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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

**2008 LOS ANGELES-SAN JOSE DEL CABO
EXEMPTION PROCEEDING**

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) Docket OST-2008-0056
)
)

CONSOLIDATED REPLY OF VIRGIN AMERICA INC.

Virgin America Inc. (“Virgin America”) hereby submits the following Consolidated Reply to the Answers of Delta Air Lines, Inc. (“Delta”) and United Air Lines, Inc. (“United”) and urges the Department to designate and grant Virgin America a two-year exemption to provide Los Angeles-San Jose del Cabo service.

Introduction

This proceeding presents the Department of Transportation (“Department”) with a clear choice for selecting a replacement carrier in the Los Angeles-San Jose del Cabo market at this critical juncture in the history of the U.S. airline industry. On the one hand, the Department can select, as it did in its two prior decisions regarding this market, a vibrant, new entrant competitor with a high-quality product, a credible service proposal, lower fares, and desirable connecting service, which will have a demonstrable competitive and market structure effect on five separate U.S.-Mexico markets. On the other, it can select between two legacy carriers with checkered service and performance histories in U.S.-Mexico markets, which have not proposed credible service, low fares, or any meaningful connecting service,

and whose selection would only exacerbate an U.S.-Mexico market structure dominated by legacy carriers.

The Department should select Virgin America, the only true new entrant applicant that can bring service, product, fare, and marketing innovation in not only the Los Angeles-San Jose del Cabo local market, but also the U.S.-Mexico national and the Western U.S.-Mexico, Los Angeles-Mexico and Western U.S.-San Jose del Cabo regional markets. Virgin America will be fit, willing and able to begin service in these five markets within 90 days of the Department's final order.

I. THE VARIOUS CLAIMS ASSERTED BY DELTA AND UNITED ABOUT VIRGIN AMERICA'S HIGH-QUALITY AND COMPETITIVE SERVICE PROPOSAL ARE WITHOUT MERIT.

The arguments of Delta and United regarding the overwhelming benefits of Virgin America's application have no merit.

1. The Seat Capacity Variances Between The Three Proposals Are Not Of Decisional Significance.

Delta and United both claim that they will offer more seats than Virgin America in the Los Angeles-San Jose del Cabo market. As Virgin America demonstrated in its Consolidated Answer at 11-13, however, neither legacy carrier service proposal is credible.

Delta's proposed Boeing 757 is demonstrably the wrong aircraft for this relatively short-haul market, and its proposed use in this market is inconsistent with Delta's use of 757 aircraft in other U.S.-Mexico markets (Exhibit VX-R-5). Delta has, in any event, changed aircraft in 48 percent of its U.S.-Mexico markets, thus rendering its statements concerning aircraft use in U.S.-Mexico markets not credible. *Id.* The 150-seat aircraft Delta proposed in the last proceeding is far more consistent with Delta's aircraft decisions in markets of similar

size and stage length as well as the average size of aircraft operated by the incumbents to and from San Jose del Cabo (Exhibit VX-SR-1). The Department can reasonably assume, for purposes of analysis in this proceeding, this is the aircraft Delta is most likely to use if it were awarded this authority.

United's "peak-period" proposal, made after it filed its initial application in this case, is even less credible, given its use of aircraft in other markets (Exhibit VX-R-7) and the proposals it has made in the two previous Los Angeles-San Jose del Cabo proceedings (Virgin America Consolidated Answer at 12). Perhaps more importantly, given the out-of-the-market schedule for its proposed service, there will be few, if any, passengers on the mistimed United peak-period proposal, and, if ever operated, the service would most likely be suspended by United shortly thereafter. Once again, the Department can reasonably assume that United would operate a 156-seat Ted aircraft on no more than a daily basis if it were selected to operate this route.

Once the Department makes these "reality" adjustments to the Delta and United proposals, no practical difference exists between the seat-capacity proposals of Virgin America (149 seats), Delta (150 seats) and United (156 seats); certainly it is not a difference of any decisional significance. See Exhibit VX-SR-2.

