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16 November 2009

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Dr Richard Chadwick
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Dear Dr Chadwick

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

Virgin Blue and Delta (together the **Applicants**) welcome the Commission's draft determination to grant authorisation to the proposed V Australia/Delta joint venture (**Joint Venture**).

The Applicants provide this submission in response to the Commission's invitation in its draft determination.

1 General response to draft determination

The Applicants strongly support the Commission's finding that the Joint Venture will deliver public benefits through:

- integration of two complementary end-to-end networks, leading to route connectivity benefits for consumers and more sustainable competition on trans-Pacific routes;
- enhanced route coverage and schedules; and
- potential cost savings which are likely to be passed on to consumers as a result of competition on trans-Pacific routes.

The Applicants also support the draft determination's conclusion that "...the ACCC considers that it is unlikely that the Joint Venture will result in any significant diminution of competition in the respective markets for international passenger transport for...(i) trans-pacific leisure travellers; and (ii) business travellers on the Sydney – Los Angeles route" (4.205).

As the Commission concludes, the Joint Venture is likely to enable Virgin Blue and Delta to compete more vigorously and effectively against the established carriers on trans-Pacific routes, which is itself an important public benefit.

The ability to enhance the service offering under the Joint Venture in competition with Qantas (and American) and United is an important commercial rationale for the Joint Venture.

However, the Commission has proposed to grant authorisation only for a period of three years, on the basis that the extent to which these benefits are realised will depend on the conduct of the Applicants under the Joint Venture. The Commission has suggested that there is limited empirical information on the extent of likely benefits in this case. The Applicants respectfully disagree with these findings and urge that the authorisation be granted for a period of at least five years. As demonstrated on the record, and supplemented by this submission, there is strong empirical evidence that the Applicants will achieve substantial public benefits.

With these limited exceptions, the Applicants urge that the correct and fully justified finding of the draft decision to authorise the proposed alliance between V Australia and Delta be confirmed in a final decision.

The public benefit case is well established

The Applicants consider that the public benefit case for the Joint Venture is a strong one and that, on the evidence provided, the Commission can have confidence that the Joint Venture will deliver material public benefits.

- The enhanced end-to-end network capability serving critical behind and beyond destinations in the US and Australia, together with the respective marketing, sales and distribution strength of Delta in the US and Virgin Blue in Australia, will enable the Applicants to match the offering of Qantas and United.
- The Applicants will provide an improved service offering in terms of seamless beyond gateway connections, increased number of direct services (particularly direct services to Brisbane and Melbourne which are currently subject to limited competition) and improved access to those direct services.
- The joint venture will deliver reduced costs through access to lower fares on each other's domestic networks as well as through the merger of sales, marketing and other functions.

Enhanced end-to-end network capability

The Joint Venture clearly enhances the strength of the competitive offering of the Applicants on trans-Pacific routes, in competition with both Qantas and United. This is a significant public benefit in its own right and is an important commercial rationale for the Joint Venture.

As stated in the draft determination, "the Joint Venture is likely to enhance the ability of the applicants to compete more vigorously and effectively against the most established operators on the route" (4.205).

Both Qantas (through its relationship with American) and United have a strong integrated network offering for origin and destination points beyond the west coast of the United States as well as access to a strong North American sales, distribution and marketing base.

By contrast, V Australia is the only airline operating on the route that does not have deep access to a North American domestic network and to the sales, distribution and marketing support of a strong US alliance partner as a source of customers. As a consequence:

- V Australia cannot offer the same degree of seamless onwards travel to its Australian customers as Qantas (through American) and United can offer, with the result that it has a lower proportion of beyond gateway travellers on its services.[1]
- V Australia lacks market access to US travellers and an effective US sales point of presence, with the result that it has a lower proportion of US originating travellers on its services.[2]

Similarly, Delta lacks access to a wide range of Australian destinations on a code share basis and the sales, distribution and marketing capability that Virgin Blue can provide in Australia.

The Joint Venture will go a long way to enabling V Australia to match the Qantas and United offering enabling it to benefit from a strong partner who is able to bring deep North American sales, distribution and marketing capability to the Joint Venture. On the other side, Virgin Blue's domestic network provides the ability for Delta to offer an integrated beyond Sydney network to its customers and the Joint Venture provides Delta access to Virgin Blue's Australian sales and marketing capability.

Delta brings to the Joint Venture:

- US originating traffic volumes available from a strong US network airline; and
- the ability to offer Australian originating passengers code share access to a wide network of beyond destinations in the US.

In this regard, the draft determination significantly underestimates the domestic US strength of Delta's network and appears to dismiss the significance of the Alaska alliance on the basis that V Australia cannot code share on Alaska. The Commission's analysis also overlooks Delta's sales, distribution and marketing strength.[3] Delta also brings the benefit of world's largest frequent flyer program to the Joint Venture's marketing advantage. **[CIC]**

Without the Joint Venture, neither carrier would have an incentive to route passengers from their domestic networks onto the other's trans-Pacific services. The Joint Venture provides the important incentive to provide broad, full-network codesharing arrangements. Without the Joint Venture, each carrier will only offer narrow codeshare access **[CIC]**, so as to retain its domestic network advantage in its home market. The Joint Venture thus facilitates the creation of a joint network offering, which enables the Applicants to produce a superior product from a consumer perspective.

Improved Service Offering

Travellers strongly prefer the convenience and assurance of online (single airline) or online equivalent travel from the many points of origin to final destinations that will be available under the Joint Venture.

