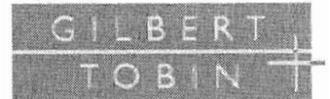


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LAWYERS

30 September 2009

By email

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Commercial in confidence

Dear Mr Hatfield

Virgin Blue Airlines Pty Ltd & Ors - applications for authorisation A91151-A91152 and A91172-A91173

We refer to your letter dated 10 September 2009 regarding applications for authorisation A91151-A91152 and A91172-A91173 (**Authorisation Application**). Your letter seeks clarification from the Applicants on several specific issues (**Information Request**) in relation to the proposed joint venture between Virgin Blue and Delta (**Proposed Joint Venture**).

We attach a consolidated response from the Applicants to the questions outlined in your letter dated 10 September 2009.

Confidential information has been redacted in this version of the response. This version may therefore be placed the Commission's public register.

In respect of the information that is redacted throughout the document, the Applicants request that this information be excluded on the that basis that it is commercially confidential to the Applicants. The disclosure of this information would unreasonably and adversely affect the Applicants in respect of their lawful business, commercial and financial affairs.

Yours sincerely

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Virgin Blue and Delta

Consolidated Response to ACCC Letter
of 10 September 2009

[RESTRICTION OF PUBLICATION OF PART CLAIMED]

30 September 2009

For the purpose of these answers, we have used Virgin Blue to refer to Virgin Blue and all its subsidiaries (including V Australia). Where it is necessary to distinguish between these subsidiaries, this distinction has been made clear in the relevant answer.

1. *A list detailing the city pairs that are likely to be offered to trans-Pacific travellers under the Joint Venture.*

By linking the end-to-end networks of Virgin Blue and Delta, consumers will enjoy the convenience of new online service in thousands of city-pairs, and the potential for new nonstop service on numerous South Pacific-North America routes. We list below the additional nonstop city pairs that are currently included in the Applicant's proposed joint venture (**Proposed Joint Venture**). Approval of the Proposed Joint Venture will foster and promote increased service on existing routes, and new service on the contemplated routes. However, implementation of any given route is subject to financial and operational feasibility at the time of commencement. The Applicants intend that all network planning decisions will be made in a highly coordinated fashion so as to maximise value to the Proposed Joint Venture.

The following nonstop city-pairs are currently included in the Joint Venture Agreement:

[REMOVED]

The Applicants are constantly evaluating new opportunities. Virgin Blue believes the following additional nonstop routes could be enabled by the Joint Venture:

[REMOVED]

The point of the joint venture is to create a single, seamless and metal-neutral network. Thus, in addition to the potential nonstop routes identified above, the Proposed Joint Venture will result in the creation of new online service connections in more than 6,500 city pairs, offering valuable new service options for those travelling behind or beyond each trans-Pacific gateway. Importantly, these indirect city-pairs represent not only new online travel opportunities in their own right, but will directly enable the development of nonstop services noted above by assisting Virgin Blue and Delta in attracting customers to the combined network.

The list below is a much abbreviated illustrative list identifying some of the larger US-Australia city pairs that would be offered under the Proposed Joint Venture. Neither partner is currently able to offer these service without relying on the network of the other. Through cooperation, both carriers will offer a broader and more attractive joint network.

[REMOVED]

2. *A list detailing the city pairs offered or that will be offered to trans-Pacific travellers absent the Joint Venture, under the applicants' existing codeshare, interline and marketing agreements (cooperation agreements).*

Absent the Joint Venture, the carriers would not implement full, unconstrained codesharing across both networks. Delta has a network advantage in terms of its access to US customers, and Virgin Blue has an advantage in terms of its access to Australian customers. The Proposed Joint Venture is essential to achieve a common bottom line, so that each partner is willing to share these advantages with the other. Consumers benefit through the expanded network opportunities, as well as the additional nonstop service that can be supported.

The codeshare agreement provides that absent the Proposed Joint Venture, reciprocal codeshare service will be limited to a much smaller number of cities [REMOVED]. This decreases the network offerings to consumers, and lessens the ability of the Applicants to commence new nonstop services.