2. Only Virgin America Has Proposed Low Fares.

Neither Delta nor United have made any proposal to bring competitive pricing to the Los Angeles-San Jose del Cabo market. Instead, they resort to attacking Virgin America's low-fare proposals, notwithstanding Virgin America's demonstrable record in fare leadership, and these legacy carriers' record of fare stagnancy in the U.S.-Mexico market. See United Answer at 7-8; Delta Answer at 15-16.

Delta's claim that its "larger aircraft will provide Delta with more inventory and stronger incentives to offer discounts," Delta Answer at 16,¹ does not bolster its claim that it might offer lower fares. It only confirms that Delta's proposed 757 aircraft is too large an aircraft for the market. Delta would be forced to resort to discount fares to fill up its empty seats, before ultimately abandoning this aircraft for one that makes sense, and offers an economically viable operation.

Only Virgin America has proposed low fares in this market, and these low fares are of decisional significance, particularly when the Department looks to select a new-entrant carrier to provide real competition to the two U.S. carriers operating in this market. For all the criticism that Delta and United direct towards new-entrant Frontier and its entry into the Los Angeles-San Jose del Cabo market, the facts speak for themselves. Fares decreased by 20%. Exhibit VX-SR-5.

3. The United And Delta Claims To Superior Connections Are Without Merit.

Although the large Los Angeles-San Jose del Cabo local market should be the primary focus in this proceeding, as Virgin America demonstrated in its Consolidated Answer, United's proposed connections provide very little in the way of meaningful new public benefits. Almost 80% of United's claimed connections are already more conveniently available over United's larger (San Francisco, Denver and Chicago) hubs. Exhibit VX-R-13. Only four small markets would receive first-time, roundtrip connecting service and the three larger markets in which United would provide competitive, connecting service are already

¹ Delta made an identical argument in the New York-Cancun route case against the low fare proposal of new-entrant JetBlue. Order 2006-6-25 at 9. DOT was not persuaded then and should reject the same argument today.

served by American, Continental and Delta. United's connections are overstated and provide no basis for an award to United.²

Delta's proposed connections are even more modest than United's, yet almost 80 percent of Delta's connections can already be made over its Salt Lake City hub. Exhibit VX-R-14. The three markets that would receive new on-line connections are, similarly, very small, providing little in the way of public benefit. Id.

Virgin America's connections, on the other hand, are superior to those of United and Delta, serving four large San Jose del Cabo markets (San Francisco Bay Area (No. 2), New York (No. 3), Seattle (No. 4) and Washington, DC (No.13), where all of the San Jose del Cabo service is connecting). Consequently, Virgin America is the best positioned applicant to provide significant inter-gateway competition in the U.S.-Mexico, Western U.S.-Mexico, Los Angeles-Mexico and Western U.S.-San Jose del Cabo markets. This was one of the Department's most important considerations when awarding Los Angeles-San Jose del Cabo authority in the two previous cases, and is of unquestioned decisional significance in this case as well.

4. Virgin America is a Competitive New Entrant

Delta and United next shift their attack to Virgin America itself, pointing to, among other things, its lack of international U.S.-Mexico experience, its 59% load factor, and the Frontier "advantages" versus Virgin America.

² UA's cites to a 1985 proceeding for the proposition that an applicant's lack of feed at its U.S. gateway renders the applicant's service proposal "less impressive." United Answer at 10, citing to Order 85-4-59 at 9. There, however, the applicants' service proposals involved DC-10 and 747 service between Houston and London, with far more seats (and much greater range) than the capacity and stage-length at issue in this proceeding. DOT's concerns in the Houston-London case are inapplicable here and, in any event, when DOT selected Frontier to serve LAX-SJD, it chose an applicant with little to no connecting service in the LAX-SJD market. Order 2006-6-25.

