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13 February 2003

Mr Tim Grimwade
General Manager of Adjudication Branch
Australian Competition Consumer Commission
PO Box 1199
DICKSON ACT 2602

Dear Mr Grimwade

APPLICATIONS FOR AUTHORISATION LODGED BY QANTAS AIRWAYS LIMITED AND AIR NEW ZEALAND

We refer to your letter dated 19 December 2002.

Please find enclosed a copy of Virgin Blue's submission in response to the applications.

If you have any questions please do not hesitate to contact either myself (02) 9263 4014 or Jonathan Callaghan (02) 9263 4058.

Yours sincerely
GILBERT + TOBIN

Luke Woodward/Jonathan Callaghan

Gilbert Jewel

Fro	Dadd, Amanda
Se	Wednesday, 12 February 2003 2:20 PM
To:	Gilbert Jewel
Cc:	Outzen Gregory
Subject:	FW: Submission

582049_2.pdf (341 KB)

Hi Jewel

This version replaces the virgin submission document that Jonathan Callaghan emailed to adjudication earlier this afternoon. Could you please ensure that this, and not the other version is placed on the public register and web site ASAP.

Cheers

Amanda

-----Original Message-----
From: JCallaghan@gtlaw.com.au [mailto:JCallaghan@gtlaw.com.au]
Sent: Wednesday, 12 February 2003 2:05 PM
To: amanda.dadd@accc.gov.au
Cc: lwoodward@gtlaw.com.au
Subject: Submission

Amanda

As discussed I attach a further version of the Submission.

Please post this copy of the submission instead of the first version I sent you.

Thanks

Jonathan Callaghan
(See attached file: 582049_2.pdf)

==

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VIRGIN BLUE SUBMISSION

IN RESPONSE TO

APPLICATIONS FOR AUTHORISATION

OF THE PROPOSED

QANTAS/AIR NEW ZEALAND/AIR PACIFIC

ALLIANCE

12 FEBRUARY 2003

TABLE OF CONTENTS

1.	INTRODUCTION AND EXECUTIVE SUMMARY	1
2.	VIRGIN BLUE	7
3.	RESPONSE TO APPLICANTS CASE FOR AUTHORISATION	17
4.	COMPETITION EFFECTS OF THE PROPOSED ALLIANCE	34
5.	MARKET REFORM	40
6.	THE APPLICATION OF THE AUTHORISATION TEST	45

1. INTRODUCTION AND EXECUTIVE SUMMARY

1.1 Qantas Airways Limited (**Qantas**) and Air New Zealand Limited (**Air New Zealand**) (the **Applicants**) together with Air Pacific Limited (**Air Pacific**), propose to enter into a strategic alliance (**Proposed Alliance**[1]) to integrate their operations on trans Tasman, New Zealand and Pacific routes.

1.2 The stated rationale for the Proposed Alliance is the desire to integrate Qantas' and Air New Zealand's operations as they claim there is only room for one networked Full Service Airline. They claim the alternative is a five year battle for supremacy on trans Tasman, New Zealand and Pacific Routes with only one likely survivor. Virgin Blue does not consider that it is credible that both of Qantas and Air New Zealand would enter into a five year price war, where only one airline survives.

1.3 The Proposed Alliance removes the head to head competition of Qantas and Air New Zealand in the trans Tasman and New Zealand markets. It also removes head to head competition in Pacific markets (which is largely ignored by the Applicants). They will fully co-ordinate all their operations, jointly set prices and share profits. To address the anti-competitive effect of the Proposed Alliance, Qantas and Air New Zealand have relied on the prospective entry of Virgin Blue on key routes if the Proposed Alliance proceeds.

