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The DHL Airways / Astar Air Cargo Controversy and Legislation in the 108th Congress

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Summary

DHL Airways and its successor, Astar Air Cargo, provide the U.S. domestic airlift for the worldwide network of DHL Worldwide Express (DHLWE). After DHLWE was acquired by the German Post Office (Deutsche Post), FedEx and UPS challenged the citizenship of DHL Airways and are challenging Astar Air Cargo's citizenship. Without designation as a U.S. citizen, Astar Air Cargo could not provide the service for DHLWE that it now does. This would force DHLWE to find alternative arrangements for serving its customers within the United States. An administrative law judge (ALJ) has examined the citizenship question regarding DHL Airways and Astar Air Cargo beginning in April 2003. The ALJ was appointed following passage of a provision in the Emergency Wartime Supplemental Appropriations Act, 2003 (P.L. 108-11) which directed DOT to make the appointment. On December 19, 2003, the ALJ issued his recommended decision and found that Astar Air Cargo, Inc. is indeed a citizen of the United States. A Department of Transportation (DOT) decision on the matter is to follow.

The subject of the citizenship challenge changed in the midst of the proceeding because the ownership of DHL Airways changed in July 2003. At that time, a group of investors (including the president of DHL Airways) purchased DHL Airways and renamed it Astar Air Cargo. The DOT ruled that only the current ownership structure of Astar Air Cargo was subject to evaluation by the ALJ.

The Astar Air Cargo citizenship evaluation is significant because only four carriers, DHLWE, TNT, FedEx, and UPS, transport express shipments (parcels and documents) worldwide. In order for these carriers to effectively compete in the large markets for express shipments between the United States and Europe, Latin America, and Asia, as well as serve points within the United States, they require access to dedicated air transportation networks and hubs worldwide. The creation of delivery networks within national borders poses problems for U.S. carriers abroad and for foreign-owned carriers in the United States. The U.S. carriers, FedEx and UPS, can provide domestic airlift within the United States because both corporations are organized as "U.S. citizens" under 49 U.S.C. §40102(a)(15). The foreign express carriers, DHLWE and TNT, cannot own or control an airline providing domestic airlift because an airline providing transportation within the United States must meet the citizenship requirements identified in the aforementioned section of the U.S. Code and demonstrate that it is under the "actual control" of U.S. citizens. The passage of a provision in the FAA reauthorization (P.L. 108-176) codified the requirement that United States air carriers must be effectively controlled by United States citizens.

Congress has shown a continuing interest in airline citizenship issues, reflecting a concern that the citizenship evaluation is performed carefully and openly to ensure fair competition between United States and foreign express carriers. Current "open skies" negotiations with the European Union could have a significant impact on express delivery carriers. This report will be updated as warranted.

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Four carriers, DHL Worldwide Express (DHLWE), TNT, FedEx, and UPS transport express shipments (parcels and documents) worldwide. In order for these carriers to effectively compete in the large markets for express shipments between the United States and Europe, Latin America, and Asia, as well as serve points within the United States, they require access to dedicated air transportation networks and hubs worldwide. Creating delivery networks within national borders poses problems for U.S. carriers abroad and for foreign-owned carriers in the United States. The U.S. carriers, FedEx and UPS, can provide domestic airlift within the United States because both corporations are organized as "U.S. citizens" under 49 U.S.C. §40102(a)(15). The foreign express carriers, DHLWE and TNT, cannot own or control an airline providing domestic airlift because an airline providing transportation within the United States must meet the citizenship requirements identified in the aforementioned section of the U.S. Code and demonstrate that it is under the "actual control" of U.S. citizens. Congress has shown a continuing interest in airline citizenship issues, reflecting a concern that the citizenship evaluation is performed carefully and openly to ensure fair competition between United States and foreign express carriers.

The market for express services is unique as nearly all competitors except FedEx and UPS are subsidiaries of partially or fully government-owned firms that generate the largest share of their revenue and profits from monopoly mail services.[1] Competition with firms owned by government-owned postal monopolies creates the potential for unfair competition as foreign governments have a financial interest in success of those firms.[2] These competitors of American firms, most of which are legally sanctioned monopolies, have advantages that U.S. firms do not have.

In providing service overseas, American firms face substantial legal restrictions that affect their ability to provide international service. For example, citizenship

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[1] The other global competitor, TNT, is owned by TPG, which also operates the Dutch postal service and is partially owned by the government of the Netherlands. Large regional competitors owned by postal operators include the United States Postal Service, subsidiaries of Royal Mail Group (headquartered in Great Britain and serving all of Europe), Groupe La Poste (headquartered in France and serving all of Europe), Canada Post and its subsidiary Purolator Courier (serving Canada and cross-border traffic with the United States), and Japan Post (serving primarily Japan).

[2] The financial interest comes in the form of revenue generated by dividend payments and proceeds from stock sales. Governments that receive dividends from competitors to FedEx and UPS include Australia, Germany, and the Netherlands.

requirements similar to those imposed by the United States limit access by FedEx and UPS to overseas markets. American carriers serving foreign express markets must hire foreign citizen air carriers to provide air transportation beyond the carrier's foreign hub. Thus, UPS hires Star Air, a Danish corporate citizen and subsidiary of the Maersk Corporation, to provide air transportation within the European Union (EU). UPS can fly shipments from non-EU destinations to its hub in Cologne, Germany, but cannot operate a network within the EU because it is an American citizen corporation. FedEx faces the same restriction.

Of the foreign carriers, only DHLWE handles sufficient volumes within the United States or between the United States and the rest of the world to support a dedicated United States air network.[3] Astar Air Cargo provides (and its predecessor DHL Airways provided) DHLWE with most of its United States air transportation network. Its primary operations are centered at the DHLWE hub at the Cincinnati/Northern Kentucky International Airport. Astar Air Cargo flies 38 planes (23 Boeing 727s, 9 McDonnell-Douglas DC-8s, and 6 Airbus A300s), serving 31 United States domestic airports and 21 international airports. Its total 2002 revenue was $300 million, nearly all generated serving DHLWE.[4]

In 2001, the German Post Office (Deutsche Post) purchased a controlling interest in DHLWE and subsequently restructured the ownership of DHLWE's U.S. operations. As part of the restructuring, the ownership of DHL Airways, the carrier that provided DHLWE's U.S. domestic air network, changed, prompting the citizenship evaluation and challenges to DHL Airways citizenship by FedEx and UPS. Ownership changed again in July 2003, when DHL Airways was sold to a group of investors (including the president of DHL Airways) and renamed Astar Air Cargo. The citizenship evaluation of Astar proceeded with a focus on the current ownership structure.