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[1] See the Applicants' response to the Commission's information request of 10 September 2009 (including Attachment 2), and additional information provided in Annexure 1 to this letter.

[2] See the Applicants' response to the Commission's information request of 10 September 2009 and additional information provided in Annexure 2 to this letter.

[3] As discussed in the Applicants' meeting with the Commission of 9 October 2009. See also additional discussion in Section 2 of this letter.

Because the Joint Venture strongly aligns Delta and Virgin Blue's interests it will result in enhanced cooperation between them and integration of the Applicants' domestic networks with the Joint Venture's trans-Pacific routes. Under the Joint Venture, Delta and Virgin Blue intend to enter into broad reciprocal codesharing access on their respective domestic and international services. The strong and consistent conclusion of Delta's Quality Service Index (**QSI**) model results previously provided to the Commission[4] and the additional Inter*VISTAS* analysis recently commissioned by Virgin Blue,[5] is that the enhanced online equivalent offer under the Joint Venture will increase overall passenger levels (and improve the fare mix) on the Applicants' flights. We are not aware of any evidence to the contrary.

The increased overall load factors and improved fare mix will in turn enable the Applicants to:

- enhance services on existing trans-Pacific routes (particularly direct services to Brisbane and Melbourne which are currently subject to limited competition);
- enter onto other trans-Pacific routes in competition with Qantas and United Airlines; and
- develop entirely new trans-Pacific services.

The evidence is that increased direct services have been developed by Delta (and Northwest) under joint venture alliances. While the Commission may reasonably question the difference in scale between Australasian and European markets and catchment areas, the general point remains that the Joint Venture provides an enhanced ability to develop such services and that there is a strong stimulation effect from such direct services.[6] The Applicants stress that aviation is a network business and that end-to-end network combinations have the same characteristics irrespective of whether the services are operated over trans-Atlantic or trans-Pacific routes. The network benefits of the Joint Venture on the initial routes are clearly demonstrated by Delta's QSI modelling. These benefits will further grow over time as the Applicants add new routes to additional hubs, and new spokes to existing hubs.

Finally, under an integrated codeshare supported by the Joint Venture, both parties will have an incentive to route passengers via the most direct trans-Pacific routes irrespective of which airline is the operator of the route. A passenger flying from Los Angeles to Brisbane on Delta under a limited codeshare would be routed through Sydney to maximise Delta's revenue. With the Joint Venture,

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[4] Delta's QSI model is a sophisticated analysis tool developed by Delta for evaluating commercial opportunities for new alliance and direct-service opportunities. **[CIC]**

[5] The Inter*VISTAS* analysis has been provided as Annexure 3 to this letter.

[6] The draft determination incorrectly dismisses the KLM/Northwest experience as irrelevant to the proposed Joint Venture, despite the evidence that the KLM/Northwest alliance supported the introduction of new direct services. While the European and trans-Pacific markets are clearly different, such differences are not relevant to the general point the Joint Venture will support the development of new direct services. The draft determination erroneously attempted to distinguish that experience based on an incorrect understanding of the KLM/Northwest relationship. For example, while the draft determination places emphasis on an existing KLM ownership interest in Northwest as a distinguishing feature, KLM disposed of its ownership interest in 1998, one year after the commencement of the joint venture (see NY Times, 'Northwest Air to Buy Back 19% Stake Held by KLM' (31 July 1997) available at: http://www.nytimes.com/1997/07/31/business/northwest-air-to-buy-back-19-stake-held-by-klm.html (site visited 15-11-09)). The development of new services has flourished under the Northwest/KLM joint venture long after the KLM investment was unwound. There is no basis to conclude that the applicants here will not be able to achieve similar network expansion of their limited trans-Pacific routes. Indeed, all of the empirical evidence and data on the record (including both the Delta QSI modelling and the Inter*VISTAS* Joint Venture codeshare analysis) supports the Applicants' position.

Delta is incentivised to put the passenger on V Australia's direct service to Brisbane, simultaneously providing a better product for that passenger and improving loads on the BNE-LAX route. The improved load factor facilitated by the Joint Venture will create opportunities for expanding the direct trans-Pacific services offered.

Reduced costs

V Australia will be able to gain access to a larger range of lower fare inventory on a larger number of US domestic routes under the Joint Venture.

The evidence is clear that on Delta North American routes lower pro-rate fares are likely to be available to V Australia under the Joint Venture, than without it. The draft determination does not accept the consistent result of studies demonstrating that joint venture alliances result in overall lower fare levels on competitive routes. **[CIC]**

Finally, there is direct evidence that the Joint Venture results in direct public benefits through cost savings available through the Joint Venture. Estimates of these cost savings have been provided to the Commission. While these are estimates, each of the items identified is naturally and logically an area in which there will be cost saving under the Joint Venture. Consistent with the Commission's conclusion, robust competition in direct trans-Pacific markets under the Australian/US Open Skies policy and the Applicants' lack of market power ensure that cost reductions will be passed through for the benefit of customers (4.131).

Authorisation should be granted for Five Years

A three year authorisation period, which commences potentially up to 6 months prior to the implementation of the Joint Venture, will hinder the full achievement of the public benefits. An unduly short authorisation period could have the unintended consequences of deterring the very risk taking and investment that the authorisation is intended to promote, because the Applicants cannot be sure they will be permitted to cooperate long enough to realise the benefits of those investments. The Applicants could potentially have as little as 18 months of Joint Venture implementation experience before applying for reauthorisation.

In light of these considerations, the Applicants submit that a three year period of authorisation does not provide sufficient time in which to demonstrate the full realisation of the Joint Venture benefits and the development of a strongly sustainable third competitive force on trans-Pacific routes with integrated domestic network offerings.

