its delivery service in the 1980s and, by the end of that decade, had sorting operations and a hub in the Greater Cincinnati/Northern Kentucky Airport. DHL, along with Airborne Express, became competitors to FedEx and United Parcel Service in the domestic express package industry. In 1990 the DHL pilots voted to be represented by the Air Line Pilots Association and, since that time, ALPA has negotiated four collective bargaining agreements with DHL and its successors, culminating in the 2008 Agreement.

In 2001 Deutsche Post purchased DHL and spun off its airline subsidiary, DHL Airways, which was later renamed ASTAR Air Cargo. Based on the requirements of the 1998 collective bargaining agreement it signed with ALPA, DHL was still bound to assign its flying to ALPA represented pilots on the ASTAR seniority list and it continued to do so pursuant to what is known as an Aircraft, Crew, Maintenance, and Insurance (ACMI) Agreement with ASTAR. Under that agreement DHL reimbursed ASTAR for the costs of the collective bargaining agreement with ALPA, and the labor contract was incorporated by reference into the ACMI Agreement. In addition, pursuant to federal aviation statutes, majority ownership in ASTAR was transferred to American citizens and eventually ended up in the control of former Northwest Airlines CEO John Dasburg and his investor colleagues.

However, in 2003 Deutsche Post, seeking to expand its North American operations in order to become a bona fide competitor to FedEx and UPS, purchased Airborne Express, merged its ground operations into DHL's, and spun off its air operations, which became ABX Air. It entered into the same sort of commercial arrangement with ABX as it had with ASTAR, and then renounced any obligation to adhere to the requirements in the collective bargaining agreement it had signed with ALPA's ASTAR pilots. This lead to several years of litigation based on an absurd ruling from the National Labor Relations Board barring ALPA from taking its contractual claim against DHL to a neutral arbitrator -- a ruling which was eventually reversed by a unanimous Court of Appeals in 2008.

While this dispute was working its way through the NLRB and the courts, negotiations over a new collective bargaining agreement between ASTAR and ALPA began in 2005 and continued through the beginning of 2008. The central issue in these negotiations was, not surprisingly, job

security and the extent to which our members could continue to perform the flying they had performed throughout the history of DHL. What we did not realize as we reached the crucial stage of this negotiation in January of 2008 was that DHL and its parent, Deutsche Post -- which in the summer of 2007 had extended its ACMI agreement with ASTAR through 2019 and, at the same time, also took a 49% ownership interest in ASTAR and placed representatives on its Board of Directors -- were in negotiations with United Parcel Service to have UPS perform all of ASTAR's flying operations. DHL not only withheld knowledge of these negotiations from both ASTAR and ALPA, it also made demands for revisions in the job security provisions of the tentative collective bargaining agreement between ASTAR and ALPA -- including settlement of litigation between ALPA and DHL -- that in retrospect were obviously designed to clear the way for its secret arrangement with UPS.

The misrepresentations and material omissions made by DHL to ASTAR and ALPA in order to influence our negotiations is now the subject of litigation and we, of course, understand that these issues are not the subject of this hearing. However, in reviewing the competitive impact of the proposed arrangement between DHL and UPS, as well as its impact on the southern Ohio communities which have depended on the employment provided by both ASTAR and ABX for several decades, the fact that this deal was made in secret without the opportunity for competitive bidding, and with the clear intent of depriving the affected parties of an opportunity to protect themselves or respond, is obviously relevant in assessing the legitimacy of what Deutsche Post is doing.

THE IMPACT OF THE ARRANGEMENT

Prior to the acquisition and integration of DHL and Airborne Express in 2003 by Deutsche Post there were four major private sector players in the U.S. express package industry: FedEx, UPS, Airborne Express, and DHL. The United States Postal Service also supplied a competitive service, the fate of which will be discussed later in our testimony. As can be seen from attached **Table 1**, at that time FedEx and UPS were the major providers of service, but each of the other competitors had established niches.