After DHLWE was acquired by Deutsche Post, FedEx and UPS initially challenged the citizenship of DHL Airways and, subsequent to its sale and renaming, are challenging Astar Air Cargo's citizenship. A successful challenge to Astar's citizenship would not prevent DHLWE from operating in the United States, but would probably force DHLWE to find alternative airlift capacity to serve customers within the United States and customers overseas that want to ship to the United States. Thus, DHLWE would have to contract with a different U.S. citizen air carrier to provide the air lift that it needs to serve its customers.[5]

The initial complaints of FedEx and UPS against DHL Airways' citizenship, which were considered in an informal proceeding by the U.S. Department of Transportation (DOT), were denied. In May 2002, the DOT Assistant General

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[3] TNT has a limited ground operation in New York, Washington, DC, and Chicago and uses Airborne to deliver elsewhere in the United States.

[4] Astar Air Cargo Facts [http://www.astaraircargo.com/about/astarfacts.html] (Page read December 12, 2003) The referenced revenue figure was for the operations of the airline under the DHL Airways name.

[5] DHL Worldwide Express operates in the United States as a foreign freight forwarder. The U.S. foreign freight forwarder will be referred to in this report as DHLWE-US.

Counsel for International Law informed DHL Airways that it met U.S. citizenship requirements.[6] The handling of DHL Airways' citizenship evaluation raised congressional concerns and Chairman Don Young of the House Committee on Transportation and Infrastructure requested that the DOT Inspector General (DOT-IG) examine the process employed in these proceedings.[7] This request led to a DOT-IG investigation.

The DOT-IG's findings were communicated in March 2003 by letter to Chairman Don Young. In that letter, the DOT-IG found that the informal review process employed by the DOT was not well suited to the evaluation of DHL Airways' citizenship. "As it evolved, it [the evaluation] was complex, contentious and controversial."[8] The DOT-IG went on to note that the more formal process instituted by the DOT did "not have certain other attributes customarily associated with a formal process, namely, access to confidential documents, similar to that provided in the Delta, Northwest, Continental code-share and frequent-flyer program reciprocity proceeding ("Alliance Carriers"), and verification either in the form of certification or sworn statements."[9]

The DOT-IG concluded that "it is in the best interest of the Department that its ultimate decision be perceived as impartial and objective. In this regard, options available to the Department include formal interrogatories under oath, public proceedings where confidential documents are available to third parties under Rule 12, or use of an administrative law judge (ALJ) to conduct fact-finding on significant matters in dispute."[10]

In April 2003, following publication of the DOT-IG's letter, Congress passed, and the President signed, the Emergency Wartime Supplemental Appropriations Act (P.L. 108-11), which included a provision that required the DOT to employ an ALJ to handle the specific docket (OST-2002-013089) that DOT had established to evaluate the citizenship of DHL Airways.[11]

The same Act contained a provision that added specific revenue and ownership criteria, beyond the citizenship evaluation by DOT, that affected the eligibility of certificated air carriers that sought to sell services to the federal government. In

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[6] U.S. Department of Transportation, Docket OST-2001-8732, *In the matter of Registration of DHL Worldwide Express, Inc., as a Foreign Air Freight Forwarder Under Part 297,* Initiated January 18, 2001 and U.S. Department of Transportation, Docket OST-2001-8736, *In re Compliance with U.S. Citizenship Requirements of DHL Airways, Inc., Third Party Complaint of Federal Express Corp. Pursuant to 14 C.F.R.302.404*, initiated January 19, 2001.

[7] "Legislators Press DOT on Citizenship Review," *Aviation Daily,* November 22, 2002.

[8] U.S. Department of Transportation, Office of the Inspector General, *Letter to Representative Don Young on DOT's Air Carrier-Citizenship Review Process,* March 4, 2003, p. 5.

[9] Ibid.

[10] Ibid. p. 6.

[11] P.L. 108-11, Section 2710.

particular, it restricted the federal government from purchasing air transportation services from any carrier that "receives 50 percent or more of its operating revenue over the most recent 3-year period from a person not a citizen of the United States and such person, directly or indirectly, either owns a voting interest in the air carrier or is owned by an agency or instrumentality of a foreign state."[12] Currently the only air carriers whose eligibility is affected are Astar Air Cargo and ABX Air, the primary contractors to DHLWE-US.[13]

The DOT transferred the complaint to an ALJ on April 17, 2003.[14] The ALJ has held at least eight days of public hearings and received thousands of pages of documents and hearing transcripts. On December 19, 2003, the ALJ concluded that Astar Air Cargo is a citizen of the United States. Following the ALJ ruling, parties can file petitions to DOT for discretionary review of the ALJ decision.

Airline Citizenship Criteria

In order for Astar Air Cargo to be deemed a citizen, it must meet statutory ownership requirements, as well as demonstrate that it is under the "actual control" of U.S. citizens. The Astar Air Cargo ownership, operating contracts, and ownership financing differs from what existed when the DOT proceeding started and the carrier operated as DHL Airways. The DOT has ruled that only the current Astar Air Cargo ownership structure is subject to review.[15]

The statutory ownership requirements are as follows: the carrier must (1) be incorporated in the United States; (2) have a president and two thirds of the board of directors and other managing officers who are U.S. citizens; and (3) ensure that no less than 75% of its voting stock is owned or controlled by U.S. citizens.[16] In his review of the DOT proceeding to consider DHL's reorganization (including the change in ownership, management, and operations), the DOT-IG concluded "there is little or no dispute that DHL Airways currently meets these three prerequisites."[17]

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[12] Ibid.

[13] DHLWE-US is used here to note that the contract is with the U.S.-based foreign freight forwarder of DHLWE, the international express carrier. ABX Air, the air operations portion of Airborne Express, was created in August 2003 as a condition of the merger between DHL and Airborne Express. In its most recent 10-Q filing, ABX Air noted, "In the event that FedEx and UPS are successful in their challenge to the citizenship of Astar, a similar challenge will likely be made regarding the citizenship of ABX." ABX Air, Inc., Quarterly Report 10-Q, for the quarter ended Sept. 30, 2003. November 14, 2003. p. 22.

[14] U.S. Department of Transportation, "Order Instituting Formal *De Novo* Review," Docket OST-2002-13089, April 17, 2003.