The successful implementation of the joint venture will require substantial investment by both parties to develop the necessary information technology and harmonise product offerings. The decision to launch new nonstop service involves substantial risks and sunk costs.

The Applicants note that no substantive joint planning has occurred at this time due to the restrictions of the US antitrust immunity process. It is also noted that as the Applicants will not have shared competitively sensitive, confidential and strategic information prior to the grant of anti-trust immunity, they have not undertaken the detailed planning of the actual configuration of Joint Venture operations. However, in response to the Commission's request, the Applicants have prepared an indicative timeline illustrating the likely commercial timeframe for implementing the Joint Venture.[7]

[7] See Annexure 4.

Therefore, to better enable the Applicants to vigorously pursue and implement the Joint Venture and demonstrate the public benefits, the Applicants propose the following authorisation:

> *The ACCC grants authorisation to applications A91151-A91152 and A91172-A91173 for the period commencing on the date of this decision and terminating on the date five years from the date of the Final Order granting antitrust immunity in the US DOT proceeding, or 1 July 2015, whichever is earlier.*

The Applicants will notify the Commission upon the grant of US antitrust immunity.

The requested five year authorisation is consistent with the period granted to other airline alliances, including the Qantas/British Airways JSA.[8] In contrast to that alliance, the proposed Joint Venture between the Applicants does not give rise to any material anticompetitive detriment, as noted by the Commission. Not only does the draft determination conclude there is no anticompetitive detriment under the Joint Venture, but the potential for new entry on the trans-Pacific routes is far more robust than in the Qantas/BA case due to the Open Skies Agreement, larger number of US and Australian competitors and unconstrained entry at US airports (which is certainly not the case at Heathrow). The Applicants are of the strong view that the Joint Venture should receive an authorisation period of five years to fully demonstrate its public benefits, as with the original Qantas/British Airways JSA decision.

Response to Issues Raised in the draft determination

The remainder of this submission addresses, and elaborates on, specific points we understand are of interest to the Commission, in particular:

- the commercial rationale underpinning the Applicants' entry into the proposed joint venture arrangements;
- how the proposed joint venture enables the Applicants to better compete with the incumbent carriers;
- whether V Australia will remain as a highly price-competitive and innovative carrier on trans-Pacific routes;
- how pricing on trans-Pacific routes may change in the future;
- the comparative cost bases of the Applicants on trans-Pacific services;
- an explanation of the creation of the Joint Venture service offering; and
- details of the implementation of the proposed joint venture by the Applicants.

The Applicants have also responded to the draft determination's findings on flow-on benefits in tourism and employment.

These issues are addressed directly below.

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[8] Qantas Airways Limited and British Airways Plc (Trade Practices Commission determination March 1995), Qantas Airways Limited and British Airways Plc applications for authorisation (A30226 and A30227) and Qantas / Air New Zealand authorisation in *Qantas Airways Limited* [2004] ACompT 9.

2 The commercial rationale for the proposed alliance is the joint network offering

Virgin Blue / V Australia

From the perspective of Virgin Blue, the commercial rationale for a trans-Pacific joint venture is the need to address limitations in V Australia's network offering and in its US sales, distribution and marketing. Without the Joint Venture V Australia has limited ability to:

- gain access to US travellers to travel on its aircraft; and
- provide an integrated V Australia ticket for Australian travellers flying beyond LAX.

Both these points are demonstrated by the material provided to the Commission.

V Australia has a disproportionately low share of US based passengers. **[CIC]** In contrast, Qantas has the benefit of American's US sales strength and United obviously can support its own sales in the US. We have provided at Annexure 2 further data in relation to V Australia's point of sale origin (i.e., US or Australia).

The Joint Venture addresses that weakness by:

- partnering with Delta's strong sales, distribution and marketing operations in the US; and
- accessing Delta's own domestic traffic (whether originating on Delta's own flights or on its codeshare flights from partners such as Alaska).

Similarly, the Joint Venture will give Delta access to Virgin Blue and V Australia's very strong sales, distribution and marketing capability in Australia and Virgin Blue traffic as a feed into Delta flights, which is a core reason for Delta to partner with V Australia, as discussed further below.

The overall result will be that the combined operations of the Joint Venture will have a stronger sales capability and source of travellers to the benefit of both airlines, competition, and consumers.

V Australia also has a disproportionately low share of Australian travellers who want to travel onwards in the United States. **[CIC]** a reflection of its lack of a competitive onwards travel offer, especially compared to Qantas and United. We have provided at Annexure 1 further data in relation to V Australia's traveller origin data.

Under the Joint Venture, V Australia:

- will gain access to a far greater number of code-share destinations than **[CIC]** available under the limited codeshare arrangement in the counterfactual;
- is likely to gain access to favourable pro-rate inventory for such destinations (where Delta will have an incentive to offer favourable rates as it will share in the revenue from such sales), enabling it to offer more competitive onward fares to other US destinations.

The Applicants note the Commission appears to significantly underestimate the strength of Delta as both a source of origination traffic for V Australia and as a source of onwards code-share destinations.

However, Virgin Blue's assessment is that Delta offers an unrivalled North American partner opportunity.