[REMOVED]

The current combined schedule is:

Sydney to Los Angeles (6 per week V Australia, 6 per week Delta¹);

Brisbane to Los Angeles (3 per week V Australia);

- Melbourne to Los Angeles (planned from December 2009, 2 per week V Australia)

[REMOVED]

3. *Details of the level of services that would be offered to trans-Pacific passengers in relation to the routes that will be available under the Joint Venture, compared to the offering absent the Joint Venture – in particular, will the Joint Venture facilitate reduction in time penalties, greater frequency, and improved connections? If so, please indicate how the Joint Venture would facilitate a more attractive service offering, and why this could not be achieved via existing cooperation agreements.*

There are a number of areas where service levels and hence public benefit gains will be achieved under the Proposed Joint Venture, beyond those available under a simple codeshare scenario. Schedule coordination otherwise unavailable through codeshare arrangements will result in:

- reductions in travel time;
- improved connectivity of available services; and
- the potential for increased frequencies on existing markets and commencement of new markets (the potential for this to occur is also enhanced through the cost savings referred to above).

Reduction in travel time

A metal neutral joint venture represents a major advancement in customer convenience through improved routings and reduced travel time. Under a codeshare scenario in which Delta operates Sydney to Los Angeles and Virgin Blue operates Brisbane, Sydney [REMOVED] [and] Melbourne to Los Angeles, there is an inherent desire for each carrier to retain as many passengers as possible on their own services. As all services from Los Angeles to Australia currently depart late in the evening, the potential for carriers to engage in revenue protection is further increased.

Consider a Delta passenger travelling from New York to Brisbane. Under a codeshare arrangement, the passenger would travel on Delta services from New York (JFK) to Los Angeles (LAX) and onto Sydney (SYD), before continuing to Brisbane (BNE) on Virgin Blue.

	Travel Path	Total Travel Time
Codeshare - DL Trans-Pacific	JFK-LAX-SYD-BNE	27:45
Joint Venture - VA Trans-Pacific	JFK-LAX-BNE	23:30
	<i>Difference</i>	<i>4:15</i>

¹ Increasing to 7 per week in December 2009

Codeshare - DL Trans-Pacific	BNE-SYD-LAX-JFK	24:00
Joint Venture - VA Trans-Pacific	BNE-LAX-JFK	20:00
<i>Difference</i>		<i>4:00</i>
Total Time Saving Under JOINT VENTURE		8:15

Under a metal neutral joint venture such as the Proposed Joint Venture, revenue protection ceases to become an issue and the passenger would be more likely to be offered direct travel on V Australia from Los Angeles to Brisbane, for a saving in travel time of 8 hours and 15 minutes over the return journey.

These benefits are multiplied thousands of times over by each and every point served by Delta behind Los Angeles – and for each an every nonstop transpacific route served (or to be served) by one joint venture partner and not the other. The Joint Venture is the key to releasing these benefits.

Connectivity

Furthermore, the Proposed Joint Venture allows for increased potential connections to and from the three Australian gateways of Brisbane, Sydney and Melbourne. Under the joint venture, there is no incentive to push passengers onto own metal services, hence the two carriers can work together to schedule feeder flights for optimal connectivity at each gateway. This has the potential to increase the number of connecting city pairs available for trans-Pacific travel. Each Australian gateway has distinct feeder markets that would have enhanced connectivity, and the resultant decrease in travel time, under a joint venture.

Port	Key Feeder Markets
Brisbane	North QLD, Regional QLD
Sydney	Regional NSW, WA
Melbourne	Tasmania, South Australia

For example, under a codeshare arrangement there is currently no ability for passengers to connect from Cairns through Sydney onto Delta's morning Sydney – Los Angeles service. Under a joint venture, however, not only could Delta passengers connect to V Australia services out of Brisbane, the two parties would be able to discuss prospective schedule changes so as to maximise connectivity in both Australia and the United States, potentially offering both daytime and evening connections from Cairns through Sydney to Los Angeles, as well as connections through Brisbane. [REMOVED] [T]he existence of a joint venture would allow both carriers to jointly design their schedules to improve connectivity and, as a result, reduce total travel times.