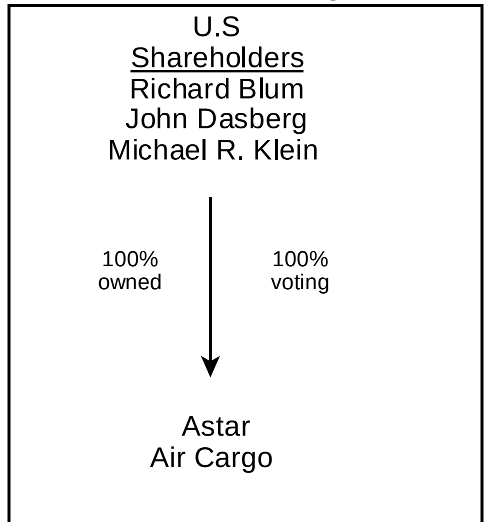
[15] U.S. Department of Transportation, *Order 2003-7-36, In the matter of the citizenship of DHL Airways, Inc.* under 49 U.S.C. Sec. 40102(a)(15), Docket OST-2002-13089, July 30, 2003.

[16] 49 U.S.C. §. 40102(a)(15).

[17] U.S. Department of Transportation, Office of the Inspector General, Letter to Chairman (continued...)

After the DOT-IG concluded his investigation of DOT's handling of the DHL citizenship review in March 2003, and after P.L. 108-11 had become law, DHL Airways was sold to an investor group that included the president of DHL Airways, John Dasberg, and two American citizen partners.[18] DHL Airways was renamed Astar Air Cargo and the ownership change became official in July 2003. The current ownership structure is illustrated in **Figure 1**.

Figure 1
Ownership Structure of Astar Air Cargo



Source: John H. Dasburg, *Testimony in Docket No. OST-2002-23089, p. 6,10.*

Although there is little dispute over whether Astar Air Cargo meets the statutory ownership requirements, the dispute centers on whether DHLWE is in a position to exercise "actual control" over Astar Air Cargo. According to the DOT-IG, "the Department of Transportation, and the Civil Aeronautics Board (CAB) before it, quite correctly, have interpreted these requirements to mean that U.S. citizens be in control of a carrier, both in form and in fact. To this end, the Department looks at the totality of the circumstances to determine whether the carrier is, in fact, under the 'actual control' of U.S. citizens."[19]

In response to DOT's handling of the DHL Airways/Astar Air Cargo case, Congress, in recently enacted Federal Aviation Administration Reauthorization legislation, codified the requirement that United States air carriers be effectively controlled by United States citizens (P.L. 108- 176; H.R. 2115, Sec. 807).[20] The

[17] (...continued)
Don Young on DOT's Air Carrier-Citizenship Review Process (DOT-IG Letter to Chairman Young). March 4, 2003, p. 3.

[18] The other two partners are Richard C. Blum, chairman of San Francisco-based Blum Capital Partners LP, a private equity firm, and Michael R. Klein, a Washington, D.C. business executive and lawyer who is a partner in the law firm Wilmer, Cutler, and Pickering. Armbruster, William, "DHL Airways Acquisition Finalized," *Journal of Commerce Online*, July 15, 2003 (page read December 8, 2003 using Factiva).

[19] U.S. DOT. IG Letter to Chairman Don Young, March 4, 2003. p. 3.

[20] Sec. 807 of P.L. 108-176 (Vision 100 – Century of Aviation Reauthorization Act) (Conference report H.Rept. 108-334) was introduced as S.Amdt. 920 to S. 824, the Aviation Investment and Revitalization Vision Act, by Senator Ted Stevens and approved by the Senate on June 12, 2003.

statutory basis for the decision of the ALJ was the U.S. Code as amended by this legislation.[21]

The question of "actual control" of Astar Air Cargo is the main issue in dispute. The DOT-IG noted seven factors that are most commonly cited to determine actual control.[22]

(1) *Control via Super-Majority or Disproportionate Voting Rights* - minority foreign owners may not have disproportionate influence with their voting rights.
(2) *Negative Control/Power to Veto* - minority foreign owners cannot possess veto rights over major corporate decisions.
(3) *Buy-Out Clauses* - a foreign entity may not be entitled to exercise buy-out clauses that, if exercised, would jeopardize the air carrier's financial or operational ability to continue in business.
(4) *Equity Ownership* - the maximum total foreign-equity ownership of an air carrier typically permitted by the Department may be up to 49%.[23]
(5) *Significant Contracts* - contracts with foreign entities may not be used to control the U.S. air carrier.
(6) *Credit Agreement/Debt* - debt-instrument clauses or bankruptcy agreements cannot allow a foreign entity to control the air carrier.
(7) *Family Relationships/Business Relationships* - a foreign citizen may not exert control over another carrier through a U.S. citizen family member or business associate.[24]

The DOT-IG noted that the first three factors were not cited by the UPS and FedEx in their initial petition. The arguments relating to the remaining factors were presented to DOT by FedEx and UPS during its initial evaluation of DHL Airways and to the ALJ in his evaluation of ASTAR Air Cargo.[25] The issues associated with these latter four factors, as argued by the parties and addressed by the ALJ, are discussed below.

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[21] Burton S. Kolko, *Recommended Decision of Administrative Law Judge in Docket No. OST-2002-13089* (ALJ Decision), United States Department of Transportation, Office of Hearings, December 19, 2003, p. 35.

[22] DOT-IG Letter to Chairman Young, pp. 8-9.

[23] Foreign individuals and entities cannot own more than 25% of voting shares.

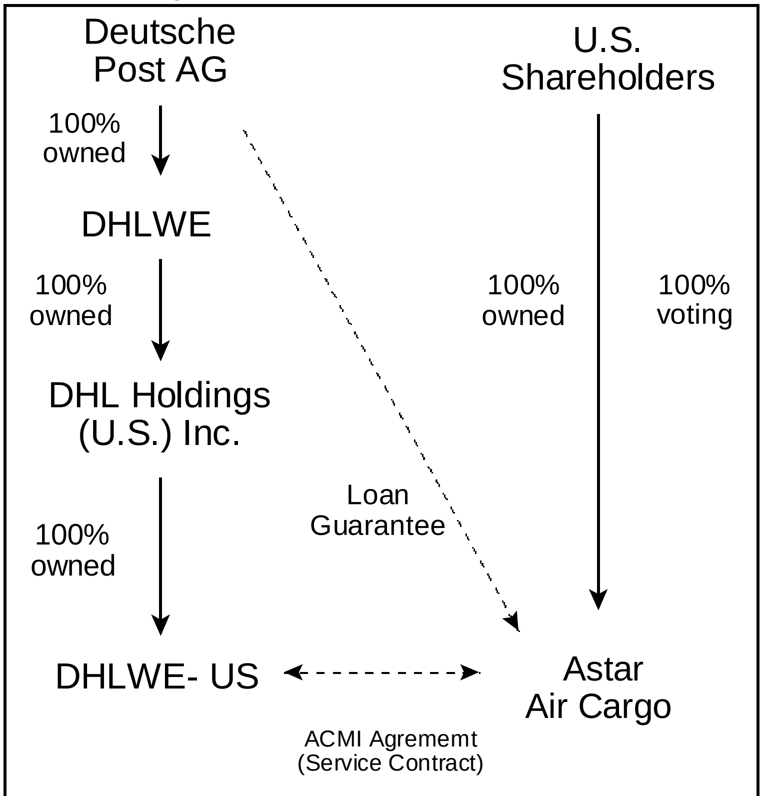
[24] DOT-IG Letter to Chairman Young, pp. 8-9.