1.4 Virgin Blue has been actively considering establishing operations on these routes. With or without the Proposed Alliance, Virgin Blue will commence on these routes. Critically the timing and scale of Virgin Blue's entry will depend on the barriers to entry. There are two main barriers to establishing a substantial scale of operations:

(a) access to facilities (including for example, Sydney, Auckland and Christchurch airports) and commercial agreements for necessary ground support and handling. Air New Zealand and Qantas, through existing arrangements with airports, control key capacity at these and other airports. Further, Air New Zealand is the monopoly supplier of many ground support and handling services in New Zealand; and

(b) the threat of strategic capacity and pricing conduct by Air New Zealand and Qantas, particularly through their low cost operations, Freedom Air, Australian Airlines and entities within the Qantas brand with low cost structures such as Impulse and Jet Connect.

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1 In this paper a reference to the Proposed Alliance includes a reference to the proposed acquisition by Qantas of an equity interest in Air New Zealand of up to 22.5% and the proposed Cooperation Agreement between Qantas, Air New Zealand and Air Pacific Limited.

1.5 The Proposed Alliance raises these barriers. That is, an additional anti-competitive effect of the Proposed Alliance is that it enables the Alliance parties to limit the scale and timing of Virgin Blue's entry and limit its competitive presence.

1.6 Under the Proposed Alliance, Air New Zealand and Qantas will not need to compete head to head but will be able to strategically target their combined fleets, and in particular their low cost operations, Freedom Air and Australian Airlines (and the low cost vehicles operating under Qantas branding, namely, Jet Connect and Impulse) to constrain the growth of Virgin Blue. Under the Proposed Alliance, Qantas and Air New Zealand have a greater incentive and capacity to target Virgin Blue, in order to deter and delay its entry.

1.7 This conduct is consistent with Virgin Blue's experience to date in Australia, for example, when Ansett first collapsed Mr Geoff Dixon, CEO of Qantas said:

> *We're going to draw a line in the sand, and we're going to stay there.*[2]

Mr Dixon also said that Qantas would take it as a failure on its part if Tesna and Virgin Blue both survived.[3]

1.8 It is also consistent with experience in New Zealand, where Air New Zealand established Freedom Air in response to entry by Kiwi in 1996, targeting specific routes operated by Kiwi. Kiwi's strategy was to provide direct services on routes out of provincial New Zealand cities to points in Australia that had not previously been served by Air New Zealand, Ansett or Qantas. With the collapse of Kiwi in 1997, Freedom Air was kept in operation on a limited basis as a strategic checking device for any new entrant. For example, in response to Virgin Blue's announced its intention to commence operations in New Zealand on 24 April 2001, Freedom Air announced three days later that it was expanding the fleet from two to four 737's, apparently to counter Virgin Blue's entry.[4] When Tasman Pacific failed and Qantas announced the commencement of its own operations in New Zealand in May 2001, Air New Zealand withdrew Freedom Air from Tasman services and re-deployed it on those domestic routes operated by Qantas. Now, Air New Zealand has re-deployed Freedom Air to operate out of Brisbane, the home base of Virgin Blue.

1.9 The Proposed Alliance raises a substantial risk that Virgin Blue's entry into New Zealand may not be as substantial as it otherwise would be. In any event, it is unlikely on current planning, that Virgin Blue would be able to provide the scale of operations, and in the

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2 Australian Financial Review, 22 February 2002.
3 ABC Television, "7.30 Report", 11 December 2002.
4 *Forgive the Cynicism,* New Zealand Evening Post, 30 April 2001, Editorial p.4.

time frame, on which the Applicants' case is founded. Without this entry, the Applicants cannot make their case.

1.10 Given the threat the Proposed Alliance poses to new entry, Virgin Blue submits that it should only be authorised if Virgin Blue (or someone else) has actually entered on a substantial scale on the trans Tasman and New Zealand routes prior to the Proposed Alliance coming into effect. The need for actual and substantive competition was acknowledged by Qantas as an essential pre-condition when it first announced its consideration of the proposal in May 2001.[5]

1.11 To enable a new entrant to enter on this scale and in a meaningful time-frame, a number of structural and other market changes would be required.