The same rationale can be applied to a passenger wishing to travel between Launceston and Los Angeles, with Melbourne – Los Angeles providing the better connection for V Australia services and no connection available to Delta services. [REMOVED]

	Existing	Total Travel Time
DJ connecting to DL	LST-SYD-LAX	No same day connection available
DJ connecting to VA	LST-MEL-LAX	18:10
DJ connecting to VA	LST-SYD-LAX	23:25

Source: APGDat Schedules – April 2010 as at 23 September 2009

Potential for increased frequencies or new services through schedule coordination under a joint venture

With more connecting markets and a greater catchment area to draw upon, load factors on both Virgin Blue and Delta services have more potential to improve and facilitate increased frequencies, particularly to Melbourne and Brisbane which do not currently have daily services. Within the existing level of frequencies there is also the potential to better distribute services (without net capacity reduction) to benefit Australian consumers. [REMOVED] Such offerings, potentially available only with the foundation of the Proposed Joint Venture, would again improve the customer proposition.

The potential scale and scope of Joint Venture service increases is very substantial and has been borne out in recent academic studies:

The first multinational alliance that received antitrust immunity from the Department, Northwest and KLM, provided strong evidence of the appeal of such alliances to consumers. Each of these airlines was a mid-sized network airline, but their alliance became a model for alliance development that led to enormous expansion. Before receiving immunity, Northwest did not provide daily service from any of its domestic network hubs to KLM's Amsterdam hub. Within a very short period of time, however, Northwest provided multiple frequencies from both of its primary hubs, Minneapolis/St. Paul and Detroit, and also added service from other U.S. cities, such as its relatively small hub at Memphis and other smaller cities such as Portland, Oregon. Northwest now provides 15 daily nonstops between eight U.S. cities and Amsterdam. This greatly expanded service is clearly attributable to network traffic flows that also support each airline's domestic network. These increased network flows lead not only to increased transatlantic travel, but strengthen the reach of the network hubs. KLM, in particular, greatly facilitated its ability to expand significantly the catchment area of its Amsterdam hub, and this allowed KLM not only to serve more transatlantic markets, but enabled Northwest to serve Amsterdam from several non-hub U.S. cities.²

The Proposed Joint Venture has the potential to increase U.S.-Australia service and network benefits in similar fashion.

Coordination of schedules also extends to the optimisation of aircraft type on each route. Under a codeshare scenario, each carrier would continue to operate existing schedules, with Virgin Blue suffering from passenger limitations and nil freight capability on the Los Angeles – Melbourne service. [REMOVED]

Essentially, services operating under a codeshare agreement only would differ little from the existing schedule. The small expected improvement in passenger feed in both Australia and the United States from a simple codeshare would provide limited load factor gains for Virgin Blue and Delta and at a rate which would produce slower further investment of capacity in the trans-Pacific market. Connectivity would remain an issue for those points that do not have adequate services into Sydney (but do into Brisbane or Melbourne), as there is still greater incentive for carriers to retain revenue on own metal services. Under a joint venture, this ceases to exist as an issue and the two parties would be able to align services to meet the public interest on both sides of the Pacific.

Maintain and preserve existing schedules

The existing schedule, shown below, shows that a joint venture would offer passengers both a daily morning and 6 times weekly evening departure from Sydney, as well as departures from Brisbane (3 per week) and Melbourne (2 per week). Under a simple codeshare, a strong predisposition toward revenue protection would see airlines favouring their own metal (i.e., putting passengers on their own

² R Bennett, P Murphy and J Schmidt, *International Airline Alliance Development – Necessary for Network Airlines and Consumers* July 2009 at page 31. Delta notes that on the four daily services and 1 200 seats that Northwest/KLM operates between Detroit and Amsterdam, only a handful of passenger journeys originate in Detroit or Amsterdam. The overwhelming majority of passengers on these services are connecting passengers moving to points beyond or behind the joint venture partner's hubs. This demonstrates the potential of "metal neutral" joint venture alliances to grow and sustain new service far beyond the levels that either partner could offer individually.

aircraft) and as a result passengers would not be able to take full advantage of the range of schedule options. [REMOVED]