[25] As the sale of DHL Airways to the Astar Air Cargo investors was completed before the ALJ held hearings, his evaluation was restricted to Astar Air Cargo.

Astar Air Cargo: "Actual Control" Issues

Astar Air Cargo has substantial business relationships (see the dotted lines in **Figure 2**) that tie it with both DHLWE's United States subsidiary, DHLWE-US, and its ultimate parent company, Deutsche Post. The details of these business relationships, the process through which existing management were hired, and the manner in which the current owners made their purchase, create the appearance of an "actual control" issue and form the focus of the evidence presented to the ALJ on

Figure 2
Business Relationships Between Astar Air Cargo, DHLWE, and Deutsche Post



Sources: Deutsche Post, Slide presentation entitled, *Analysts' Conference*, April 8, 2002, p.26, and John H. Dasburg, *Testimony in Docket No. OST-2002-23089, pp. 6,10*.

the factual issues subject to dispute.[26]

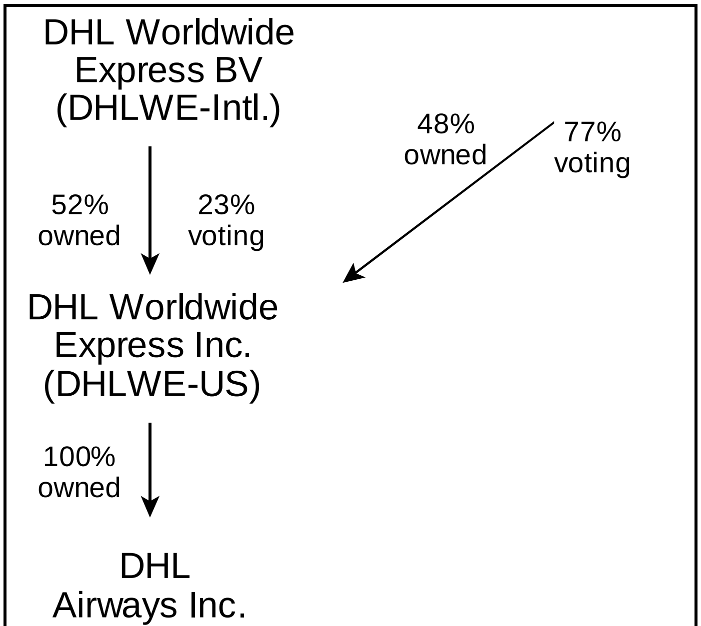
Equity Ownership. FedEx and UPS have taken the position that the shifting ownership structure of DHL Airways from what existed at the time that Deutsche

[26] DOT-IG Letter to Chairman Young, pp. 6-11.

Post gained control of the majority of DHLWE indicates that DHLWE had control over the ultimate owners of DHL Airways and, subsequently, Astar Air Cargo.

As it was consolidating ownership of DHLWE, Deutsche Post faced the problem of restructuring DHLWE's United States operations to rationalize ownership, to coordinate operations with its international network, and to continue to have access to the airlift that DHL Airways provided to meet customer demand in the United States and abroad.[27] Complicating this challenge, Deutsche Post documents indicate that it was concerned that DHL Airways may not have met U.S. statutory ownership requirements even before Deutsche Post purchased the majority of DHLWE shares.[28] (**See Figure 3**)

Figure 3
DHL Airways Ownership Structure Prior to Deutsche Post Purchase



Source: Deutsche Post, Slide presentation entitled, *Analysts' Conference*, April 8, 2002, p.26

To meet the statutory requirement and continue to have access to the services provided by DHL Airways, Deutsche Post sold an ownership stake in DHL Airways to William Robinson, a United States citizen and one of the founders of DHL International. Following the sale of a stake to Robinson, DHL Airways apparently

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[27] Prior to Deutsche Post's purchase of DHLWE, DHL Airways, like many of DHLWE's local operating entities, was owned by both the corporation and citizens of the countries within which DHLWE operated.

[28] Deutsche Post. Slide presentation entitled *Analysts' Conference*, April 8, 2002, p. 26

met the statutory ownership criteria, with Robinson owning 55% of the total shares and 75% of the voting shares in DHL Airways.

In his letter to Chairman Dan Young, the DOT-IG recommended that DOT address whether the allegation that Deutsche Post owned a majority stake in DHL Airways prior to the reorganization of DHLWE was true (see **Figure 3**) and, if so, whether that has any legal significance given the later ownership structure.[29]

In its brief, FedEx/UPS[30] argued that Deutsche Post and DHLWE orchestrated the transitions that ultimately resulted in the creation of Astar Air Cargo.[31] Astar Air Cargo argued that only the Astar Air Cargo's ownership and management structure was relevant, given the direction of DOT to the ALJ to evaluate only the Astar Air Cargo ownership structure and not any structure that preceded it. Astar Air Cargo maintains that its structure meets the specific statutory requirements regarding citizenship of owners and management.[32] As to the FedEx/UPS charge of orchestration by DHLWE, Astar Air Cargo argued that its current owners' decision to purchase the airline was made independently and was not part of a Deutsche Post-directed plan to restructure DHL Airways to meet U.S. citizenship requirements.[33]

In his decision, the ALJ rejected the arguments of FedEx/UPS. He stated that he found no merit in the "contention that a continuum of control exists."[34] He noted that some questions about control over DHL Airways may have existed from provisions in the agreements between DHL Airways and DHLWE but they had been terminated with the sale of DHL Airways and had no relevance to the current control of Astar Air Cargo.[35]

Significant Contracts. Astar Air Cargo provides service to DHLWE-US using an Aircraft, Crew, Maintenance, and Insurance agreement (ACMI agreement). ACMI agreements are common in the airline industry. For example, FedEx has two ACMI agreements with Air T, Inc. (Air T) subsidiaries Mountain Air Cargo, Inc. and CSA Air, Inc. that employ small planes to deliver FedEx shipments to smaller markets. Both DHLWE-US and UPS purchase dedicated air transportation services using small planes to serve small markets in the United States from Ameriflight. Because UPS does not have the right to operate flights within the EU, it employs Star

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[29] Department of Transportation, Office of the Inspector General, *Letter to Representative. Don Young on DOT's Air Carrier-Citizenship Review Process,* March 4, 2003, pp. 8.