(a) Air New Zealand would need to divest Freedom Air. This would:

(i) remove a bullet from the Applicants' gun, that is, it removes a likely vehicle for a strategic capacity/pricing response from the Applicants;

(ii) provide a vehicle for a new entrant to immediately commence operations in New Zealand. Time to market is critical in establishing a substantial competitive response to the Proposed Alliance;

(iii) provide an immediate and substantial scale of operations, through four 737s, (the same scale as Qantas' existing operations in New Zealand);

(iv) off-set the anti-competitive effects of the rationalisation of capacity under the Proposed Alliance, ie it ensures that more capacity remains in the market than otherwise and that a greater share of that capacity is independent of the Proposed Alliance;

(v) provide a vehicle from which a new entrant may expand; and

(vi) cause the Applicants to use their core brands and services in responding to entry by Virgin Blue, which should result in more broadly based reductions in price than may otherwise occur.

(b) To ensure that this outcome is not undermined through the establishment by the Alliance parties of a new low cost operator or the redeployment of an existing low

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5 "*Qantas also realised that the proposal could not proceed without the Ansett Group: commencing significant operations on the trans Tasman and some other competitive routes; starting a domestic airline within New Zealand*": Qantas ASX release issued by Qantas Public Affairs, 31 May 2001

cost operator, there should be appropriate restrictions on Air New Zealand and Qantas establishing another low fare airline, and Qantas should be restrained from flying Australian Airlines in addition to Impulse and Jet Connect aircraft on the trans Tasman, New Zealand and Pacific routes for a period of three years.[6]

(c) New entrants must be provided access to terminal facilities on a level equivalent to that enjoyed by the Applicants, particularly during peak times. There are several affected airports[7] which have substantial capacity constraints, including to gates and check-in facilities. These include, without limitation, the key gateway ports of Sydney, Auckland and Christchurch. The Australian Competition and Consumer Commission (**Commission**) should also be satisfied that there are sufficient suitable peak time slots at constrained airports, ie Sydney and Auckland.

In critical respects, Air New Zealand, and to a lesser extent Qantas, control access to these facilities, particularly where they have contractual rights to the use of such facilities such as gates and check in counters. To the extent that Qantas/Air New Zealand cannot assign leases of facilities or enter into sub-leases, they should relinquish their rights of access to a new entrant, and facilitate that process with the airport operator.

(d) Air New Zealand must enter satisfactory commercial arrangements for maintenance services, spares and parts; ground handling services and equipment at all major airports; and route reprotection. Air New Zealand is currently the monopoly supplier of many of these services.

(e) The Applicants should provide an undertaking to limit their capacity response to new entry. The undertaking should prohibit them from increasing capacity for a period of two years on any route following new entry.

1.12 Without these conditions, there can be no guarantee that there will be a sufficient level of competition to permit the Proposed Alliance to proceed. In this context, Virgin Blue has

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6 This is in line with the Canadian regulatory response to the Air Canada acquisition of Canadian Airlines.

7 Virgin Blue is currently considering the feasibility of operating services from a number of airports and expects there to be a number of airports with severe capacity limitations.

engaged Frontier Economics[8] to review the modelling of the detriments and benefits undertaken by NECG [9]. Frontier Economics conclude that NECG have:

(a) understated the detriments in that:

(i) the price increases and capacity decreases identified by the Applicants have been substantially understated, and the dead weight loss associated with the Proposed Alliance has been underestimated as a result; and

(ii) the Applicants have failed to identify a likely detriment in that the Proposed Alliance is likely to have a similar effect on freight services as it has on passenger services, namely to increase prices and reduce capacity;

(b) overstated the benefits. The principal reasons for this are:

(i) there is no basis for the tourism benefits the Applicants have alleged will occur should the Proposed Alliance proceed;

(ii) the cost savings are unsubstantiated and appear to be cost savings attributed to the Applicants failing to engage in inefficient and potentially unlawful conduct, which in any event is implausible;

(iii) the Applicants have not measured scheduling efficiencies arising between the factual and counterfactual scenario, but instead have compared the schedules if the Proposed Alliance were to proceed with the existing schedules, which has the effect of overstating the scheduling efficiencies; and

(iv) there is no reason why the Proposed Alliance should not result in any new direct services that otherwise would not have occurred.