When DHL, which had already been acquired by Deutsche Post, further consolidated the industry by purchasing Airborne it made the following representations justifying the decision in a 2003 prospectus:

The UPS/FedEx duopoly today has a 79% share of the U.S. air express delivery market (versus Airborne and DHL's combined 21% market share). (See attached **Table 2.**)

The Airborne/DHL combination will act as a stronger third competitor in the expedited door to door delivery of small packages and documents and will have the ability to bring reduced prices and better service to small and medium-sized businesses.

In the markets Airborne competes in today, made up primarily of large, corporate accounts, its price levels are substantially lower than its competitors. The expanded DHL company will have the capital and resources to leverage this value into the small to mid-sized marketplace.

No aspect of this prediction turned out to be true. The air express market is more concentrated than ever, with what DHL described as the FedEx/UPS "duopoly" in control of an even greater share of express package volume and a far greater share of revenue than in 2003. (See attached **Tables 3-6**.)

As can also be seen, the consolidation of DHL and Airborne has diminished, not enhanced, the market share of the combined entity, which now controls less than 10% of express package revenue. The bottom line of this is clear -- Deutsche Post managed to take two niche competitors with a portfolio of premium business customers, both of which were likely survivors in the industry, consolidate and restructure them to its needs, and then run them into the ground. Now, after stripping both carriers of their ground operations, it proposes to leave the airlines for dead.

This point is often inadequately understood. DHL has stated that it is simply switching to another contractor for its lift. Aside from the fact that there was no opportunity for either ASTAR or ABX to compete with the UPS bid because it was made and negotiated in secret, neither ASTAR nor ABX can legitimately be thought of as outside contractors with respect to DHL. As made clear above, prior to Deutsche Post coming on to the scene, both DHL's and Airborne's air operations had each been part of the same corporation as and were integral to its ground operations. What is now DHL Ground (the result of the merger between DHL and Airborne) was built by ASTAR and ABX Air. These air operations were originally built to service DHL and Airborne, were restructured by Deutsche Post to support the merged DHL ground operation, and the rendition of service by both carriers was strictly controlled by Deutsche Post. In that both carriers were built and modified to DHL's needs, there is virtually no chance either will survive once their relationship to DHL is terminated. In short, two carriers which were viable competitors before Deutsche Post came on the scene have been deprived of the product they were built to transport and are being thrown under the bus along with their employees and communities.

This is an unconscionable result simply based on its ramifications for affected employees and consumers. However, we also note ASTAR provides major support for the Civil Reserve Air Fleet (CRAF), and if this deal is allowed to go through, our government will be denied access to a substantial part of the lift it is counting on and, in fact is using on routine basis. This Committee should understand that the CRAF contract in place is between the United States and ASTAR, not DHL. Therefore, DHL will not be able to remedy the gap in available lift for our military which will be created by the cessation of ASTAR's operations. This is a bitter result for our ASTAR members, close to forty percent of whom have served in our nation's armed forces, and who have been recognized by the United States government for their enthusiastic and courageous participation in CRAF.

Why has this happened? Both ASTAR and ABX have met all performance targets set for them by DHL and have provided 99% on time performance. The pilot workforces at both carriers, while reasonably compensated, are not as well compensated as pilots at UPS or FedEx. DHL's problem in North America is not the cost or effectiveness of its air operations. Its problem has been providing effective enough service on the ground to take market share from UPS or FedEx. This problem will not be solved by switching to another provider of lift, much less by transferring this responsibility to DHL's principle competitor. To put it simply, DHL's

difficulties in North America are not due to the cost or effectiveness of its lift, but rather with its inability to effectively implement the ambitious business strategy it announced in 2003.

In this respect, Deutsche Post has pointed to the contract for lift between the United States Postal Service and FedEx as an example of and precedent for what it is trying to do. This precedent is inapplicable. To begin with, the USPS is not even covered by US antitrust laws and the cost and rendition of its service is carefully regulated. More important, less than one percent of the USPS' volume is express or expedited delivery. Hence, the Postal Service only competes with FedEx in a very narrow portion of its product line. By contrast, UPS offers a competing product for virtually every DHL offering. Finally, as can be seen in the tables we have presented, while FedEx has supplied excellent service to the USPS, the USPS/FedEx contract has not been an effective formula for preserving market share for the Postal Service's express mail product. (See attached Table 6.)