[CIC]

While Delta may have "only" the fourth largest presence at LAX, it is the third largest network airline behind American and United, V Australia's other competitors on the trans-Pacific routes. Rather than being a weakness of the Joint Venture, the fact that Virgin Blue is able to partner with the third largest network operator out of LAX (when the other two are its competitors on the trans-Pacific routes) is a critical strength. Delta is the largest domestic US carrier, based on the most recently available Bureau of Transportation Statistics figures.[9]

The draft determination appears not to fully accept the network advantage achieved under the Joint Venture, for example stating that (4.76):

> *The ACCC notes that the information available does not clearly substantiate the extent to which network advantages are likely to arise as a result of the Joint Venture. In particular, the ACCC notes that Delta does not have a significant presence at either Los Angeles or San Francisco, which are the two key hubs on the United States west coast for trans-Pacific flights.*

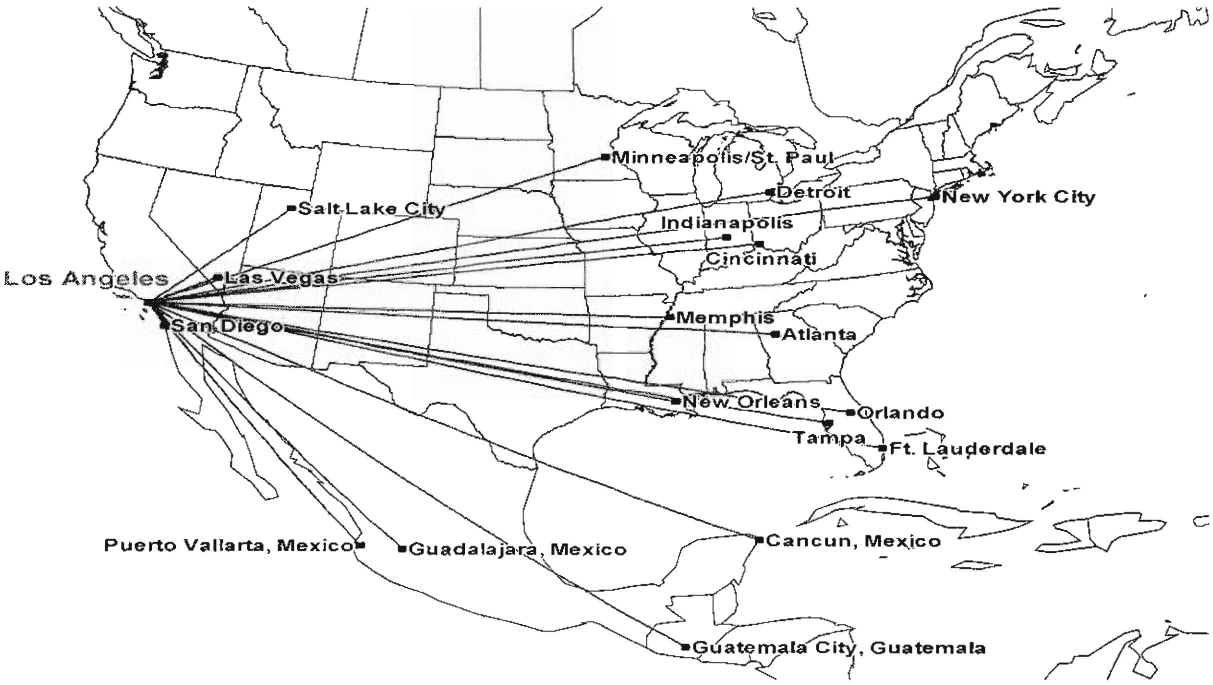
In respect of San Francisco, the Applicants do not accept the Commission's assertion that Delta does not have a significant presence at this gateway. In terms of mainland US destinations, Delta offers non-stop services with its own aircraft from San Francisco to Salt Lake City, Cincinnati, Atlanta, New York, Memphis, Minneapolis/St Paul and Detroit and is also able to support service to Honolulu and Tokyo, as well as Paris and Amsterdam via its European Joint Venture partnership with Air France/KLM. Moreover, as described below, Delta's codeshare arrangements with Alaska will drive a significant body of traffic from the west coast through the Joint Venture's potential trans-Pacific routes out of San Francisco. This network traffic will support the introduction of services through this hub.

The Commission's focus on Delta's alleged (and incorrect) lack of connectivity between Los Angeles and San Francisco is misplaced. **[CIC]** As was the case with Los Angeles, the domestic network feed provided by both Delta and Alaska will promote and sustain potential new joint venture services.

In addition, the Applicants strongly reject the view that Delta does not have a substantial presence at Los Angeles. Delta has a robust presence at LAX. It has further buttressed its position at LAX and on the west coast generally through an important strategic partnership with Alaska Airlines. A few key illustrations of the strength of Delta are set out below:

- Delta has a large number of onwards flights from LAX to significant US destinations. Delta serves 18 cities non-stop from Los Angeles, being 14 US cities and, 4 non-US cities. The non-stop destinations served by Delta out of LAX are illustrated in the diagram below.

[9] BTS figures from the year December 2007 to November 2008 show Delta/Northwest with a combined share of 17.7%, compared to the next largest competitor American at 14.4%.



- including LAX, these destinations represent 15 of the top 40 (and 9 of the top 20) US-Australia markets;
- the US cities Delta serves non-stop from Los Angeles account for nearly 60% of US-Australia passenger demand.

In relation to the codeshare relationship with Alaska, it is important that the Commission appreciate that the Alaska relationship provides access for Delta on a codeshare basis to a large number of additional travellers.

[CIC]

The Alaska relationship is significant:

- including codeshares with Alaska, Delta serves 38 cities nonstop from/to Los Angeles (29 US cities and 9 non-US cities).
- including codeshares with Alaska, Delta serves 19 of the top 40 (and 12 of the top 20) US-Australia markets nonstop from Los Angeles.
- including codeshares with Alaska, the US cities Delta serves nonstop from Los Angeles account for 75% of US-Australia passenger demand.