[30] FedEx and UPS filed joint briefs with the ALJ. Therefore when the actions of the parties jointly are referred to, "FedEx/UPS" will be used.

[31] *Post Hearing Brief of FedEx Express and UPS in the matter of the citizenship of DHL Airways N/K/A Astar Air Cargo, Inc.* (FedEx/UPS Brief), Docket OST-2002-13089, November 10, 2003, pp. 22-29.

[32] John H Dasburg, *Testimony,* presented in Docket No. OST-2002-13089, pp. 5-6.

[33] Astar Air Cargo, Inc.'s Post Hearing Brief in the matter of DHL Airways, Inc., (Astar Brief), docket No. OST-2002-13089, October 31, 2003, pp.16-21.

[34] ALJ Decision, p. 12.

[35] Ibid.

Air, a Danish citizen airline and a subsidiary of the Maersk Corporation, to provide airlift within the EU. These contracts provide examples of the ACMI contracts that are typically used by express carriers when it is more economical to contract for air service or when airline citizenship restrictions prevent the express carrier from flying the planes themselves.

Under the 11-year ACMI agreement between DHLWE-US and Astar Air Cargo, Astar is responsible for providing air lift (aircraft and crew) between points and on a schedule agreed to by DHLWE-US. This contract provides the air lift that DHLWE-US needs to link its ground operations within the United States and overseas and ensure that time-definite delivery commitments are met. Because Deutsche Post, DHLWE, and DHLWE-US are foreign entities, they are required by U.S. law to contract with a U.S. citizen carrier to offer domestic airlift. If Astar Air Cargo is deemed to be a U.S. citizen carrier, DHLWE can continue to use their services. Otherwise it will need to find alternative airlift capacity from one or more U.S. citizen carriers capable of meeting its needs.[36] Regardless of who provides the airlift, the air network needs of DHLWE would be identical.

The details of the Astar Air Cargo ACMI agreement have been a central focus of the proceeding before the ALJ as contracts specify in detail the actions of all parties and by their nature could limit the actions of parties to such a degree as to create a situation that would prevent independent action of the contractor, in this case Astar Air Cargo. The FedEx/UPS critique of Astar Air Cargo's ACMI contract has focused on the following six issues:

- Astar Air Cargo generates 90% of its revenue from this relationship and is considered to be financially dependent on DHLWE-US business. UPS and FedEx argue that this dependence will grow as Astar Air Cargo, which now generates 85-90% of its remaining business from the Federal government, loses its remaining business with the U.S. military as a result of the Emergency Wartime

[36] Contracting out the air lift required for a freight forwarder's network has a precedent following closure of Emery Air Freight's (now Menlo Forwarding) subsidiary airline. Emery then contracted with Ryan Air International to provide the dedicated air lift that it required. In addition to Astar Air Cargo, DHLWE-US currently contracts with both Northwest Airlines and Ameriflight to serve routes out of DHLWE-US's Cincinnati/Northern Kentucky hub. Other carriers are currently operating aircraft, which could conceivably replace Astar Air Cargo, should it be deemed not to be a U.S. citizen. These alternatives include Kitty Hawk Cargo and Ryan International Airlines, among others.

Supplemental Appropriations Act.[37] Based on hearing testimony, ASTAR was recently forced to return one of its two non-dedicated aircraft to the lessor when its contract for military cargo was terminated because it could not replace the lost cargo.[38] FedEx and UPS further argue that the market for domestic air cargo services is so weak that finding non-governmental customers would be exceptionally difficult.[39]

FedEx/UPS contend that Astar's reliance on DHLWE for 90% of its revenue provides evidence that Astar Air Cargo is under the control of a foreign entity. In support of that contention, they cite the 50% test established in section 2710 of the Emergency Wartime Supplemental Appropriations Act:

> an air carrier shall not be considered to be effectively controlled by citizens of the United States if the air carrier receives 50 percent or more of its operating revenue over the most recent 3-year period from a person not a citizen of the United States and such person, directly or indirectly, either owns a voting interest in the air carrier or is owned by an agency or instrumentality of a foreign state...[40]

FedEx/UPS conclude, that "ASTAR's concession that DHL has provided over 50% of ASTAR's revenues since its 2001 reorganization should be enough, in and of itself, to justify a finding that DHL controls it."[41]

The ALJ agreed that Astar Air Cargo hardly exists apart from DHLWE's need for its services. However, he disagreed with the contention that DHLWE could credibly threaten Astar Air Cargo with the loss of its business. Without a credible threat, he did not believe that the predominant customer had the ability to control the supplier.[42]

- The ACMI agreement limits ASTAR Air Cargo's ability to sell services to third parties using the equipment dedicated to DHLWE-US and restricts how it prices air transportation services to third parties using non-dedicated aircraft. Astar Air Cargo is prohibited from selling services using dedicated aircraft to express delivery companies with "annual revenues in excess of $5 billion (other than the United States Postal Service or any affiliate of [DHL]

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[37] FedEx/UPS Brief, *pp. 30-32*.

[38] Ibid., p. 70.

[39] Ibid. pp.65.

[40] P.L. 108-11.

[41] FedEx/UPS Brief, pp. 29-30.

[42] ALJ Decision, p. 24.

Worldwide)."[43] This effectively prohibits Astar Air Cargo from using the aircraft dedicated for the use of DHLWE-US for transportation needs of its direct competitors: FedEx, UPS, or TNT. With respect to pricing, FedEx/UPS state "the ACMI Agreement requires ASTAR to price such services 'at the incremental cost and expense thereof.'"[44] FedEx/UPS argue that these restrictions effectively allow DHL to control the price at which Astar Air Cargo may offer services to third parties.[45] Astar Air Cargo counters that these provisions do not apply to business outside of air transportation services and does nothing more than set a price floor on business that Astar solicits from other customers, which protects DHLWE-US from cross-subsidizing Astar's third-party business. FedEx/UPS note that there is no evidence that Astar intends to enter any other line of business and, furthermore, points to its financing agreement with Boeing that expressly prohibits Astar from engaging in other lines of business.[46] As to the cross-subsidy argument, FedEx/UPS counter that to the extent that "the ACMI agreement was intended to prevent Astar from using its own profits to support third-party business...DHL not only may dictate price, but may tell ASTAR how it may spend its profits, thus providing influence over ASTAR's most fundamental policy decisions."[47]

The ALJ rejected FedEx/UPS's arguments relating to limitations on seeking outside business. "That the carrier may procure and develop meaningful air freight business independent of DHLWE demonstrates in itself that DHLWE does not control it. Control rests in the hands of Astar [Air Cargo] because it maintains the power of choice to pursue the business model it crafts."[48]

- Astar Air Cargo relies on DHLWE-US to provide ground services that are necessary to meet its commitments to DHLWE-US. These ground services include loading and unloading cargo from aircraft and delivery vans, loading and unloading cargo from the cabin and belly of the aircraft, and driving and operating various transport vehicles and ground service equipment necessary to transport containers between airplanes and load and off-load cargo. FedEx and UPS argue that Astar Air Cargo's reliance on DHLWE-US for the provision of ground services precludes it from seeking business from other customers because it does not have ground support other

[43] ACMI Service Agreement between DHL Worldwide Express, Inc. and Astar Air Cargo (ACMI Agreement), Inc., Section 4.1(a)(ii).