In this matter, it strikes us as obvious that relying on your principle competitor for your primary mode of transportation and giving it close to perfect information on your pricing strategy is not a good way to maintain, much less enhance, a corporation's market share. Indeed, the erosion of DHL's market share is probably already occurring. Many DHL customers have been targeted by UPS and have been told that DHL's service is now dependent on UPS and pointing out the comparable services provided by UPS. DHL has not yet provided investors with a tally of the impact of the announcement of the DHL/UPS deal on reduced volume run through DHL's Wilmington hub, but the feedback we are getting from flight crews and sort personnel is that the negative impact of this announcement has been significant and volume has been appreciably diminished. It is inevitable that DHL products will lose market share, and the so-called "duopoly" that Deutsche Post claimed that it wished to address will become more entrenched as the result of this arrangement. No amount of "firewalls" or restrictions on information or product sharing will prevent this result and, in any case, the Department of Justice's own antitrust guidelines make clear that such arrangements are not favored and are rarely sufficient to remedy competitive concerns

Conclusion

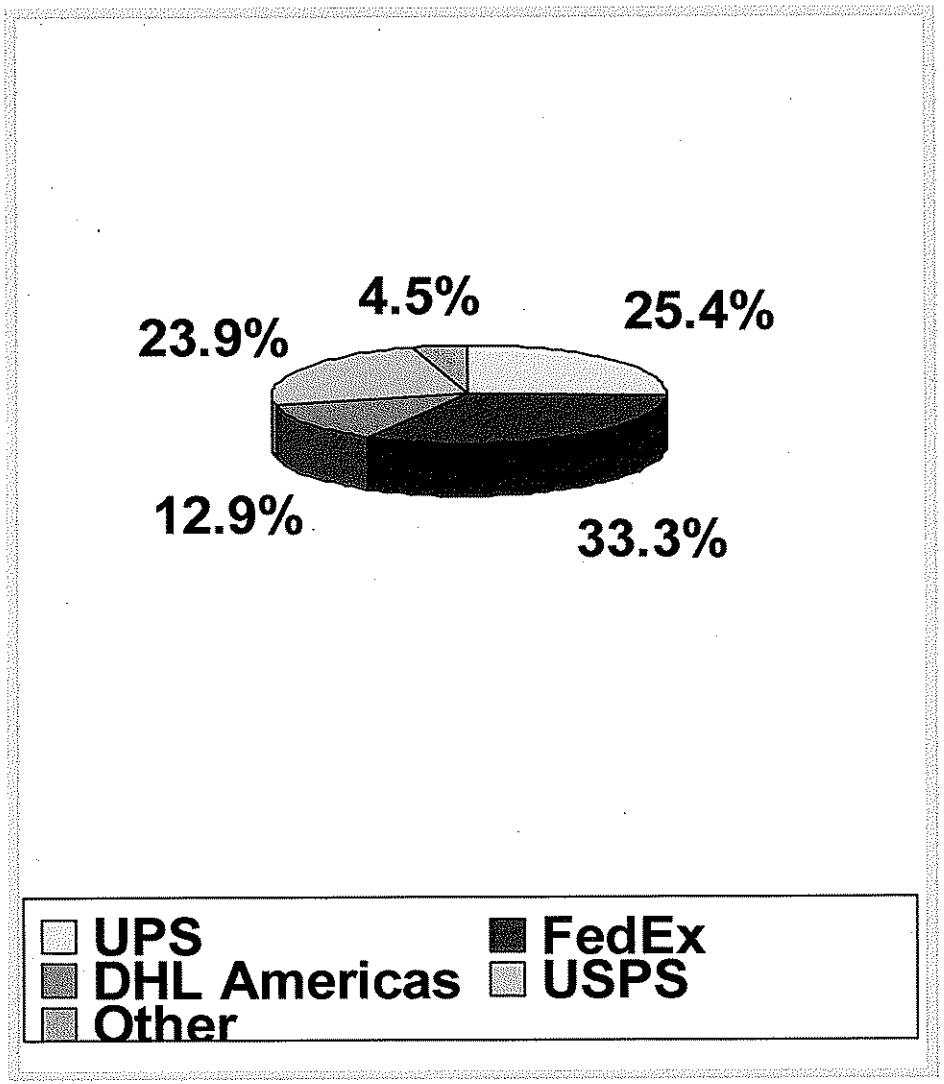
As pointed out earlier, the discussions between UPS and Deutsche Post occurred in secret and neither the providers of lift nor public officials in Ohio were told anything about it until the May 28, 2008 press conference. The reason for this seems obvious: the company officials promoting this arrangement did not want to provide adversely impacted parties or citizens with an opportunity to point out the flaws in the plan or develop alternatives. Indeed, the flaws in the announced plan are so obvious that we suggest DPWN may have additional components to the strategy which it has not yet made public.