1.13 Frontier concluded:

In this case, clearly the expected benefits identified by NECG as resulting from the proposed alliance would not outweigh the expected costs. The key factor that

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8 Critique of the NECG Report on the Qantas and Air New Zealand Alliance – a report prepared for Gilbert & Tobin dated February 2003 (**Frontier Report**). A copy of the Frontier Report is included at Attachment 1.

9 Report on the Competitive Effects and Public Benefits Arising from the proposed Alliance between Qantas and Air New Zealand dated 8 December 2002 (**NECG Report**).

may lessen that detriment caused by the lessening of competition would be the prospect of entry – providing that entry were on a scale that would effectively replace the rivalry that the proposed alliance is designed to destroy.

1.14 In any case, given the inherent risks to competition from the Proposed Alliance, it should not be authorised under any circumstances for more than three years.

2. VIRGIN BLUE

History of Virgin Blue

2.1 The Virgin Group announced the commencement of a low-fare airline[10] in Australia in November 1999. Virgin Blue commenced operations on 31 August 2000.

2.2 Virgin Blue's strategy was, and remains, to price air travel at a level that is readily affordable for most people – it will price its fares at levels that expand the overall demand for air travel by making it more affordable for those who otherwise could not afford to fly at all or as often.

2.3 Virgin Blue's experience, consistent with the experience with other low fare carriers around the world, is that offering widely available low fares, leads to a substantial increase in demand for travel. The increase in demand is typically in the order of 15-30% depending on the nature of the route.

2.4 The increase in demand is driven by the wide availability of low fares. For example, Virgin Blue offers what it calls fully flexible fares (that is a fare without any travel restrictions or similar conditions) which is equivalent to a full economy fare at prices which may be in the order of more than 50% below the standard full economy fare offered by Qantas or, at the time, Ansett.

2.5 The impact of Virgin Blue and Impulse on the volume of air travel in Australia is demonstrated by a 26% increase in passenger numbers travelling between Sydney and Brisbane between the year prior to Virgin Blue's entry on that route (August 2000) and the year of entry. On the Brisbane to Melbourne route there was a 30% increase during the same period.[11]

2.6 This experience is consistent with the experience in the United States[12] and Europe.

2.7 In order to offer widely available low fares, Virgin Blue's strategy (as with other low fare airlines) is to keep costs as low as possible. It does this by:

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10 The concept of a low fare airline is explained in more detail in the US Department of Transport's paper *The Low Cost Airline Service Revolution* dated 23 April 1996.

11 Based on Department of Transport passenger numbers, BNE/SYD (1999: 3,286,423; 2000: 4,427,797); BNE/MEL (1999: 1,707,840; 2000: 2,231,510).

12 The Department of Transport *The Low Cost Airline Service Revolution* dated 23 April 1996.

(a) maximising the efficient operation and utilisation of its aircraft, through operating a single class of jets, namely Boeing 737s, configured to a single seat class, and by adopting more efficient operating systems (including its revenue and reservation management systems) with efficient airport procedures minimising aircraft time spent on the ground; and

(b) not bundling costly customer services such as complementary meal services, frequent flyer programs or club lounges into its fares.[13]

2.8 Virgin Blue's start up strategy was to target short haul routes that were likely to have a strong increase in demand in response to low fares. Generally these were routes that were attractive for leisure customers, who are typically more cost sensitive than business customers, however, these were not necessarily leisure routes as such. Virgin Blue has also targeted routes that were not serviced or were under serviced by the incumbent airlines.

2.9 An integral part of the of Virgin Blue experience in Australia, as with other low-cost airlines, has been the response of Qantas to its entry. When Virgin Blue commenced operation in Australia, Qantas embarked on an aggressive campaign of substantial capacity expansions directed at the new routes operated by Virgin Blue. Qantas had the ability through its substantial fleet and financial backing to quickly redeploy significant capacity and to match or beat low fare offers on the new routes entered by Virgin Blue (albeit at below cost). Examples of Qantas' predatory strategy are discussed below.