First, the Los Angeles-San Jose del Cabo market is not a long-range transatlantic or transpacific market with several formidable U.S. and foreign carrier competitors, which control substantial amounts of behind-gateway traffic. It is a 910-mile, essentially resort market with a very substantial local traffic base. Virgin America already serves many markets that are larger and longer than Los Angeles-San Jose del Cabo, and successfully competes with much larger U.S. carriers in those markets, including United. For example, Virgin America has already had a dramatic effect on first-class and main-cabin fares in the Los Angeles-New York (JFK) market--a market that is far larger and longer, and has more formidable competitors, than Los Angeles-San Jose del Cabo. Exhibit VX-R-10.

Second, even though Los Angeles-San Jose del Cabo is like many U.S. domestic markets, Virgin America is well-equipped to deal with all aspects of international service. Exhibit VX-101 details the extensive management, operational, airport, planning, sales and marketing experience of those who work for Virgin America, including specific experience in Mexico generally,³ San Jose del Cabo in particular,⁴ and at U.S.-Mexico “new entrants” such as America West, Frontier and JetBlue.

Third, achievement by a new-entrant carrier of an overall 61%, not 59% as erroneously claimed by United, load factor after only four months of operation is a very positive, not negative sign, particularly when it was achieved while operating during only one “peak” month. In fact, Virgin America achieved a strong 79% load factor during August 2007, its first month of service and the only peak month in which it flew during this four

³See VX-101, which discusses the specific experience in Mexico of several Virgin America officials, including Messrs. Weatherly, Hall, Goodmann, Green and Thornton and Ms. Daniels.

⁴For example, Mr. Goodmann was responsible for Continental’s overall sales/marketing and related start-up activities at San Jose del Cabo. Mr. Thornton assisted in the preparation/opening of America West’s San Jose del Cabo station. Exhibit VX-101 at 3.

month period – with only 19 days of booking before the first flight on August 8th. As United and Delta well know, airline markets are seasonal and September and October are not typically the strongest months of the year. For example, Exhibit VX-SR-3 demonstrates the seasonality of the Los Angeles-San Jose del Cabo market, with September, October and November traffic levels well below August levels. Virgin America is proud of what it has been able to accomplish in seven short months of operation, and is eager to bring its high-quality, low-cost, low-fare product to Los Angeles-San Jose del Cabo.

Finally, Delta's and United's arguments that (a) new entrants cannot compete effectively against incumbents, and (b) Frontier had a better service proposal than Virgin America, are simply wrong. Exhibits VX-SR-4 and 5 demonstrate that new entrants can have a far greater impact than incumbents on competition in U.S.-Mexico markets. Los Angeles-Cancun, a market in which only legacy carriers compete, grew only 41% between calendar 2003 and the year ended third quarter of 2007, and fares actually increased by 8% in the year ended 3Q 2007. Exhibit VX-SR-5. On the other hand, the New York-Cancun market, a market which had new entrant competition provided by JetBlue, actually grew by 76% during the comparable period, or almost twice as much. Exhibit VX-SR-4. Moreover, as noted supra, Frontier's entry into the Los Angeles-San Jose del Cabo market resulted in a 20% fare decrease in that market. Exhibit VX-SR-5. Virgin America can be expected to have similar competitive effects in the Los Angeles-San Jose del Cabo market.

Exhibit VX-R-1 compares Virgin America's benefits versus those that have been offered by Frontier. The differences are substantial, particularly the over 10 percent larger aircraft (149 seats v. 132 seats), two-class service (first and main class v. coach only) and connections at Los Angeles to four cities with substantial traffic to and from San Jose del

Cabo (San Francisco, No. 2, New York, No. 3, Seattle, No. 4, and Washington, DC, No. 13). Each of these differences will constitute a significant improvement over the product and competition provided by Frontier, and will, contrary to the claims of Delta and United, permit Virgin America to be successful in the Los Angeles-San Jose del Cabo market.