[44] ACMI Agreement, Section 4.2.

[45] FedEx/UPS Brief, p. 61.

[46] Ibid., p. 64.

[47] Ibid., p. 63.

[48] ALJ Decision, p. 25.

than that which DHLWE-US provides to offer other customers.[49] Astar Air Cargo counters that it is a common industry practice to use third-parties to provide ground services and that Astar Air Cargo trains all DHLWE-US employees that perform the ground services for it.[50] According to the ACMI Agreement, the use by Astar of DHLWE equipment and facilities is subject to two important conditions: (1) ASTAR must "reasonably" determine that it needs DHL's equipment or facilities; and (2) it can use that equipment and facilities unless they "are fully utilized such that they are not available for use by ASTAR."[51] FedEx and UPS claim that "ASTAR's ability to serve third parties depends on the availability of DHL resources and DHL's willingness to provide them."[52]

The ALJ rejected FedEx/UPS's argument because Astar Air Cargo has complete control over whom it hires to perform the ground operations that DHLWE now performs. In particular, he notes that there is no contractual obligation to hire DHLWE employees and the decision to use DHLWE employees was Astar Air Cargo's.[53]

- The cost-plus nature of the contract and attendant audit rights are said to grant DHLWE-US "a controlling influence over ASTAR's management or policies."[54] This argument focuses on the nature of cost-plus contracts. Under such contracts, the customer has an interest in ensuring that he is not overcharged for services rendered. As such, the customer, here DHLWE-US, is granted audit rights to review the books of the supplier, in this case Astar Air Cargo. The argument contends that "the audit process is intrusive and likely to raise fundamental, second-guessing type questions by the persons conducting the audit" and that people possessing audit rights in cost-plus contracts "have a substantial ability to influence the audited person's activities."[55] Astar Air Cargo counters by arguing that the audit provisions in the cost-plus contract are limited, standard in cost-plus contracts, and subject to third party arbitration in the case of dispute.[56] The ALJ sided with Astar Air Cargo in regards to ACMI's cost-plus and audit provisions.[57]

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[49] FedEx/UPS Brief, pp. 76-80.

[50] Astar Brief, pp. 44-45.

[51] ACMI Agreement, Section 4.3.

[52] FedEx/UPS Brief, p. 80.

[53] ALJ Decision, p. 30.

[54] Ibid., p. 56.

[55] Ibid.

[56] Astar Brief, pp. 45-46.

[57] ALJ Decision, p. 31.

- The ACMI agreement appears to impose significant barriers for Astar Air Cargo's current owners that may prevent them from selling more than half of their interests in the company. These barriers come from contract provisions that require consultation with DHLWE-US on certain types of ownership changes and DHLWE-US's ability to change significant provisions of the ACMI agreement that would adversely affect Astar Air Cargo upon change of ownership.[58] These contract provisions may result from DHLWE-US's interest in ensuring that Astar Air Cargo is not sold to an entity that would result in a question of citizenship or that entity being under the control of one of DHLWE-US's direct competitors. FedEx/UPS contend that these restrictions, regardless of their rationale, create a situation that gives DHLWE control over the ability of Astar Air Cargo owners to sell the stake in the company. Astar Air Cargo counters that its owners have a wide range of options for selling shares in the company without triggering the consultation provision and the potential for financial risks to Astar Air Cargo's new owners. These options include selling the equity in Astar Air Cargo while retaining at least 50% of the voting rights, selling the equity and voting power in a dispersed offering to the public or private investors, so long as no individual or group owned more than 50% of the voting rights, and selling their interest in the holding company that owns the stock in Astar Air Cargo, as the ACMI agreement contains no provisions restricting sale of the holding company.[59] The ALJ concluded that the "change of control" provisions only restrict a fraction of Astar Air Cargo owners rights to transfer their ownership stakes, and he did not view those provisions as reflecting significant control by DHLWE over Astar Air Cargo.[60]

- Control requires that the owners bear substantial residual risk, or risks associated with the possibility of liquidation. The contractual relationship between Deutsche Post/DHLWE and Astar Air Cargo may be so favorable toward Astar that it removes all residual risks of ownership for the three United States investors of an Astar Air Cargo. The parties disagree as to the risk that the three Astar Air Cargo investors bear. FedEx/UPS maintain that "In most transactions, the risk of loss transfers from seller to buyer at closing. The evidence shows that DHL transferred none of its risk to the Dasburg group on July 14, 2003. Instead, and consistent with its

[58] Section 13.1(h) of the ACMI Agreement requires that DHLWE-US be notified by Astar Air Cargo prior to the change in control. Sections 6.1 and 10.5 of the ACMI Agreement both allow DHLWE-US to modify the agreement in ways that would financially hurt the new owners and Section 13.1(i) increases the on-time performance requirement.

[59] Astar Brief, pp. 49-52.

[60] ALJ Decision, p. 23.

> treatment of ASTAR as a cost center, DP/DHL assumed all risks."[61] The parties differ in regard to the liquidation value of Astar Air Cargo assets, the costs associated with liquidation, and the financial commitments that DHLWE-US would have to Astar Air Cargo and its creditors if Astar Air Cargo was forced to shut down. Astar Air Cargo also challenges the premise that a favorable contract that minimizes risk to Astar Air Cargo investors would represent the potential for control.
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> The ALJ did not address the role that residual risk has on the question of control directly. Instead he addressed the impact that contractual terms that eliminated the risk associated with DHLWE pulling its business away from Astar Air Cargo would have on control. He concluded that these terms put Astar Air Cargo in a better position as they reduced DHLWE ability to control Astar Air Cargo by trying to put it out of business.[62]

In summary, the ALJ rejected most of FedEx/UPS's arguments relating to the ACMI agreement.

Credit Agreements/Debt. This third citizenship evaluation factor centers on contentions that the methods that Astar Air Cargo investors used to finance its purchase and working capital could create a situation that places Astar Air Cargo under foreign control.

