

Why Amazon Is Taking To The Skies

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Online sales continues to skyrocket year over year, putting more and more pressure on logistics companies like FedEx Corp. and United Parcel Service Inc. to deliver the dizzying number of packages consumers are buying. At no time is that pressure felt more than the holidays, which has long been known as the peak season for these legacy logistics firms.

FedEx and UPS have moved heavy package loads every holiday season for decades, but the new spike in volume is proving that not even their time-tested infrastructure was prepared for this new age of e-commerce.



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In light of this increasing pressure, UPS announced on June 19, 2017, that it will impose a new peak charge during selected weeks during the upcoming holiday season. (No word yet on whether FedEx intends to follow its lead, and whether these costs will be passed down to consumers.) Amazon.com Inc., of course, is one of the primary drivers of this high-volume trend, but it also has a well-earned reputation for relentlessly searching for new efficiencies in its endless quest to cut costs.

Last year, without much fanfare, Amazon began making moves to cut out the middlemen entirely. Now those moves are coming into clearer focus and demonstrating just how prescient Amazon's leadership was. As soon as later this year, Amazon's thoughtful planning may even help its customers skip these higher holiday fees entirely.

In early 2016, Amazon created Amazon Prime Air, entering into agreements with air cargo companies Air Transport Services Group (ATSG) and Atlas Air Worldwide Holdings Inc. to create an Amazon-only fleet of aircraft. ATSG will lease and operate for Amazon 20 Boeing 767 freighter aircraft for up to seven years.

According to ATSG's website, a single Boeing 767-300SF can swallow 16,034 cubic feet of volume and carry a payload of nearly 125,000 pounds. Meanwhile Atlas will lease and operate for Amazon 20 more Boeing 767 aircraft for as many as ten years. As of the end of last year, ATSG already had 14 aircraft in the air for Amazon and expected all 20 to be operating by July 2017.

Atlas is currently operating at least four planes with the entire fleet expected to be deployed by the end of 2018. By then, Amazon will have pulled off a remarkable feat, building an entire fleet of 40 planes in a

little more than two years, and it won't have to share a single cubic foot of that cargo volume with anyone else.

That's not all. In conjunction with the aircraft deals, earlier this year Amazon began operating a massive hub operation at the Cincinnati/Northern Kentucky Airport (CVG). Aircargoworld.com reported that Amazon's fulfillment facility at CVG will grow to accommodate as many as 200 daily takeoffs and landings by the Amazon Prime Air fleet and will include a 350,000-square-foot loading wing and parking positions to accommodate more than 100 aircraft, making it Amazon's largest processing facility in the world.

With CVG as the hub, Amazon Prime Air flights are operating from Ontario, California; San Antonio; Seattle; Tampa; and Charlotte among other spokes in the wheel. Few companies besides Amazon even boast the resources to go from zero aircraft to a major player in air cargo this quickly.

In different ways, both Amazon and UPS are taking advantage of recent events and the seasonal effect of the holidays. UPS reported that in 2016, growth in e-commerce, and particularly demand for residential products, had outpaced traditional bricks-and-mortar businesses. UPS stated in its 2016 annual report that given "these trends, our products most aligned with business-to-consumer shipments have experienced the strongest growth."

Air freight companies, like UPS and Atlas, make the majority of their money — and experience highest demand — in the last quarter of the year. In a company press release, Alan Gershenhorn, UPS Chief Commercial Officer, said that during the holiday season, "UPS flexes its delivery network to process near double our already massive regular daily volume, and that creates exceptional demands."

Even as Amazon takes over an increasingly large portion of its own deliveries, UPS is still well-positioned to profit from the e-commerce boom. Air freight options for retailers have actually shrunk over the last few years, representing a golden opportunity for UPS.

Air cargo company World Airways filed for bankruptcy and ceased all operations in March 2014. Evergreen International Aviation preceded it in December 2013. And some of the remaining air cargo companies have been acquired by larger airlines. In April 2016, for example, Atlas acquired Southern Air and is incorporating Southern's assets into the Atlas fleet.

Fewer options mean less competition. These dynamics have allowed the big air freight carriers like UPS to command higher prices — particularly in the holiday season — because there are fewer alternatives for retailers to turn to. So, not surprisingly, UPS is aiming its surcharge at deliveries in this high-demand, low-supply holiday period.

While this puts pressure on other retailers like Wal-Mart Stores Inc., Amazon is likely immune to the UPS price hikes. With its own dedicated freighter fleet which is not subject to the seasonal winds of commerce, Amazon can hold its shipping prices steady while its competitors are forced to raise them or, worse, eat the cost.

And by complementing its air cargo fleet with its growing ground delivery system, Amazon's reliance on UPS will be far less than its competitors and the impact of third-party surcharges will be greatly minimized if not eliminated. Amazon may be building the groundwork for a future that does not include FedEx or UPS deliveries of Amazon orders at all.

Amazon has repeatedly shown that it is unafraid to make large investments in anticipation of changes in commerce that others don't see, an approach that seems to always keep Amazon one step ahead of both its digital and bricks-and-mortar competitors. Just a few weeks ago, of course, Amazon made a large leap into the grocery business with its surprise bid for Whole Foods Market Inc. But Amazon pulled an even greater surprise on its retail competitors months ago when it launched Amazon Prime Air.

Amazon's competitors are no doubt evaluating their own options as Prime Air soars past. When it comes to owning your own cargo air force, can Wal-Mart afford to be far behind?

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