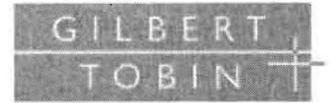


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25 November 2010

By email

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Dear Richard

Virgin Blue and Air New Zealand Applications for Authorisation – Information provided by Qantas/Jetstar Group and Emirates

We refer to the public register version of Qantas' comments in response to the ACCC's questions dated 27 October 2010, which was provided to the Applicants on 23 November 2010, and to the ACCC's questions to Qantas, dated 22 October 2010.

The Applicants are concerned that this information has come very late in the authorisation process and, as a result, the ACCC will not have the opportunity to adequately test this information. The Applicants have no real opportunity to respond to Qantas' submissions and, more importantly, have not had the benefit of seeing and responding to the ACCC's assessment of this information, for example in the Draft Determination.

The Applicants are confident that the Alliance will enable them to offer an enhanced product to better compete with Qantas/Jetstar on the Tasman with the result that more passengers will choose to fly on the Alliance rather than on Qantas. The Alliance, together with Virgin Blue's proposed alliances with Etihad and with Delta, will also make Virgin Blue a much stronger competitor to Qantas within Australia, particularly for Australian corporate accounts and for international travel to and from Australia.

Qantas has a clear interest in protecting its current market position, including an interest in thwarting Virgin Blue's strategy of building a more competitive network and service offer for Australian travellers through international alliances. Support by Qantas for the conclusions in the Draft Determination suggests that Qantas opposes the Alliance, indicating that the Alliance is in fact pro-competitive.

There is a risk that Qantas' response to the ACCC's inquiries is calibrated to impede Virgin Blue's international alliance strategy.

Further, it is not apparent that the response to the ACCC's questions reflects the commercial judgments and assessment of Qantas (we note the response was provided by internal competition lawyers and the Qantas General Counsel). Nor is it apparent that the responses have been tested or corroborated against Qantas' internal assessment of the Alliance in particular and Virgin Blue's international alliance strategy more generally, or against Qantas' actual market behaviour and public statements.

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The issue of Qantas/Jetstar's likely response to the Alliance is important for an assessment of both the public benefits and competition effects of the Alliance. The Applicants consider that there are two critical issues that should be considered:

- 1 whether Qantas/Jetstar has the ability and incentive to enter or expand its services in response to any attempt by the Applicants to raise fares above the competitive level or to withhold capacity; and
- 2 what is Qantas/Jetstar's real assessment of the impact of the Alliance on the service levels and the overall competitiveness of Virgin Blue and Air New Zealand; in particular, what is Qantas' internal assessment as to whether the Alliance will improve the competitiveness of Virgin Blue's offer to Australian travellers.

The ACCC's questions, and Qantas' response, do not directly address these two questions.

In relation to the first issue, there is nothing in Qantas' response that suggests that they would be unable or unwilling to competitively respond to the Alliance on particular routes. Consistent with Qantas' response, Qantas will take any opportunity to maximise its Group profitability, including by deploying Qantas and Jetstar on the same routes, as they have to date on 4 Tasman routes and 20 domestic Australian routes. Qantas' response confirms that it makes the decision to deploy Jetstar on a route by route basis and that Jetstar is likely to be deployed on leisure routes, noting that the Tasman is predominantly a leisure market.

As the Applicants have previously submitted, Qantas/Jetstar:

- face no operational or regulatory barriers to expansion on the Tasman;
- have a significant number of aircraft on order that will need to be deployed and are capable of deployment on the Tasman; and
- have consistently shown through their actual market behaviour that they will take any profitable opportunity.

There is no evidence of Qantas/Jetstar engaging in accommodating strategies to date and nothing to suggest that Qantas/Jetstar would in the future. Qantas has vigorously sought to defend its position on all routes. Qantas has publicly emphasised that it intends to maintain a 'line in the sand' of at least 65% market share within Australia and will use a combination of Jetstar and Qantas to do so.¹ It is similarly aggressive across other markets, as illustrated by Jetstar's expansion following Pacific Blue's withdrawal from domestic New Zealand. If the Alliance sought to increase fares above competitive levels this would create a profitable opportunity for Qantas/Jetstar who would respond by deploying capacity and undercutting fares. The likelihood of this response will constrain the Alliance.

Any conclusion to the contrary would be at odds with the actual practical experience of Qantas/Jetstar behaviour.

While the Applicants have not been able to see Qantas' full response as it has been redacted for confidentiality, the Applicants submit that it should be tested against its actual market behaviour, its internal documents and its public statements as well as the information provided by the Applicants to date.

¹ See: Steve Creedy, "Qantas spreads its wings again but CEO Alan Joyce cautious", *The Australian*, 14 June 2010.

Qantas/Jetstar's real assessment of the likely impact of the Alliance would be a strong indicator of the significant public benefits, particularly the pro-competitive effects, which will result from the Alliance. In its response Qantas recognises that business passengers usually require a number of alternative services throughout the day and that leisure passengers also benefit from such flight options. Under the Alliance the Applicants will be able to offer more frequencies and a better schedule which, as Qantas has recognised, is a benefit to both business and leisure passengers and will improve the overall service offering of the Alliance. A review of Qantas' internal documents assessing the impact of the Alliance would allow the ACCC to properly assess Qantas' assessment of the impact of the Alliance on service levels and on the Applicants' competitiveness. The Applicants submit that no weight should be placed on the comment by Qantas that the Alliance is not necessary to create a stronger competitor.

Importantly, the response of Qantas/Jetstar does not provide probative support for a contention that Qantas/Jetstar will not be an effective constraint on the Alliance. The Applicants submit that it is unsafe to draw any adverse conclusions from Qantas' response, particularly in the light of the evidence provided to date by the Applicants and the limited opportunity to adequately test Qantas' response.

Qantas' response notes the competitive constraint provided by Emirates on the Tasman. Emirates' response to the ACCC's questions confirms this competitive constraint, showing that they are strongly committed to the Tasman and that their services are profitable. Emirates verifies the Applicants' submission that it will up-gauge its aircraft on Auckland-Brisbane, adding additional capacity on this route from January 2011. Emirates is a strong competitor and will continue to exert significant competitive constraint on the Alliance.

Emirates' statement that "alliances act to dissolve competition over time" should not be given weight in the assessment of the proposed Alliance. The Applicants have demonstrated the public benefits that will result from the Alliance which outweigh any potential detriment to competition, particularly in the context of strong competition from Qantas/Jetstar and Emirates, as well as low barriers to further entry and expansion. If the ACCC has any residual competition concerns, these can be addressed by the ACCC imposing conditions on authorisation as proposed.

Please contact us if you would like to discuss anything raised in this letter.

Yours sincerely,



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