In regard to financing, Astar Air Cargo investors borrowed $50 million from Boeing Capital for the purchase of DHL Airways. This loan is secured by the required ACMI agreement payments that Astar Air Cargo receives from DHLWE-US and those payments are guaranteed by DHLWE-US's ultimate corporate parent, Deutsche Post. Furthermore, to ensure repayment, the principal on the note is paid directly to Boeing through a lock-box arrangement.[63]

FedEx/UPS contend that the financial guarantee makes the financing of the purchase of Astar Air Cargo dependent on DHLWE-US and Deutsche Post.[64] They argue that "the record contains no evidence that the Dasburg group could have obtained the financing without DP/DHL [Deutsche Post/DHLWE]. With a DP guaranty in hand, it is irrelevant as to whom actually found Boeing. The financing was predicated on the DP credit and Boeing made sure it was not exposed to Astar performance risk."[65]

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[61] FedEx/UPS Brief, p. 51.

[62] ALJ Decision, p. 28.

[63] Presumably the principal payment is only a portion of the ACMI payment from DHLWE-US and Astar Air Cargo.

[64] FedEx/UPS Brief, pp. 45-49.

[65] FedEx/UPS Brief, pp. 46-47.

Astar Air Cargo argues that the loans were procured by the investors, the payment guarantees and the loan were obtained independently, and that there is no evidence that the guarantee can be withdrawn and only withdrawal of the guarantee can create a situation in which the guarantor, Deutsche Post, could have control over Astor Air Cargo.[66]

In examining the guarantee, the ALJ found that while the guarantee undoubtedly made Boeing Capital's decision easier, the evidence does not show that Boeing Capital would not have agreed to finance the purchase on presumably favorable terms without the guarantee. He notes that the guarantee raises eyebrows but does not show control of Astar Air Cargo by Deutsche Post.[67]

Also in regard to financing, Astar Air Cargo negotiated that all receivables associated with equipment maintenance costs that were booked by DHL Airways, including receivables from DHLWE-US, should remain with Astar Air Cargo and not with DHLWE-US. This receivable is booked as an asset on Astar Air Cargo's books. This asset, valued at $61 million, provides Boeing Capital additional assurance that its loan will be repaid. The parties disagree whether DHLWE's agreement to leave the asset with Astar Air Cargo resulted in DHLWE creating the environment in which Astar Air Cargo could get a loan, and therefore resulted in DHLWE controlling Astar Air Cargo's ability to get credit. The ALJ concluded that the receivable was a legitimate expense owed DHL Airways/Astar Air Cargo for "services already rendered and was not something Deutsche Post or its subsidiaries can legally refuse to pay."[68]

Family Relationships/Business Relationships. The final citizenship evaluation factor focuses on questions relating to the relationship between the current management and ownership team of Astar Air Cargo and DHLWE-US, DHLWE, and Deutsche Post. Astar Air Cargo's president, John Dasburg and its third investor, Michael Klein, have connections that, at a minimum, raise questions about the potential for control.[69]

John Dasburg, the president of Astar Air Cargo, was originally hired by DHL Airways at the time that DHLWE-US was a minority owner of DHL Airways and had a member on the board of DHL Airways. The hiring process began shortly after the death of the previous president of DHL Airways. During the hiring process Mr. Dasburg met with John Fellows, DHLWE-US's chief executive; Uwe Dörkin, DHLWE CEO; and Klaus Zumwinkel, Deutsche Post president. Both Mr. Fellows and Mr. Dörkin were decision makers in the Dasburg hiring, as would be expected given DHLWE-US's ownership stake in DHL Airways and position on the DHL Airways board. FedEx/UPS contend that both the hiring process and the subsequent negotiation for the sale of DHL Airways to a group headed by an individual hired with input from Deutsche Post, DHLWE, and DHLWE-US indicates a business

[66] Astar Brief, pp. 54-55.

[67] ALJ Decision, p. 17.

[68] ALJ Decision, p. 16.

[69] FedEx/UPS Brief, pp. 22-29 and 75-76.

relationship that creates the opportunity for DHLWE-US and Deutsche Post to control the purchasers of Astar Air Cargo.[70] In response, Astar Air Cargo argued that neither the hiring process nor the purchase negotiating process created a situation in which DHLWE or Deutsche Post controlled the actions of Astar Air Cargo. Furthermore, Astar notes that Dasburg was employed by DHL Airways for a total of 3½ months prior to the purchase of Astar Air Cargo, which would not indicate that Dasburg has strong ties or commitments to DHLWE-US, DHLWE, or Deutsche Post.[71] In regards to Dasburg, the ALJ concludes that his actions were independent of DHLWE or Deutsche Post. He notes that Dasburg took the job with DHL Airways clearly intending to buy the company and that his credentials lent credibility to Astar Air Cargo both as a U.S. citizen carrier and as a carrier that would be capable of meeting the exacting service standards that DHLWE would require.[72]

With respect to Michael Klein, a potential conflict is alleged to occur because he is a partner in the law firm of Wilmer, Cutler, & Pickering, which represents Astar, various DHL entities, and Deutsche Post.[73] FedEx/UPS contend that Klein's partnership in Wilmer, Cutler, & Pickering, a firm that generates fees from DHLWE-US, DHLWE, Deutsche Post and firms with connections to the German government (Lufthansa and Deutsche Telekom), creates a situation in which influence or pressure could be exerted on behalf of Deutsche Post or the German Government. In the view of FedEx/UPS, "Deutsche Post can assert influence over Astar through means as simple, and untraceable, as a water cooler conversation between Klein and another Wilmer Cutler & Pickering partner, be it someone on the other side of the ethical wall or member of the firm's management responding to pressure from the Germans."[74] In response, Astar Air Cargo asserts that there is no evidence that control could be exercised through Klein's law firm. Finally, Astar Air Cargo notes that Wilmer, Cutler & Pickering has set up appropriate procedures to separate Mr. Klein from any influence from other partners dealing with Deutsche Post, or DHL entities.[75]

The ALJ stated that he could not rely on nonlegal or self regulatory safeguards as they exist primarily for the client's benefit and can be modified, changed or ignored without the Department [DOT] – or anyone else's – knowledge.[76] However, he concluded that the internal conflicts within Wilmer, Cutler, & Pickering, and the "whatever it might suggest in terms of appearances of impropriety does not show that Klein or Astar, is actually controlled by the foreign entities."[77] The ALJ concluded that the evidence, presented before him, offered "no reason to suspect that because

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[70] FedEx/UPS Brief, pp. 22-29.

[71] Astar Brief, p. 57.