5. Virgin America Will Obtain Necessary Authorizations For International Service.

Delta and United have both questioned Virgin America's ability to initiate Los Angeles-San Jose del Cabo service within 90 days of the issuance of the Department's final order in this proceeding. But, carried to its logical extreme, this would mean that a true new entrant carrier for award of new authority in a particular country could never be considered by the Department for an award of that authority in a contested case, a result which directly conflicts with the Department's policy of encouraging new entry to provide competitive alternatives to entrenched incumbents in international markets. Indeed, if the Department had adopted such a policy during the New York-Cancun proceeding, the very successful award of that authority to JetBlue (see Exhibit VX-SR-5) would not have occurred since JetBlue had not, before it applied for that authority, provided any service to Mexico.⁵

In any event, Virgin America does not anticipate any difficulty in meeting this schedule. As demonstrated in its direct exhibits (Exhibit VX-101), a significant number of Virgin America's officials, including President and CEO David Cush (who held several senior positions at American Airlines involving international air service), have extensive experience providing international air service, Mexican air service and, indeed, Los Angeles-San Jose del

⁵ Indeed, JetBlue held authority to serve international destinations for a mere 18 months when it was awarded New York-Cancun authority. Notice of Action Taken in Docket 2004-17265; Order 2006-9-8.

Cabo air service. Exhibit VX-101. Virgin America is confident that the Department will find that Virgin America is fit to provide international air service.

Delta's suggestion that Virgin America will for some reason be slow to obtain operating authority in Mexico is simply not tenable. Virgin America has already taken and will be taking a variety of steps to ensure necessary governmental approvals, and anticipates no delays in its start up. Exhibit VX-SR-8. The operating rights at issue in this proceeding – rights which the Department has characterized as “a valuable resource obtained in exchange for granting Mexico route opportunities for its airlines to serve the United States” (Order 2008-2-14 at 2) – were obtained for the benefit of the U.S. traveling public largely through the Department's efforts. To ensure that the U.S. public enjoys the fruits of the Department's efforts and the full benefit of these rights, Virgin America has no doubt that the Department will support and aggressively work to ensure that the airline it chooses in this proceeding receives prompt consideration from the Mexican authorities.

6. Virgin America Controls Its Own Route Strategy, Not Delta.

Finally, Delta criticizes Virgin America for not applying for an available designation to offer service between San Francisco and San Jose del Cabo and/or other Mexican beach destinations, and seeks to substitute its judgment about where Virgin America should fly for the judgment of Virgin America.

Thankfully for consumers, Delta is not in charge of Virgin America's route planning decisions on where and when to fly. Rather than adopt an “all coach” model or fly point-to-point to smaller markets and non-hubs, Virgin America's business philosophy for its domestic network and international services is to serve the top markets and go head-to-head against legacy carriers like Delta. As shown in Exhibit VX-SR-6, San Jose del Cabo is the largest

Los Angeles-Mexico market and is significantly larger than, for example, Los Angeles-Cancun, Puerto Vallarta and Mexico City. Virgin America assumes that is why Delta has now sought to serve this market on two separate occasions.

By comparison, the San Francisco markets are smaller than the comparable Los Angeles markets as shown in Exhibit VX-SR-7. Virgin America's goal is to be in the airline business over the long term, and the airline carefully examines the markets that it serves, focusing on high quality, high daily local O&D traffic.