Existing Schedule (expected to be retained under joint venture)														
Flight Description	Departure Airport	Departure Time	Arrival Airport	Arrival Time	Subfleet	Block Time	Days of Operation							Freq
VA 1	SYD	21:05	LAX	17:45	VA 77W	13:30	1	2	-	4	5	6	7	6
VA 2	LAX	22:10	SYD	6:05	VA 77W	14:25	-	2	3	4	5	6	7	6
VA 7	BNE	10:00	LAX	6:15	VA 77W	13:00	1	-	3	-	5	-	-	3
VA 8	LAX	23:05	BNE	6:15	VA 77W	13:55	1	-	3	-	5	-	-	3
VA 11	MEL	21:30	LAX	18:55	VA 77W	14:25	-	-	3	-	-	-	7	2
VA 12	LAX	23:10	MEL	8:00	VA 77W	15:45	-	2	-	-	-	-	7	2
DL 16	SYD	9:25	LAX	6:10	DL 77L	13:45	1	2	3	4	5	6	7	7
DL 17	LAX	22:40	SYD	6:40	DL 77L	15:00	1	2	3	4	5	6	7	7
Total													36	

[REMOVED]

4. *Whether the codeshare arrangements between Virgin Blue and United will continue in the event that the Joint Venture is implemented.*

No. [REMOVED]

5. *Whether the codeshare arrangements between Virgin Blue and United will continue in the event that the Joint Venture is not implemented.*

No. [REMOVED]

6. *A list of each of Virgin Blue's and Delta's existing codeshare and interline partners insofar as relevant to the trans-Pacific routes.*

In this section, Virgin Blue and V Australia have been used to differentiate the legal entities involved in the existing codeshare and interline agreements relevant to the trans-Pacific routes.

Virgin Blue currently has a codeshare agreement with United Airlines whereby the United code is displayed on certain Virgin Blue flights. The Virgin Blue code does not appear on any United flight [REMOVED]

V Australia currently has a unilateral interline agreement with Virgin America [REMOVED]

Virgin Blue currently has a unilateral interline agreement with Alaska Airlines [REMOVED]

Virgin Blue currently has a bilateral interline agreement with Continental [REMOVED]

Virgin Blue currently has a bilateral interline agreement with Virgin Atlantic [REMOVED]

Virgin Blue currently has a bilateral interline agreement with Delta on their respective domestic networks, but the parties do not currently interline on their trunk routes. The parties also have concluded a codeshare agreement, pursuant to which the VA code will appear on Delta's US-domestic flights beyond LAX, Delta will code share on intra-Australia and Trans-Tasman services operated by Virgin Blue and/or Pacific Blue, and Delta and VA also will code share on each other's US-Australia services. That codeshare agreement has not yet been implemented, although various regulatory approvals have been received from the US authorities.

Virgin Blue recently announced a unilateral codeshare agreement that allows Virgin Blue to code on Emirates trans-Tasman flights (Sydney to Auckland and Christchurch only). Emirates does not code on V Australia.

Delta maintains interline relationships with 157 carriers around the world, including Qantas, United, American, and V Australia. However, given the strong customer preference for online travel Delta believes that its codesharing and alliance relationships are more relevant to the market in question. Delta has a codeshare relationship with the Virgin Blue carriers, and, for the reasons discussed above, the Proposed Joint Venture is essential to maximising the benefit of that relationship in the U.S.-Australia marketplace.³ Delta also maintains an important strategic codeshare relationship with Alaska Airlines, which supports and feeds Delta's west coast international services, including LAX-SYD and future Joint Venture transpacific services.

7. [REMOVED] *Please comment on the impact the Joint Venture would have on capacity on each of the trans-Pacific routes.*

As noted above in the answers to questions 1, 2 and 3, if the Proposed Joint Venture proceeds the existing schedule is expected to be maintained and significantly expanded as the joint venture is implemented.

By contrast, absent the Proposed Joint Venture, the Applicants consider that the likely outcome in the near term will be either the existing schedule or a reduced schedule. [REMOVED]

Historic pre- and post- antitrust immunity capacity data for alliances demonstrate that enhanced coordination under antitrust immunity has generated substantial capacity growth in hub-to-hub markets. Northwest/KLM is the oldest and best example. After receiving immunity for their alliance and later for their joint venture, Northwest/KLM increased their transatlantic hub-to-hub ASMs by 380%.⁴ Like Northwest/KLM 15 years ago in the transatlantic, the Applicants here are small players in the U.S.-South Pacific market. By realising the potential of this end-to-end network combination, the travelling public stand to gain important benefits from the grant of authorisation through continued faster capacity growth and enhanced competition over time.

³ [REMOVED]

⁴ U.S. Department of Transportation T100 data, CY2008 vs CY1992.