[72] ALJ Decision, p. 5 and p. 15.

[73] FedEx/UPS Brief, pp. 75-76.

[74] Ibid., p.75.

[75] Astar Brief, p. 57.

[76] ALJ Decision, p. 32.

[77] Ibid.

of common representation Klein and his group have not been (and are not) completely separate and independent of Deutsche Post, DHLH and DHLWE."[78]

In deciding in Astar Air Cargo's favor in nearly all of the specific issues as well as the overall question of "actual control," the ALJ focused on two questions. First, what is the nature of the relationship between Astar Air Cargo and DHLWE? He noted that even though DHLWE is a demanding client with the specific requirement that Astar Air Cargo's services mesh smoothly with DHLWE's other operations, and Astar Air Cargo has little other business, the relationship is simply that Astar Air Cargo is a provider of services and DHLWE is its client. The ALJ concluded that the provision of a service by Astar Air Cargo that produced a portion of the activity necessary to provide a seamless integrated network for package delivery need not result in "actual control."[79]

The second question is, "who has the power to direct or dominate ASTAR [Air Cargo]?"[80] The ALJ's response is "and the answer is ASTAR."[81] He concludes that "an examination of the question in fact shows that ASTAR is, so to speak, its own person; it is functionally independent of DHLWE. Neither DHLWE nor the DHL network can be said to be in actual control of ASTAR in any relevant or meaningful sense."[82]

Issues Following the Proceeding

Following the ALJ decision, the DOT will accept petitions from parties for discretionary review of the ALJ decision. The DOT will issue a final ruling shortly thereafter.

The Astar Air Cargo decision may have implications for negotiations between the United States and the European Union (EU) on opening aviation markets in the United States and Europe.[83] American cargo carriers are interested in greater access to European markets, just as European carriers are interested in access to the U. S. market. The underlying public policy issue in this instance is significantly broader than the DHL/Astar citizenship case.

At present, the United States and the EU are engaged in negotiations that seek to replace existing bilateral agreements with EU member states with a single, comprehensive agreement for an "Open Aviation Area" between the United States and the EU. Negotiations will cover rules governing market access (routes, capacity,

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78 Ibid. DHLH is DHL Holdings, the U.S. holding company for all DHLWE's interests in the United States.

79 Ibid., p. 33.

80 Ibid.

81 Ibid.

82 Ibid., p. 32.

83 Don Phillips, "U.S., EU. to Hold Talks on Opening Aviation Markets," *The Washington Post*, June 25, 2003, P. A7.

frequency), the setting of air fares, and the effective application of competition. Of critical importance to airlines on both sides of the Atlantic are discussions over how or whether to open each side's internal/domestic market to airlines of the other side. Both sides are interested in the removal of restrictions that apply to foreign ownership and control.[84] In the United States, removal of such restrictions would require Congressional action.

An Open Aviation Area may be important for creating the conditions to allow fair and open competition between U.S. and foreign-owned global express carriers. American carriers believe that open skies could provide them with substantial benefits.[85] As demand for high-quality, global express services expand, carriers desire the ability to offer global integrated air networks both in home markets and overseas. As discussed, under U.S. law carriers providing transportation to meet this demand within the United States must be corporate citizens. Most other countries have similar requirements. In the absence of an Open Aviation Agreement, it is unlikely that either the United States or the EU will unilaterally relax restrictions on ownership and control. Recent congressional action clearly indicates a concern that foreign-owned companies not be allowed to exploit loopholes in U.S. law and regulation.

The Astar Air Cargo case also illuminates the importance of access to air markets for U.S. express carriers in other parts of the world where they compete with the European express carriers DHL and TNT. For example, improving access for U.S. carriers in Asia will go beyond improving their ability to serve express customers between Asia and the United States. These changes also improve the American carriers' competitive position to handle shipments within Asia and between Asia and Europe. This is illustrated by the impact that the expansion of air cargo market access granted FedEx and UPS in Hong Kong had on the service that they offered between Europe and Asia. The new service authority granted these companies allowed them connect their substantial Asian networks to their European hubs in Paris and Cologne respectively.[86] UPS, for example, with its expanded authority to handle cargo from Hong Kong to Cologne, can link its Asian hubs in Hong Kong, the Phillippines, and Singapore to Europe using UPS owned or leased aircraft and UPS employee crews. FedEx can do the same with the flights that it was granted. Both carriers also expanded service between Hong Kong and their hubs in the Phillippines. Neither of the global, Europe-headquartered, express carriers has the same capabilities.

Open skies agreements with smaller countries can also have a significant impact for U.S. cargo carriers in their ability to compete with DHL and TNT. Both UPS and FedEx have announced intentions to expand operations in Thailand following the

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[84] Adrian Schofield, "Negotiators Must Not Draw Out U.S./EU Talks, Byerly Says," *Aviation Daily*, November 7, 2003, p. 1.

[85] Angela Greiling Keane, "Early Cargo Harvest?" *Traffic World*, October 20, 2003, p. 31.

[86] "DOT Selects U.S.-Hong Kong All Cargo Carriers," *Journal of Commerce Online*, September 12, 2001 as viewed on Factiva, December 22, 2003.

signing of an open skies agreement between Thailand and the United States.[87] Initially, UPS plans to expand the number of flights between Thailand and its hub in the Phillippines and is studying the potential of Thailand as a hub bridging Indochina (Vietnam, Laos and Cambodia) and the Indian subcontinent.[88] FedEx's plans in Thailand appear to be moving in a similar direction.[89] The EU would need to negotiate a similar agreement with Thailand in order for DHL and TNT to do the same without using the services of contracted air lift.

Intense competition for business in fast growing Asia-to-Europe and Asia-to-North America traffic lanes requires the provision of seamless service in more places than ever before. As all express carriers expand their business outside of their home markets in the United States or the EU, the interest in open skies agreements will increase. Congressional action may be required to modify or remove those restrictions in the United States in conjunction with future open skies agreements.

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[87] "UPS Sees Hub Role for Bangkok, Thailand," *Bangkok Post,* October 31, 2003 as viewed using Factiva December 22, 2002 and Srisamorn Phoosuphanusorn, "FedEx to Expand in Thailand As Open Skies Pact Takes Hold," *Bangkok Post,* October 22, 2003 as viewed using Factiva, December 22, 2002

[88] "UPS Sees Hub Role for Bangkok, Thailand," *Bangkok Post,* October 31, 2003 as viewed using Factiva, December 22, 2002

[89] Srisamorn Phoosuphanusorn, "FedEx to Expand in Thailand As Open Skies Pact Takes Hold," *Bangkok Post,* October 22, 2003 as viewed using Factiva, December 22, 2002