Absent the Delta relationship, V Australia would not have access to the Alaska codeshare network.[10] While it is true that V Australia will not be able to codeshare immediately and directly with Alaska, as discussed below, V Australia will be able to gain the benefit of the Alaska network traffic through the Delta codeshare. Delta can immediately put the advantages of the Alaska network to work in fuelling

[10] V Australia currently has a limited interline arrangement with Alaska, which, for the reasons discussed, is significantly inferior to codesharing from a customer marketing perspective.

Joint Venture flights – by putting DL* coded traffic from Alaska flights onto DL* coded flights operated by V Australia. **[CIC]**

Likewise, V Australia is unlikely to conclude a codeshare arrangement with American or United, since American is committed to its oneworld partnership with Qantas, and United would be unwilling to feed V Australia traffic at the expense of United's own metal service. Delta is V Australia's best alliance choice, and that relationship is further enhanced by Delta's partnership with Alaska.

Delta also brings a substantial benefit to V Australia through access to double connect passengers. In many US-Australia routes, double connecting service is competitive:

- **[CIC]**% of the passenger traffic onboard Delta's Los Angeles-Sydney service is double connecting behind/beyond Los Angeles;

[CIC]Also important from Virgin Blue's perspective is Delta's strong brand presence in the US. It has the world's largest frequent flyer program, larger than either American or United and a significantly higher customer satisfaction rating than either American or United. Delta has an extensive range of lounge facilities around the globe, more than any other US carrier.

From Virgin Blue's perspective Delta is the ideal US carrier for an alliance. It is not a traditional, high-cost legacy carrier and its product and business model are much more closely aligned to V Australia than those of United and American. Delta and V Australia share a common vision for a superior trans-Pacific product. Delta is an innovative market participant and has a low cost, high quality product that is fully compatible with V Australia. For example:

- Like V Australia, Delta entered the US-Australian market with new Boeing 777 aircraft featuring 180-degree flat beds in business class, which will be fitted on its entire fleet by 2013.
- Delta has the largest fleet of audio-visual on demand (AVOD)-equipped aircraft in North America.
- Delta is the world's largest WiFi enabled carrier with access installed on 240 aircraft, increasing to more than 500 aircraft in 2010.

Delta – Commercial Rationale

The Delta commercial rationale for the Joint Venture is very much the reciprocal of Virgin Blue's, having regard to the Australian domestic market strengths that Virgin Blue brings to the Joint Venture.

Importantly, Delta is the world leader in terms of know-how and commercial benefits that can be obtained through joint venture alliances with other airlines. Northwest, which is now part of Delta, pioneered the JV concept with the highly successful Northwest-KLM joint venture. Delta, Air France and KLM now operate the world's leading cross-border airline joint venture. Together, the airlines represent 25 percent of the trans-Atlantic market, operate more than 100 daily round-trip trans-Atlantic flights, serve more than 400 destinations in Europe and North America, generate about $**[CIC]** billion in annual revenues and employ more than 170,000 people. By building a fully integrated network across the Atlantic, the joint venture partners have substantially expanded service and price competition to the benefit of consumers.

This wealth of practical experience has enabled Delta to develop a sophisticated commercial appreciation of the drivers of traveller behaviour, and how different modes of service impact on traveller choice, and the ability to model those travel decisions. That modelling is internalised in the QSI analysis described to the Commission in our submission of 7 October 2009.

[CIC]It is appropriate to restate some of the key conclusions from that analysis:[11]

- Importantly, the QSI results for the Joint Venture when compared with the Limited Arms Length Codeshare scenario strongly support the Applicants' public benefit case.
- When comparing the Joint Venture scenario against the Limited Codeshare scenario, the QSI predicts marked increases in load factors on all routes for both Delta and V Australia (which increases utilisation and is a direct efficiency benefit) as well as marked increase in connecting customers (reflecting increased service benefits to customers, in terms of timeliness of travel and convenience).
- The higher QSI achievable under the Joint Venture compared with the Limited Codeshare scenario is itself direct evidence of public benefit, as it is a measure of the enhanced product offering achievable under the Joint Venture from the customer's perspective. **[CIC]**

These increases in load factors, and the increased revenue they generate, are significant as they ultimately support increased capacity on existing or new routes.

As with Virgin Blue, Delta's options for available alliance partners that can provide domestic access is relatively limited. The only international airlines that have a domestic Australian network are Virgin Blue and Qantas.

3 The proposed joint venture makes the Applicants better able to compete with the incumbents

An important aspect of the analysis set out above is that the Joint Venture will enable V Australia and Delta to provide a competitive offering against Qantas and United. Importantly, without the alliance V Australia could simply not match either of Qantas or United on the trans-Pacific routes in terms of:

- access to the US customer base; and
- ability to offer a single V Australia ticket through to multiple one-stop and double-connect destinations in the US.

Without the Joint Venture, V Australia will have **[CIC]** codeshare destinations in the US. Under the Joint Venture, V Australia will have access to:

- the 18 direct destinations served by Delta from LAX;
- **[CIC]**
- hundreds of double-connect destinations through Delta's US network;

[11] The QSI takes historical fare data as an input and does not model actual fares (which has led to a significant disparity between the "average fare" in the QSI**[CIC]** and the actual average fares in the current market). This apparent disparity does not affect the validity of the analysis, however, as the QSI is a tool to evaluate the impact of potential alliances and is not intended to predict fares.