In ALPA's case, the secrecy was clearly intended to deprive us of the chance to attempt to protect ourselves both in bargaining and by continuing litigation that we undoubtedly would have maintained had we known of DHL's true plans. In short, we have an arrangement which will inevitably eliminate competition and employment, cooked up in secret in order to bypass affected companies and US citizens. Neither the result nor the procedure used to achieve it are good or in the interest of the US economy.

For these reasons, we believe the transfer of DHL's lift to UPS requires, at the very least, careful scrutiny by this Committee, the Judiciary Committee, and the Department of Justice, before any deal is consummated. Further, as suggested by Chairman Conyers of the Judiciary Committee at last week's hearing, we would urge this deal be held in abeyance pending such scrutiny and, given the significant public interest both with respect to employment in Ohio and preservation of competition in the express package industry, we believe any confidentiality restrictions entered into by the parties should be waived or voided.

Thank you for your time and interest in this important matter. I will be happy to answer any questions.

Total Domestic U.S. Parcel Air Express Volume Market Share 2003

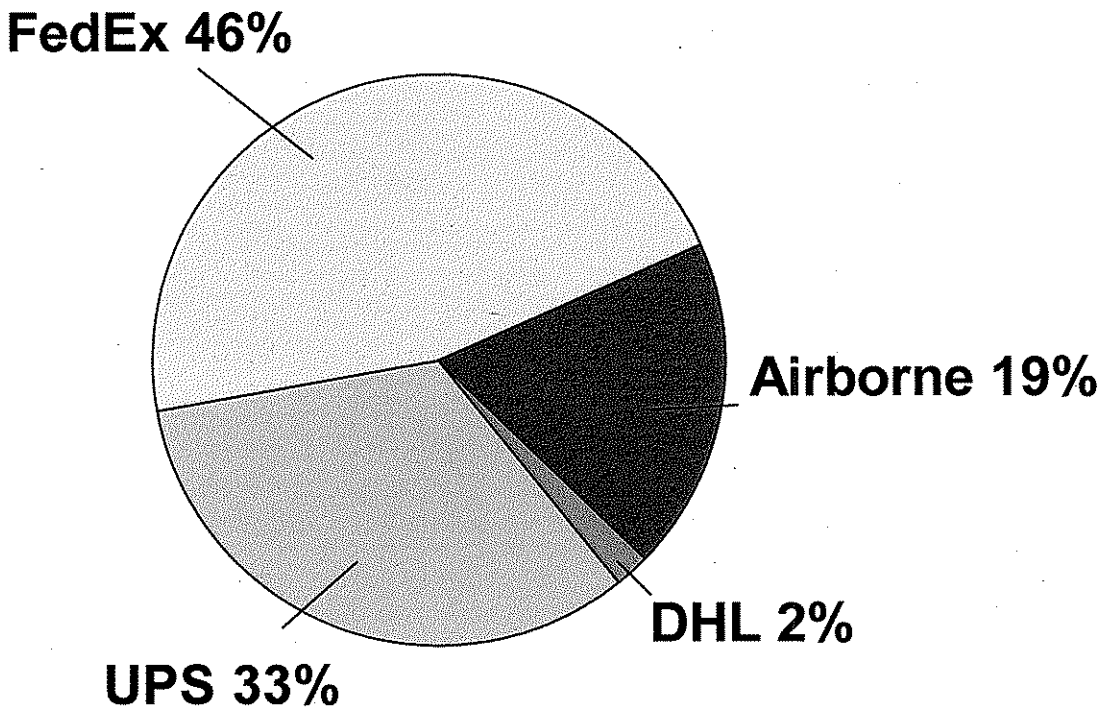


Source: Bears Stearns, Airfreight & Surface Transportation report January 2008

Table 1

2003 DHL Airborne Express Transaction Info

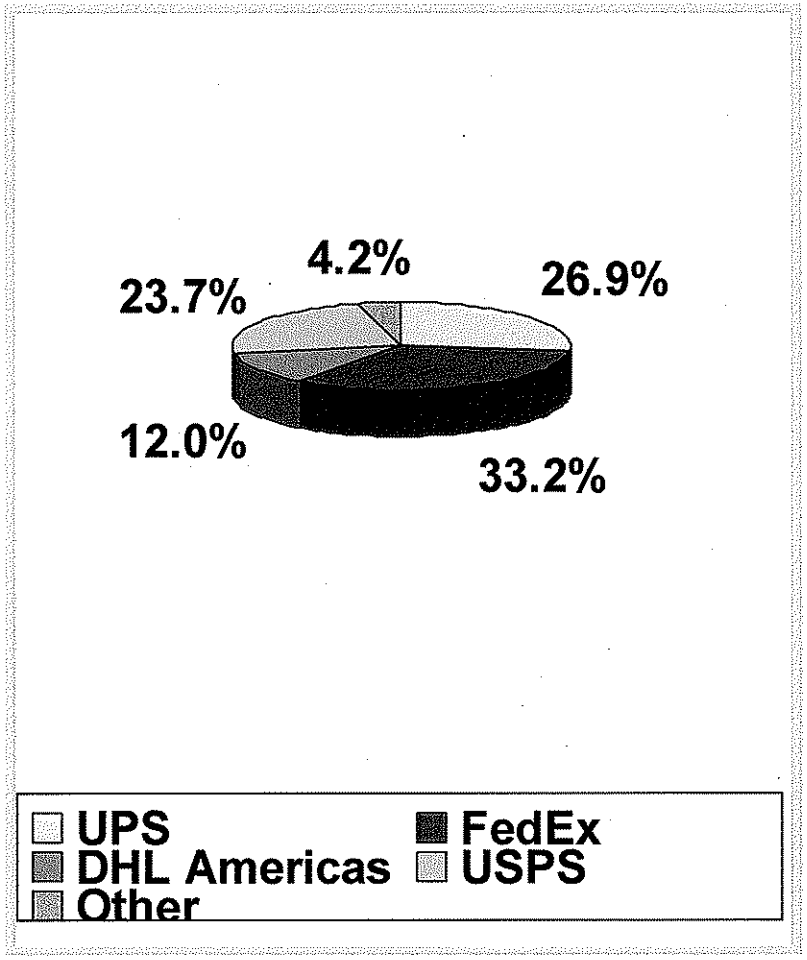
"The UPS/FedEx duopoly today (2003) has a 79% share of the US airexpress delivery market versus Airborne & DHL's combined 21% market share."