(a) Signalling a substantial increase in domestic capacity prior to the start up of Virgin Blue and Impulse. For example, in February 2001, Qantas announced its half-yearly profit results. Commenting on these results, *The Sydney Morning Herald* reported that:[14]

> *"Qantas Airways has signalled it will escalate competition in the domestic aviation market after yesterday reporting a sharp drop in interim earnings and warning that there is little to suggest trading conditions will improve in the second half ...*
>
> *Chief executive-designate Geoff Dixon said Qantas would 'stand our ground' on domestic routes and continue its aggressive response to the new market entrants.*

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13 As discussed below Virgin Blue is considering offering similar services such as customer lounges and valet parking – but it will be on a user pays basis.

14 *Sydney Morning Herald,* "Qantas steps up fare war as profit dives 22pc", 23 February 2001, p. 21.

The fall in profit was concentrated in Qantas' eastern seaboard services, the routes targeted by discount operators Impulse Airlines and Sir Richard Branson's Virgin Blue.

In the six months to December, net profit fell 22.2 per cent to $262.9 million, reflecting a sharp deterioration in yields as revenue rose 13.1 per cent to $5.1 billion."

At the same time as Qantas announced it was experiencing a sharp drop in profits concentrated on those routes where there had been new entry, it also announced that it would suspend certain international routes in order to bring these large aircraft back to fly on domestic routes. In a press release this decision was stated to be as a result of a "comprehensive business review".[15] This same press release recorded this decision as:

"the redeployment of aircraft from suspended international services to meet new competition on key domestic routes."

Therefore, Qantas' response to declining profits on certain major routes as a result of matching the low fare airline's pricing was to further bolster capacity on these unprofitable routes. The aircraft to be brought back to add capacity to domestic routes were four Boeing 767-300 aircraft, which are wide bodied jets which seat 228 passengers. These aircraft are almost double the capacity of the 117 seat Boeing 717s then operated by Impulse and larger than the 162 seat 737-400s then operated by Virgin Blue. They are also designed for long-haul operations rather than the domestic trunk routes for which they were being used.

The Sydney Morning Herald noted that:[16]

"Concerns immediately turned to the prospect of another fare war after Qantas announced the job cuts and a decision to swing four Boeing 767-300 aircraft on to domestic routes, after suspending all services to China and Canada.

The redeployment will boost Qantas' domestic capacity by 11 per cent, compared with the market's 7.5 per cent rate of growth."

(b) Targeted increases in capacity on particular routes operated by Virgin Blue. For example, Qantas increased its capacity on the Adelaide/Brisbane route in response

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15 Qantas press release, "Qantas Results for the Half Year Ended 31 December 2000", 22 February 2001.

16 *Sydney Morning Herald, supra* note 14.

to Virgin Blue's entry on that route by 50%, the effect of which was to trigger a substantial reduction in fares, yields and load factors on that route. The Commission has subsequently commenced proceedings alleging a contravention of the misuse of market power provisions in relation to this incident.

Another example arose following the collapse of Ansett, where flights serving Canberra were severely disrupted. Despite appeals by Canberra Airport for Qantas to increase its services, Qantas only substantially increased capacity on the Brisbane-Canberra route, which was the only route into Canberra served by Virgin Blue. Qantas added 10 return flights per week, targeting the departure times of the Virgin Blue service. Qantas also added three return flights per week between Canberra and Melbourne, which amounted to less than 10% of the capacity lost when Ansett and Kendall exited the route.[17]

(c) Re-routing international services to include domestic sectors, which substantially increased effective domestic capacity. These services included Townsville to Singapore via Brisbane, Cairns to Singapore via Brisbane, Sydney to Osaka via Cairns and Adelaide to Singapore via Darwin. Qantas later announced that the Townsville services would be discontinued from March 2002 at which point it conceded that the service had been introduced to boost domestic capacity between Brisbane and Townsville.[18]