- subject to the development of other potential direct destinations, **[CIC]** access to direct routes from those hubs.

Another important aspect of the enhanced competition available under the Joint Venture is the availability of low cost codeshare inventory to V Australia under the Joint Venture, which will enable V Australia to offer a more competitive combined air fare with Delta to destinations beyond the US gateways than is possible under an arms-length arrangement. There is a clear incentive for Delta to offer lower cost inventory to V Australia under the Joint Venture, where this drives increased sales of trans-Pacific fares by V Australia. This is because Delta shares in the overall revenues that V Australia will earn on trans-Pacific services under the Joint Venture. This benefit will be taken into account in the price that Delta provides to Virgin Blue for codeshare inventory. Without the incentives of the revenue sharing, Delta will not factor in the benefit from an overall increase in trans-Pacific services on V Australia flights (or Delta operated flights sold by V Australia). The failure to take into account this effect leads to a higher price for consumers.[12]

This advantage has been previously conveyed to the Commission in our meeting of 10 October 2009 and the letter of 16 October 2009. With the integrated Joint Venture, Delta will treat V Australia's network as its own and will be incentivised to provide access to all its fare classes.

[CIC]The reason for the greater availability of lower fares is that, as noted above, under the Joint Venture Delta benefits from additional trans-Pacific sales on V Australia metal and therefore has an incentive to facilitate such sales by reducing the cost of the North American domestic leg of a V Australia ticket.

This clear and quantifiable conclusion, coupled with the high proportion of passengers who travel beyond the west coast gateways and the substantially larger number of destinations that V Australia will be able to offer as a codeshare destination, can only support a conclusion that this is a very material benefit of the Joint Venture.

Further, it is one that will enable V Australia to offer fares that are competitive to those of Qantas and United to points beyond/behind the west coast gateways. The Applicants consider that it could be reasonably assumed that Qantas benefits from favourable codeshare arrangements with American, while United can clearly internalise the benefits of the sale of a combined trans-Pacific and domestic leg in one ticket price.

[12] The draft determination misapplied the conclusion that the removal of "double marginalisation", as reviewed in several academic studies, would result in lower fares. The consistent conclusion of those studies is that in competitive markets, overall fare levels decrease. This important conclusion was rejected by the Commission (at 4.127). The Applicants continue to stress that this rejection is without factual or academic support. The draft determination incorrectly focuses on the applicability of double marginalisation to the coordination of prices on the trans-Pacific flights operated by V Australia and Delta. The relevant double marginalisation is for the respective domestic legs at either end of the trans-Pacific routes. The consistent conclusion of the academic evidence on this effect is that the cost advantage on behind/beyond legs has an ancillary effect on the hub-to-hub (i.e., trans-Pacific) routes that drives prices down.

The Commission does appear to recognise that there would be an incentive to offer a codeshare lower fare on the domestic leg under the Joint Venture (at 4.125). Notwithstanding that, the Commission concluded that it was not persuaded about the extent to which the Joint Venture would "eliminate double marginalisation and deliver a public benefit of lower fares in this case."

4 V Australia will remain as a highly price-competitive and innovative carrier on trans-Pacific routes

Virgin Blue has a strong track record of providing highly competitive fares, service innovation and developing new routes and services in its relatively short 9-year history. The Applicants fully support the Commission's conclusion that "...[t]here is no reason to believe that the strong competition on price and service currently evident in the market from the entry of V Australia and Delta will not continue under the Joint Venture" (4.205).

V Australia's entry onto the trans-Pacific routes is a further example of the preparedness of Virgin Blue to develop new services and to introduce strong fare competition. In its short history to date, V Australia has been an innovative and highly price-competitive entrant on trans-Pacific routes. The Commission has concluded that Virgin Blue plays a role in driving price competition and innovation (4.174) and is a vigorous and effective competitor (4.180). Virgin Blue strongly agrees with that conclusion. The Applicants would also note that Delta is itself a strong price competitor and highly innovative, as noted earlier in this submission.