[REMOVED]

8. *An estimate or quantification of the effect of removing 'double marginalisation' incentives on the applicants' trans-Pacific routes.*
9. *An estimate or quantification of the effect of removing 'double marginalisation' incentives on the applicants' beyond codeshare routes.*

Airlines pricing is highly dynamic and it is impossible to predict with certainty the future fare that will be offered in the marketplace. However, what can be known with certainty – and which has been borne out in numerous governmental and academic studies – is that the joint venture structure creates inherent efficiencies and incentives for more competitive pricing by joint venture alliances than arms-length codesharing.

The Proposed Joint Venture provides for highly coordinated pricing and yield management of both eastbound/northbound and westbound/southbound services [REMOVED] Under the Joint Venture Agreement, the carriers can jointly price a fare without the separate profit markups and thus offer lower fares. The applicants are thus competing with other, larger players in the marketplace – rather than each other – and can jointly price the product lower and more competitively to attract consumers to the combined network.

In terms of a specific quantification of the effect of removing 'double marginalisation' incentives, the Applicants note that a number of studies show that fares under an antitrust immunity arrangement are about 16 percent lower than connecting itineraries under arm's-length codesharing.⁵

As noted by Brueckner, empirical analysis of international city-pair markets shows that codesharing leads to a reduction in interline fares, but antitrust immunity has an even larger downward effect on fares. Cooperation among international carriers generates substantial fare benefits for passengers, over and above any convenience gains they may enjoy.

The Applicants estimate that the effect of removing such incentives through a 'metal neutral' alliance on the trans-Pacific and beyond codeshare routes will be of the same order as the historical cost analysis established by Brueckner.

10. *An estimate or quantification of the cost savings identified in section 8.3(c) of your submission dated 9 July 2009, namely:*
 - a. *Coordination of marketing spend and activities*
 - b. *Maintenance of a single sales, marketing and customer service team and operations in Australia and the United States*
 - c. *Joint procurement arrangements*

Consistent with the experience of prior joint venture alliances, the Applicants believe they can obtain significant cost savings through economies of scale, cost rationalisation, greater efficiencies and synergies.⁶ However, because both operations are start-ups, the data provided below has been extracted from budgeted rather than actual figures.

⁵ See, e.g. J.K. Brueckner, 'International Airfares in the Age of Alliances: The Effects of Code-Sharing and Antitrust Immunity', REVIEW OF ECONOMICS AND STATISTICS 85 : 105-118 (2003).

⁶ Supporting submission, *Qantas Airways Limited and British Airways Plc application for authorisation A30226-7* at page 25; Supporting submission, *Qantas and Air New Zealand applications for authorisation A30220-2, A90862-3* at page 78.

[REMOVED]The main sources of these cost savings are estimated to arise from:

- efficiencies/reduction in duplication - [REMOVED]
- procurement - [REMOVED]

A variety of other (largely non-quantifiable) synergistic benefits may also be accessed across time as the partnership develops and grows:

use of the most efficient aircraft on a particular route - [REMOVED]

- increased aircraft utilisation (and therefore increased capacity) that may be possible due to network and/or schedule;

anticipated increased load factors given the broader network and frequency offering, which will enable fixed costs to be spread across larger passenger numbers, reducing unit costs; and

Virgin Blue may be able to access a variety of Delta's systems that may produce efficiencies for it [REMOVED]

Attachment 1 provides detailed estimates by line item of cost savings from Virgin Blue as they relate to its trans-Pacific operations, with most of the savings estimated to be in relation to US expenditure.

[REMOVED]

For its part, although it is difficult to quantify precisely, based on prior experience and savings achieved in other alliance relationships, Delta anticipates the following range of cost efficiencies as summarised in the table below:

[REMOVED]

The range of savings realized will depend on the degree of integration and delegation achieved by the partners. For example, under the Northwest/KLM Joint Venture, each partner was able to entirely eliminate its respective sales force and advertising in the territory of the other, resulting in annually recurring savings of millions of US dollars in reduced overhead. Likewise, it is unnecessary to employ duplicative analysts and revenue management experts if those functions can be delegated to the partner carrier in its home originating market. These savings will be realized over time as the partners develop comfort, familiarity, and integrate their commercial functions under the joint venture.