(d) Engaging in a strategy of pushing Virgin Blue off marginal routes. For example, prior to its collapse Ansett flew nine weekly flights between Brisbane and Mt Isa. Qantas had not had a regular service on that route since 1989. After the collapse of Ansett, Virgin Blue commenced a regular service on 18 September 2001 of five flights per week. On 19 September Qantas announced that it would re-commence a regular Brisbane-Mt Isa service with 12 Bae-146 flights each way per week, which exceeded the capacity previously used by Ansett to service that route. These aircraft had previously been used to target Impulse's Melbourne/Newcastle operations. Virgin Blue was forced to withdraw from the route.

2.10 Qantas' ability to impede the successful entry of a new entrant is supported by its vertically integrated operations. Qantas Business Travel (**QBT**) is the dominant provider of business travel agency services in Australia and also the dominant provider of travel agency services to the Australian Government. QBT has adopted a number of practices designed to limit the success of Virgin Blue in the business market. These include:

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17 As advised by Canberra International Airport, 16 October 2001.

18 *Townsville Bulletin* "Qantas Dumping International Flight" 15 December 2001.

(a) the practice of not booking the best available fare on the day for business clients, often contrary to contractual arrangements, where these fares are offered by Virgin Blue; and

(b) the practice of including a global financial offer which bundles low cost services with preferential rates on overseas and business class travel which is only available through Qantas. This significantly impacts upon the ability of other airlines, both international (such as United Airlines and Air New Zealand) and regional carriers (such as REX) who cannot offer the same scope of services to compete.

2.11 Qantas' response to Impulse's entry was similar. For example:

(a) it responded to Impulse's new regional service between Newcastle and Melbourne for $318 return, by increasing the size of its aircraft operating on the Newcastle-Melbourne route and offered return fares for $159 and $189. Impulse withdrew from the route. Following Ansett's collapse, Qantas removed these aircraft and placed them on the Brisbane - Mt Isa routes;

(b) following Impulse's announcement that it would commence services between Sydney, Melbourne and Brisbane, Qantas began offering restricted tickets at up to 75% off standard economy fares for travel between Sydney, Melbourne and Brisbane; and

(c) on 7 May 2000, Impulse introduced unrestricted fares of $139 each way between Sydney and Melbourne and $119 each way between Sydney and Canberra, commencing on Impulse's launch date of 5 June 2000. Qantas announced matching fares effective from 5 June 2000 "by two o'clock that day". [19]

2.12 It is noted that Air New Zealand has engaged in a similar strategic response to new entry, through Freedom Air which is, discussed at paragraph 4.19 below.

2.13 The response of Qantas to the entry of Virgin Blue and Impulse, in substantially expanding capacity, led to a fierce price war that placed enormous financial strain on the new entrants and Ansett (due to its inefficient operations and maintenance problems).

2.14 In May 2001 Impulse announced that it would cease operations in its own right and that it had entered into a wet-lease arrangement with Qantas (with an option for Qantas to

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19 *Sydney Morning Herald*, "Dogfight Alert as Airlines Vie for Market", 9 May 2000.

acquire it). Qantas subsequently acquired Impulse which continues to operate as a separate airline operating company although it is branded as a Qantas operation.

2.15 In September 2001, Ansett was placed in voluntary administration and in March 2002 it ceased flying.

2.16 The collapse of Ansett and the purchase of Impulse by Qantas has had a profound effect on the success of Virgin Blue and Qantas. Since Ansett's collapse, both Qantas and Virgin Blue have expanded their domestic capacity. Qantas' market share initially rose from approximately 50% to almost 90% of a capacity constrained market. This was due principally to its ability to immediately redeploy international capacity following the September 11 attacks to service demand flowing from Ansett's collapse. Virgin Blue was not able to add additional capacity as quickly as Qantas. Since that time, the market share of Qantas has decreased given the growth of the market and the ability of Virgin Blue to slowly increase its capacity on key routes. Qantas now accounts for approximately 75% of domestic capacity. Virgin Blues was able to increase domestic trunk operations and now offers approximately 25% of the total domestic capacity.[20] In effect, Qantas was able to secure the overwhelming majority of Ansett's market share by moving first.