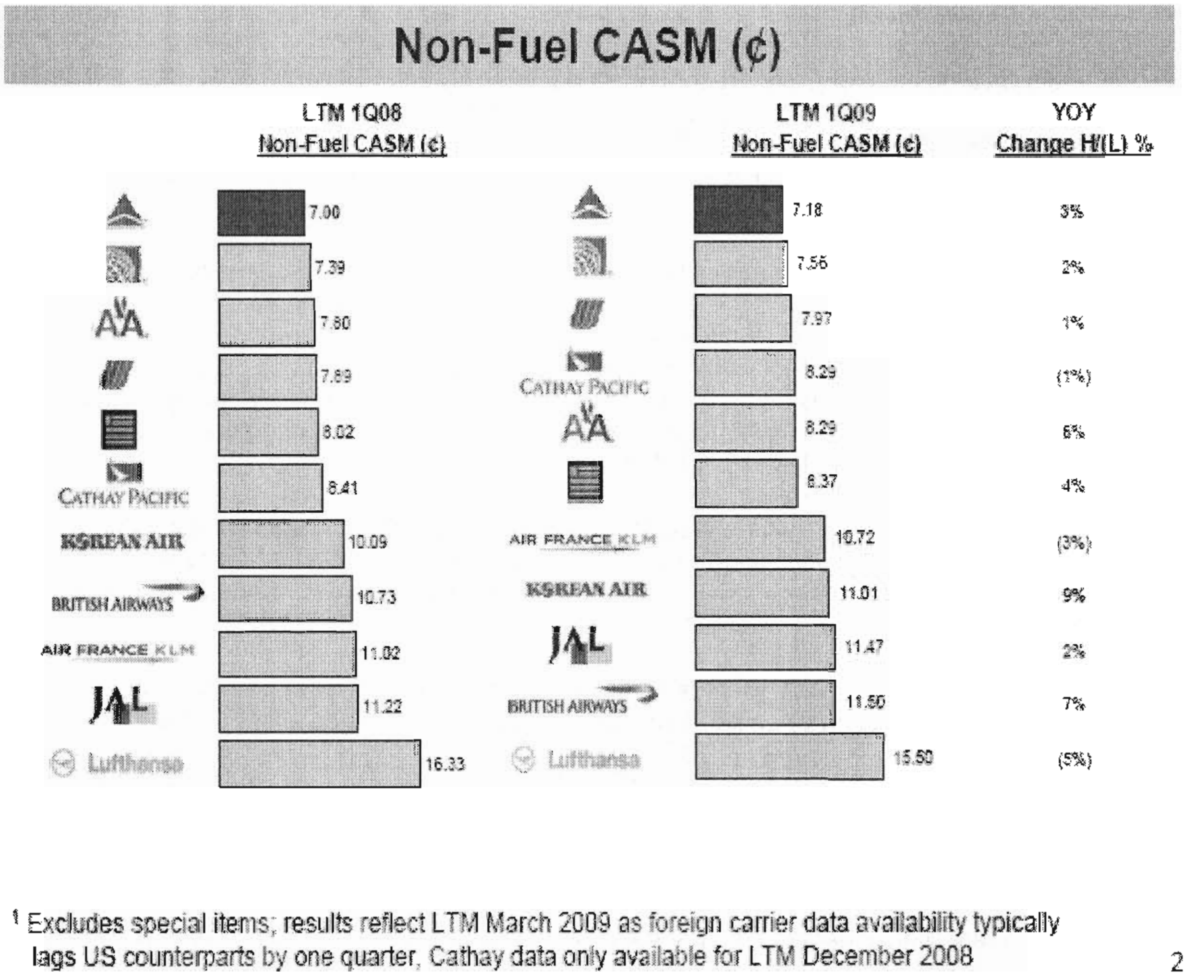
The Commission notes that the important question is whether or not V Australia (and presumably Delta) will continue to be a vigorous and effective competitor in the market when operating "in tandem with Delta" (and presumably when Delta is operating in tandem with V Australia) under the Joint Venture (4.182).

The Commission considers there is some risk that V Australia's influence as a vigorous and effective competitor may reduce when its partner is a "traditional full service airline". The Commission concludes that this is unlikely (4.183).

Virgin Blue and Delta strongly support that conclusion. It is well founded as the Joint Venture will not in any way reduce the incentives to remain highly competitive on the route. There are a number of bases supporting that conclusion, including:

- Virgin Blue is proud of its reputation for price competition and innovation, and has differentiated itself from its competitors on that basis. Virgin Blue has no intention or incentive to enter into a commercial arrangement that would undermine this reputation. In fact Virgin Blue is entering into this arrangement to extend the strength of its competitive offering through the broader Joint Venture platform and through an expanded and more competitive offering beyond LAX service.
- The Joint Venture actually supports continued strong price competition from V Australia. Under the Joint Venture, Virgin Blue will be managing pricing and marketing for the Australian market and will continue to offer an innovative and highly price-competitive product. In effect, the Joint Venture allows the opportunity to promote in the Australian market competitive fares over the broader US beyond markets and thus compete more effectively with the networks offered by Qantas and United.
- Delta is itself a low cost operator and highly innovative. Delta is the lowest cost airline among its global network carrier peers. Set out below is a comparison of the non-fuel cost per available seat mile for a range of leading global network airlines.[13]

[13] These figures represent an industry benchmarking exercise and should not be used to draw precise conclusions concerning actual costs. However, they are indicative of the relative costs of various airlines and are provided on that comparative ground.



- Finally, the strong position of the incumbents on trans-Pacific routes give the Applicants a clear incentive to innovate and develop their joint product (e.g., by introducing more direct services) to win customers from Qantas and United.

Another very real commercial and public benefit that the Applicants see from the Joint Venture is the opportunity that higher loads on trans-Pacific routes offers to support the introduction of new direct services, particularly on the BNE-LAX and MEL-LAX routes **[CID]**. These opportunities will only arise if the Applicants continue to be strongly price competitive in the trans-Pacific market.[14]

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[14] The draft determination noted that (4.116):

> *The ACCC accepts that the Joint Venture would facilitate the ability of the applicants to jointly adjust, upwards or downwards, capacity on the routes. Such a flexibility in relation to capacity can lead to higher fares as well as lower fares. Accordingly the ACCC does not believe that it can be assumed that the Joint Venture will give rise to a public benefit in the form of lower fares through increased capacity.*

The Applicants do not support any conclusion that the Joint Venture would lead to the reduction of capacity on trans-Pacific routes. The commercial rationale of the Joint Venture for both Applicants, along with associated modelling, is based around the premise of increasing utilisation on trans-Pacific routes by linking domestic networks. The conclusion that the Joint Venture

5 Costs

The Applicants consider that the different cost base of each carrier is not relevant to the competitive strength of the Joint Venture. The Joint Venture will operate under a revenue sharing model rather than a profit sharing model. **[CIC]**

Under the revenue sharing model, each Joint Venture party will continue to have an incentive to keep its cost base as low as possible as it directly gains the benefits of its own lower costs. In addition, the improved network offering will drive higher loads. The Applicants do not consider that there is any basis to conclude that any difference in cost base will lead to a less efficient competitor on trans-Pacific routes, or that it will have any adverse effect on competition or pricing.