Source: DHL Airborne Express Transaction Information, July 14, 2003

Table 2

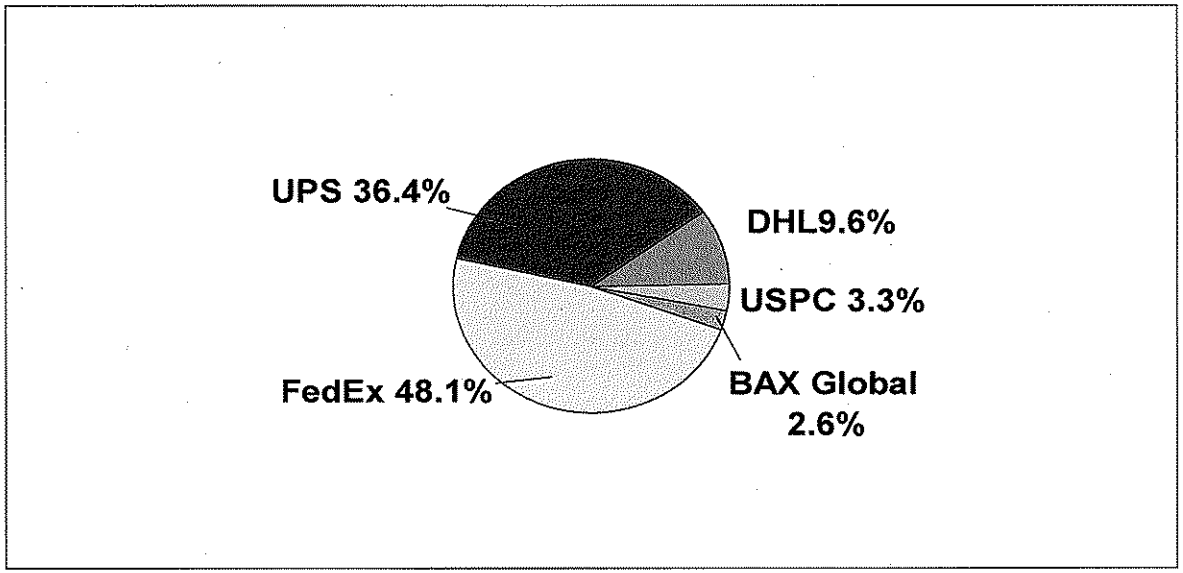
Total Domestic U.S. Parcel Air Express Volume 2007E



Source: Bears Stearns, Airfreight & Surface Transportation report January 2008

Table 3

U.S. Domestic Express Revenue 2007



US Domestic Express Revenue in 2007 ($millions)

Express	FedEX (FY08 including USPS)	$ 14,020	48.1%
	UPS	$ 10,600	36.4%
	DHL	$ 2,800	9.6%
	USPS Express Mail	$ 950	3.3%
	BAX Global	$ 750	2.6%
	Express total	**$ 29,120**	**100.0%**

Source: ACMG's U.S. Domestic Air Freight & Express Industry Performance Analysis 2008

Table 4

U.S. Domestic Air Freight & Express Revenue 2007

US Domestic Air Freight & Express Revenue in 2007 ($millions)

Express	FedEX (FY08 including USPS)	$	14,020	42.7%
	UPS	$	10,600	32.3%
	DHL	$	2,800	8.5%
	USPS Express Mail	$	950	2.9%
	BAX Global	$	750	2.3%
	Express Subtotal	**$**	**29,120**	**88.7%**
Freight	Combination Carrier Freight	$	1,300	4.0%
	All-Cargo Carrier Freight	$	1,100	3.4%
	Freight Forwarders	$	1,030	3.1%
	Freight Subtotal	**$**	**3,430**	**10.5%**
Mail	Combination Carrier Mail	$	210	0.6%
	All-Cargo Carrier Mail	$	55	0.2%
	Mail Subtotal	**$**	**265**	**0.8%**
Grand Total		**$**	**32,815**	**100.0%**

Source: ACMGs U.S. Domestic Air Freight & Express Industry Performance Analysis 2008

Table 5

Total Domestic U.S. Parcel Air Express Volume Market Share 2000 – 2010E

Market Share

	2000	2001	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E
UPS Air Service	21.1%	22.8%	23.4%	25.4%	25.5%	25.7%	26.6%	26.9%	26.8%	27.2%	27.6%
FedEx Express	30.7%	31.3%	32.2%	33.3%	33.6%	33.6%	32.8%	33.2%	33.3%	34.0%	34.3%
DHL Americas	13.1%	13.2%	13.0%	12.9%	12.6%	12.1%	11.3%	12.0%	12.2%	12.3%	12.5%
USPS	28.6%	27.9%	26.9%	23.9%	23.8%	24.3%	25.0%	23.7%	23.5%	22.4%	21.6%
Other	6.5%	4.8%	4.6%	4.5%	4.5%	4.3%	4.3%	4.2%	4.2%	4.0%	3.9%
Total Volume	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Bears Stearns, Airfreight & Surface Transportation report January 2008

Table 6