2.17 When Virgin Blue commenced operations in August 2000, it serviced the Brisbane-Sydney and Brisbane-Melbourne routes with four Boeing 737s. At the time of Ansett's collapse it operated approximately nine Boeing 737s and flew approximately five routes. Virgin Blue now operates 29 Boeing 737s on the routes set out in Table 1 with 1330 departures per week.

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20 There are other operators with limited operations on domestic trunk routes, such as Regional Express on Sydney-Canberra. However, these airlines do not operate on main trunk routes such as Sydney-Melbourne.

Table 1: Direct routes flown by Virgin Blue (schedule effective 28 April 03)

Origin	Destinations	No of Flights per week
Adelaide	Brisbane, Gold Coast, Melbourne, Perth, Sydney	14, 7, 40, 7, 28, (total 96)
Brisbane	Adelaide, Cairns, Canberra, Darwin, Mackay, Melbourne, Perth, Rockhampton, Sydney, Townsville	14, 21, 7, 7, 14, 59, 7, 7, 114, 14 (264)
Cairns	Brisbane, Melbourne, Sydney	21, 7, 7, (35)
Canberra	Brisbane, Melbourne, Sydney	7, 14, 14, (35)
Coffs Harbour	Sydney	7, (7)
Darwin	Brisbane	7, (7)
Gold Coast	Adelaide, Melbourne, Sydney	7, 21, 30, (58)
Hobart	Melbourne	27, (27)
Launceston	Melbourne	14, (14)
Mackay	Brisbane	14, (14)
Maroochydore	Sydney	9, (9)
Melbourne	Adelaide, Brisbane, Cairns, Canberra, Gold Coast, Launceston, Perth, Sydney	40, 59, 7, 14, 27, 14, 21, 126, (308)
Perth	Adelaide, Brisbane, Melbourne, Sydney	7, 7, 21, 21, (56)
Proserpine	Sydney	1, (1)
Rockhampton	Brisbane	7, (7)
Sydney	Adelaide, Brisbane, Cairns, Canberra, Coffs Harbour, Gold Coast, Maroochydore, Melbourne, Perth, Proserpine	28, 114, 7, 14, 7, 30, 9, 126, 21, 1, (357)
Townsville	Brisbane	14, (14)

2.18 In the context of the stark distinction between what are referred to as VBAs and FSAs by the Applicants, it is notable that:

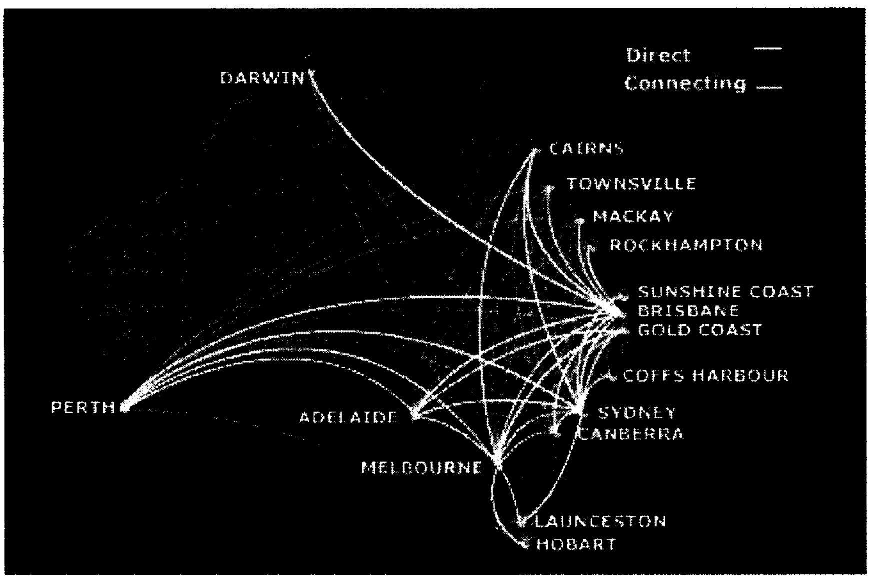
(a) Virgin Blue has a high frequency of operations on key routes. For example, it operates 18 flights in each direction per week day on Melbourne-Sydney, providing an frequency that is attractive to business customers;