Delta has experience with other alliances with higher cost carrier (e.g., Air France/KLM). The mere fact of a higher cost alliance partner has not undermined the overall competitive strength of the joint venture or stifled new route development. What is important to the success of the joint venture is the overall revenue contribution of each alliance partner, not their cost position. If a route is not profitable for one operator because of its cost position, but it is for another, then that party would operate the route and would benefit from the additional traffic that it gained from its higher cost alliance partner. At the same time, the arrangement would benefit the higher cost alliance partner by enabling it to provide a codeshare service where it would not be competitive operating its own higher cost services.

The Applicants therefore consider the issue of costs irrelevant and immaterial to the authorisation. Nevertheless, the Applicants have sought to respond to the Commission's request for further information concerning the costs per available seat kilometre of each Applicant. The Commission should be aware that the comparison of this data is problematic and is likely to produce misleading results. The unit cost base is driven by a combination of aircraft configuration, class mix and seat total, which makes the comparison between cost bases prone to misleading conclusions. Due to the differing configuration of inventory on the Applicants' aircraft, for example, it is difficult to accurately gauge their comparative costs on trans-Pacific routes. Differing internal accounting policies and treatments between the two airlines (for example the treatment of hedging, exchange rates, etc) will also distort any comparison.

The Applicants have produced for Delta, profit and loss statements in respect of its LAX-SYD route and for Virgin Blue, the profit and loss statement in respect of its international operations through V Australia.[15] It should be noted that V Australia's financial information thus includes all three trans-Pacific routes and is not LAX-SYD specific.

Despite the significant caveats on the usefulness of such apples-to-oranges cost comparisons, the Applicants submit that they are each efficient, low-cost operators with fully compatible business models and that their costs on trans-Pacific services are broadly comparable.

6 Future pricing and competition on trans-Pacific routes

The Applicants consider that the financial performance of all airlines operating direct services in the trans-Pacific market over the last year is unlikely to be sustainable. The financial performance of all airlines has been affected by broader economic conditions (notably depressed demand due to the global financial crisis and swine flu). These factors have had a profound effect.

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facilitates a reduction in capacity is not supported by the empirical evidence provided to the Commission and runs contrary to the Applicants' shared intention in relation to the Joint Venture.

[15] See Annexures 8 and 9.

The current level of services on the trans-Pacific route is not sustainable in the medium to long term if these market conditions continue indefinitely. Average fares (but not necessarily fare levels) would have to increase at prevailing load factors for services to be maintained at current levels.

It is important to note that the Joint Venture is not a response to GFC market conditions. The Joint Venture is a long term commercial alliance based on the key commercial benefits outlined above. The Applicants are not seeking authorisation on the basis that without authorisation one or both of the parties would withdraw from the route.

Looking forward, the Applicants consider that average fares (as opposed to fare levels) on trans-Pacific routes are likely to rise. This will be a result of an improvement in economic conditions and the removal of the high number of promotional fares offered by Delta and V Australia as the Applicants have sought to build consumer demand for their services. However, while average fares are likely to rise, the Applicants expect that there will be continued availability of low fares as the trans-Pacific routes will remain strongly competitive.

7 Additional benefits to US-Australian tourism and increased employment

The Commission has rejected the Applicants' submissions that the Joint Venture would provide a boost to tourism between the US and Australia (4.138) and increased employment in Australia (4.140).

The Applicants strongly reject the assumption that additional capacity and sustainable competition can be considered a binary condition on trans-Pacific routes. The Joint Venture will increase loads and drive additional services, thus increasing capacity on trans-Pacific routes. Although the Applicants have not attempted to quantify or strongly rely on this public benefit, it should be clear that through the expansion of capacity on trans-Pacific routes and the extension of competition into beyond destinations in both countries, the Joint Venture will have the necessary ancillary effect of facilitating increased tourism between the US and Australia, and between North America and Australia more generally. In particular, increased direct services to Brisbane and Melbourne would undoubtedly have a beneficial tourism impact on those cities as well as regional parts of Victoria and Queensland.

Further, the Applicants consider that increased employment is a consequent public benefit arising from the Joint Venture's other benefits. It is widely accepted that tourism has a significant multiplier effect on employment because tourism industries are employment intensive.

8 Joint Venture service offering

The Applicants understand that the Commission wishes to understand the mechanics of creating a seamless product offering, given the differences in their respective trans-Pacific product before the Joint Venture.

The Applicants stress that Delta's commercial experience indicates that the most important factor in integration from a consumer perspective is the ease and reliability of transfer and scheduling. The integration of operations in the Joint Venture to attain a seamless transfer will be the focus of the Joint Venture planning.

The KLM/Northwest alliance experience is relevant in this context. There are significant differences in individual product (e.g., number of classes offered and aircraft configuration) between the alliance partners. Nonetheless, Delta's experience is that consumers regard the combined product as effectively seamless.

In addition, as indicated above and in earlier communication with the Commission, the Applicants consider each other to be an excellent cultural fit and do not anticipate difficulty in producing a consistent, though not necessarily identical, trans-Pacific product.

9 Conclusion

For the reasons stated above, the Applicants submit that the Commission's Final Determination should confirm the draft determination and authorise applications A91151-A91152 and A91172-A91173. However, the authorisation should be for a period of five years on the terms proposed in Section 1 above.

Yours sincerely

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