As shown in Exhibits VX-R-3, 4, 5, 19 and 20, Delta does not appear to follow such an approach in selecting and serving U.S.-Mexico route markets. Although Delta holds a significant amount of U.S.-Mexico authority and operates a significant amount of service in U.S.-Mexico markets, it exited the Los Angeles-Mexico City market in January 2005 and three other Los Angeles-Mexico markets, Acapulco, Hermosillo and Tijuana, over the last 12 months and has reduced its Los Angeles-Mexico seats by 22% in the last year. Exhibit VX-R-4. Moreover, it exited six other U.S.-Mexico markets (including two San Jose del Cabo markets) recently – Atlanta-Rejon and Zihuatanejo; Cincinnati-San Jose del Cabo; New York-Acapulco and San Jose del Cabo; and Raleigh-Durham-Cancun. Exhibit VX-R-3. Furthermore, Delta has, in the overall U.S.-Mexico market, reduced its weekly flights by seven percent and its weekly seats by twelve percent. Id. Finally, Delta has changed its aircraft type in fully 24 of its 50 (or 48%) nonstop U.S.-Mexico markets over the past several years. Id.

Each airline is, of course, entitled to adopt its own operating philosophy. Virgin America's philosophy is to carefully evaluate the various market options that are available, and select the ones that will permit it to offer sustained high-quality, low-fare service for the

benefit of the public over a significant period of time. Given the relative size of the various San Jose del Cabo markets Virgin America considered, the Los Angeles-San Jose del Cabo market, when coupled with Virgin America's growing presence at Los Angeles, was the clear choice.

II. VIRGIN AMERICA WILL PROVIDE THE GREATEST PUBLIC BENEFITS, INCLUDING SIGNIFICANTLY ENHANCED SERVICE, LOWER FARES, MEANINGFUL CONNECTIONS AND A VERY FAVORABLE COMPETITIVE EFFECT ON FIVE SEPARATE U.S.-MEXICO MARKETS.

Award of Los Angeles-San Jose del Cabo authority to Virgin America will provide the greatest benefits to the traveling and shipping public, including:

- consistent, year-round, daily roundtrip service with brand new 149-seat, two-class Airbus A320 aircraft;
- a very high quality, in-flight experience unmatched by the other applicants;
- well-timed and competitive local service with roundtrip connections between Los Angeles and San Francisco, New York, Seattle and Washington, DC (the Nos. 2, 3, 4 and 13 U.S.- San Jose del Cabo markets);
- fares that will be as much as 45 percent lower than fare levels offered in the market today;
- cargo service to and from San Jose del Cabo that will be integrated at Los Angeles into Virgin America's growing cargo network;
- aggressive and innovative marketing and promotions that will grow the market and provide an effective competitive spur to the incumbent carriers;
- formidable intra-gateway service and fare competition at Los Angeles to American, Alaska and Mexicana in the local Los Angeles-San Jose del Cabo local market; and
- substantial inter-gateway service and fare competition to the incumbents in four other markets – the U.S.-Mexico national market, and three regional markets, the Western U.S.-Mexico market, the Los Angeles-Mexico market and the Western U.S.-San Jose del Cabo markets, that can only be provided by Virgin America, because Delta and United are already incumbents in each of these four markets.

Conclusion

None of the arguments raised by Delta or United provide any, much less a reasonable, basis for selecting either Delta or United over Virgin America to provide service in the Los Angeles-San Jose del Cabo market. Virgin America is fit, willing and able to provide international service and eagerly looks forward to the opportunity to bring its dynamic, aggressive and competitive high-quality, low-fare service to the traveling public in U.S.-Mexico markets.

WHEREFORE, for the foregoing reasons as well as those discussed in its Application and Answer, Virgin America Inc. respectfully requests that the Department grant it an exemption from 49 U.S.C. § 41101, a designation, and such other additional relief as may be necessary in order to permit Virgin America Inc. to provide scheduled foreign air transportation of persons, property, and mail between Los Angeles and San Jose del Cabo as more fully described above.

Respectfully submitted,

/s/ _____
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February 29, 2008

CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of February, 2008, a copy of the foregoing Consolidated Reply of Virgin America Inc. was served by electronic mail on the following:

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Virgin America Inc.