(b) Virgin Blue actively targets business customers. For example, it is considering introducing a frequent flyer program, lounges and valet parking;

(c) Virgin Blue has an integrated network of operations, where its customers can book travel on interconnecting sectors. Virgin Blue currently offers 72 connecting services between cities it does not fly directly. Figure 1 illustrates the interconnected services offered by Virgin Blue; and

(d) Virgin Blue is actively pursuing negotiations with overseas carriers to provide domestic feeder services and has entered into an agreement with United Airlines for feeder traffic.

Figure 1 – Virgin Blue Destinations



source: www.virginblue.com.au

2.19 In addition, Virgin Blue is actively seeking opportunities to fly to international destinations. It has sought expressions of interest from Airports within the Asia/Pacific region that wish to be included in the Virgin Blue network. Virgin Blue has received expression of interest from 16 international airports and is giving due consideration to each of these destinations. Virgin Blue wishes to provide services to New Zealand and within New Zealand (discussed further below).

2.20 In order to accommodate this expansion, Virgin Blue has recently signed an agreement with Boeing for the supply of 10 aircraft from August 2003 and granting options for the purchase of a further 40 aircraft. The value of the contract is potentially as much as AUD$5 billion.

New Zealand Expansion of Virgin Blue

2.21 Virgin Blue has long identified a desire to offer services across the Tasman and on New Zealand domestic routes. In general Virgin Blue considers that the trans Tasman and New Zealand domestic routes offer a substantial opportunity to Virgin Blue to enter, given its low fare model.

2.22 To date, Virgin Blue has not commenced operations on those routes in part due to its former ownership structure[21] and also due to its focus on establishing successful operations in Australia in a very difficult market. With the demise of Ansett, and the failure of the Tesna consortium in March 2002, Virgin Blue's focus has been on securing its position in the Australian market, in response to the rapid deployment by Qantas of capacity to absorb the market share of Ansett.

2.23 Virgin Blue's planning for entry on the trans Tasman and New Zealand routes is not complete. However, Virgin Blue has taken or is taking the following steps to commence such operations:

(a) commenced discussions with Auckland Airport over access to both international and domestic terminal facilities. It is also considering other potential options available to it in Auckland in the event that facilities cannot be made available to it at Auckland Airport on reasonable commercial terms;

(b) initiated the process for obtaining a New Zealand Air Operators Certificate, including identifying and interviewing key personnel for such operations; and

(c) written to Air New Zealand regarding the entry into commercial arrangements for ground handling. Virgin Blue will shortly seek to enter into negotiations in relation to route reprotection and maintenance and access to parts and equipment.

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21 Initially Virgin Blue was a foreign carrier and was not considered an Australian airline until Patrick Corporation Limited took a 50% equity stake in Virgin Blue in March 2002.

2.24 Virgin Blue's planning includes active consideration of a number of international routes and domestic routes. When determining whether it is feasible to offer a service in Australia, as a general rule, Virgin Blue believes that it is possible to provide services to any city that has a population of greater than 50,000. Virgin Blue believes that the same principle could be applied to New Zealand.

2.25 Virgin Blue has targeted a one third market share in the domestic Australian air services market. It believes that it is possible to achieve similar market penetration in the New Zealand and trans Tasman markets over time. However, this will depend upon the strategic response of the Proposed Alliance. In any case it does not believe that the growth of its market share will be achieved at the same rate at which it occurred in Australia.