11. *Whether any of the cost savings at 10(a)-(c) above could be achieved through the applicants' existing cooperation agreements and if so, a comparison of the cost savings with and without the Joint Venture.*

The Applicants believe that the cost savings are only likely to be achieved under a metal neutral joint venture arrangement such as the Proposed Joint Venture. With existing cooperation agreements, each applicant must undertake the costs to market, advertise, distribute, and support its own product independently. While some joint purchasing benefits might be legally achievable, such cooperation is unlikely absent the deeper commercial relationship contemplated by the Proposed Joint Venture.

12. *The proportion of each of Virgin Blue's and Delta's passengers travelling beyond relevant city gateways, including details of their destination.*
13. *The proportion of each of Virgin Blue's and Delta's passengers whose travel originates outside of relevant city gateways, including details of the destination.*

The Applicants do not have complete information on all of its passengers' origins and final destinations. Where passengers book travel on a single ticket, origin and destination information should be captured by the Applicants. However, where a passenger independently books travel on a different carrier (either to get to the point of departure of the Virgin Blue flight or for onward travel), only the trans-Pacific leg will be recorded on the Applicants' respective booking systems.

Therefore, the information provided below in response to questions 12 and 13 will necessarily understate the proportion of passengers travelling beyond relevant city gateways and the proportion of passengers whose travel originates outside of relevant city gateways, while simultaneously overstating gateway to gateway traffic.

Virgin Blue traffic information

The table below summarises the proportion of Virgin Blue's passengers travelling both beyond and from behind relevant city gateways. Because Virgin Blue does not have access to historical data on passengers' origins and final destinations, the information is based on bookings held at 14 September 2009 for all travel in the period September 2009 – August 2010.

[REMOVED]

Where 'behind' or 'beyond' segments refer to Australian domestic routes, these figures include Virgin Blue domestic connections. Note that these figures capture traffic to and from countries other than Australia and the United States (e.g., amongst others Canada, Mexico and Argentina in the Americas and New Zealand, Papua New Guinea and the Solomon Islands in Australasia).

Information from V Australia on the actual destinations of beyond passengers and origins of behind passengers is provided in Attachments 2 and 3, following.

Delta traffic information

The table below provides information on traffic composition for Delta's Los Angeles-Sydney flight for its first two months of operation (July-August 2009). Traffic is divided into four groups: (1) local Los Angeles-Sydney (2) Behind/Beyond Los Angeles-Sydney (3) Behind/Beyond Sydney-Los Angeles and (4) Behind/Beyond Los Angeles-Behind/Beyond Sydney.

[REMOVED]

Detailed information on the volume of traffic in the specific city-pairs that underlie the data summarised here is provided in Attachment B.

[REMOVED]

With the aligned incentives enabled by the Proposed Joint Venture, each airline expects to carry a significantly higher percentage of behind/beyond foreign gateway traffic than it does today, enhancing the viability of their gateway-to-gateway services and increasing network competition against the incumbents in the US-Australia market.

14. *Please provide details of monthly pricing data for Virgin on each of its respective trans-Pacific services from February to August 2009.*

Details of published fares (as opposed to the average fares paid) are provided in Attachment C to this document, being an excel spreadsheet of V Australia fare tariffs. [REMOVED]

15. *Please provide details of any promotions and/or discounts offered by each of Virgin Blue and Delta since the commencement of their trans-Pacific services including:*

- a. *the nature of the offer(s)*
- b. *time-frame of the offer(s)*
- c. *route to which the offer(s) applies*

[REMOVED]

Attachment D, being a spreadsheet detailing the V Australia daily fare filing log as at 16 September 2009, provides details of all the promotions offered by route between 8 November 2008 and 15 September 2009, including the timeframe for the offers. **[REMOVED]**

Delta's promotional fares for SYD-LAX are set forth in Attachment E.

16. **[REMOVED]**

Attachments

Attachment 1 – Virgin Blue line item estimate of cost savings on its trans-Pacific operations

Attachment 2 – Virgin Blue beyond traffic

Attachment 3 – Australian-originating passengers on Virgin Blue trans-Pacific

Attachment 4 – Delta behind/beyond traffic on SYD-LAX

Attachment 5 – Published V Australia fare tariffs

Attachment 6 – V Australia daily fare filing log as at 16 September 2009

Attachment 7 – Delta promotional fares for SYD-LAX