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LAWYERS

10 December 2010

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Dear Darrell

Virgin Blue / Air New Zealand – Applications for authorisation of proposed Alliance

We refer to your telephone conversation with Luke Woodward on 8 December 2010.

The ACCC has noted that Virgin Blue has provided confidential information about its financial performance on the Tasman and the likely counterfactual if the Alliance is not authorised, in particular it has provided this information in Annexure B to the Applicants' submission in response to the Draft Determination. The ACCC would like to refer to that information in its reasons and has asked Virgin Blue to provide a version that can be publicly disclosed.

Set out below is a version of the information in Annexure B which can be publicly disclosed and referred to by the ACCC.

Pacific Blue's Tasman services were loss-making in 2009 and again in 2010. In contrast, Pacific Blue's services to Fiji, the Pacific Islands and South East Asia were profitable over this period as were Virgin Blue's domestic Australian services.

In these circumstances, the likely counterfactual is that Pacific Blue will maintain a Tasman presence; however it cannot be assumed that Pacific Blue will continue to expand its services and add capacity as it has in the past. In fact, it is more likely that Pacific Blue will cut Tasman capacity in order to reduce its losses and to more profitably redeploy capacity, as it has on other loss-making routes.

Under the new CEO John Borghetti, Virgin Blue is implementing a "Game Change Program" to improve the airline's competitiveness against Qantas, particularly in the business market. One of the pillars of the Game Change Strategy is the optimisation of Virgin Blue's network so as to use the aircraft more productively. This involves reviewing loss-making routes with a view to redeploying aircraft to more profitable routes. As part of this strategy, Virgin Blue has already announced the withdrawal of Pacific Blue from domestic New Zealand due to unsustainable losses over 2 years. As part of the same strategic network review, Virgin Blue has also announced that V Australia will cease operating its loss-making Johannesburg and Phuket routes.

If the Alliance is not approved, Virgin Blue will be forced to review its services on loss-making Tasman routes with non-trunk routes the most likely target of a review, due to lower passenger demand levels and reduced network feed. Any Pacific Blue capacity withdrawn from the Tasman could more profitably be deployed to Fiji, the Pacific Islands, South East Asia and

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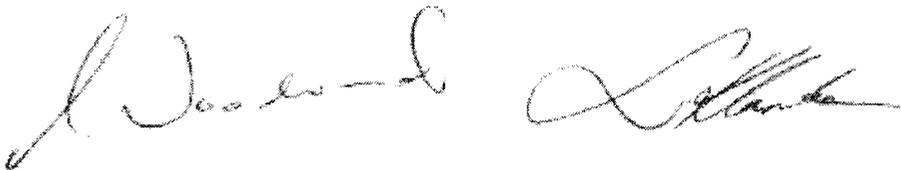
to Australian domestic routes. It is worth noting that many of Pacific Blue's current Tasman services were commenced during the GFC and resulted from redeployment of aircraft previously allocated to Australian domestic market growth. Pacific Blue has recently been granted additional capacity to fly to Bali which Virgin Blue plans to utilise from mid April 2011.

In the context of current losses on the Tasman, the cost savings from the Alliance are very material. Based on Pacific Blue's current financial performance, these cost savings alone would halve losses on the Tasman over a two year period. As the Alliance will result in an improved product which is expected to increase passenger numbers on the Applicants' services, increased load factors would also increase the profitability of Pacific Blue's Tasman services. Increased load factors will also make further expansion of services much more likely to occur than would be the case without the Alliance.

The Alliance is critical to enable Pacific Blue to maintain a substantial and competitive presence on the Tasman.

Please let us know if you would like to further discuss.

Yours sincerely
Gilbert + Tobin



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