Surrebuttal Exhibits to Application for LAX-SJD Service

February 29, 2008

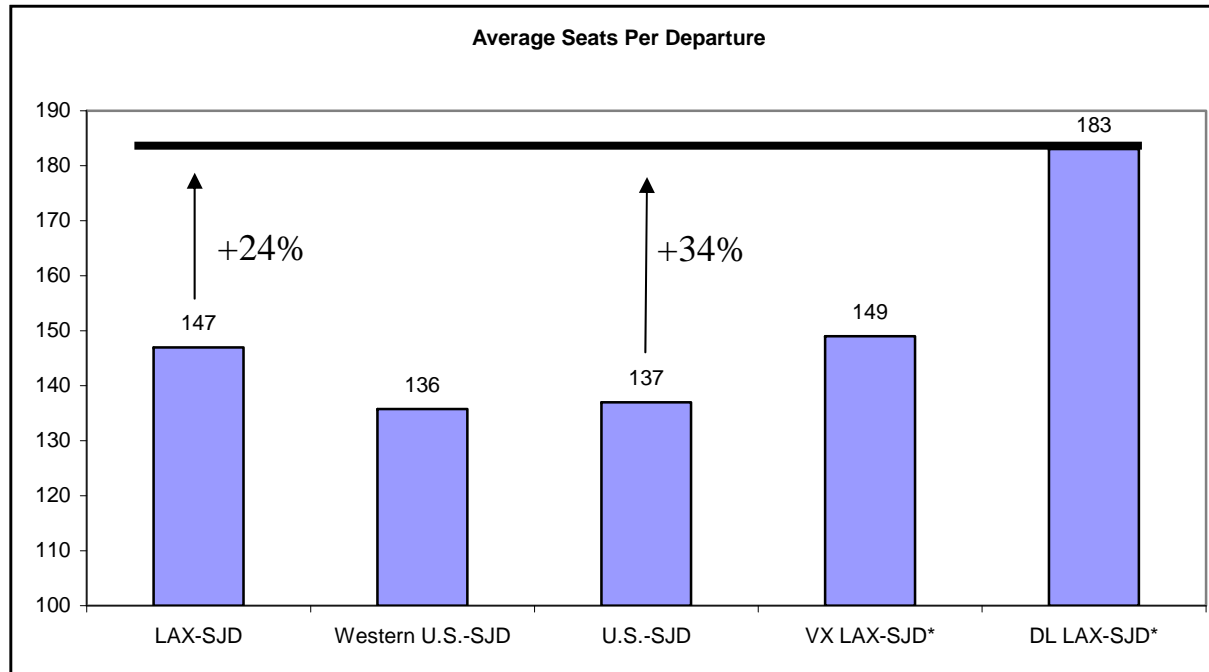
**Virgin America Inc.
Surrebuttal Exhibits
Los Angeles-San Jose del Cabo**

<u>Title</u>	<u>Exhibit Number</u>
Delta's Proposed Capacity is Not Appropriate for the LAX-SJD Market	VX-SR-1
Capacity Differences Between the Three Applicants, After Appropriate Adjustment, are Negligible and Not of Decisional Significance	VX-SR-2
Virgin America's System Load Factor Reflects Seasonal Trends	VX-SR-3
Virgin America's Low Fares Will Significantly Expand the LAX-SJD Market	VX-SR-4
Only Virgin America Will Keep Low Fares in LAX-SJD	VX-SR-5
San Jose del Cabo is the Largest Los Angeles-Mexico Market	VX-SR-6
LAX-SJD is Much Larger than Markets Delta 'Suggests' Virgin America Should Serve	VX-SR-7
Virgin America is Aggressively Working to be in Position to Initiate Los Angeles-San Jose del Cabo Service	VX-R-8

Delta's Proposed Capacity is Not Appropriate for the LAX-SJD Market



- The average incumbent in LAX-SJD operates with 147 seats per departure, an appropriate size for this market.
- Delta's proposed 757 is 24% larger than the average incumbent in LAX-SJD and is 34% larger than the average U.S.-SJD aircraft.
- The Department should be skeptical of Delta's proposed seating capacity.



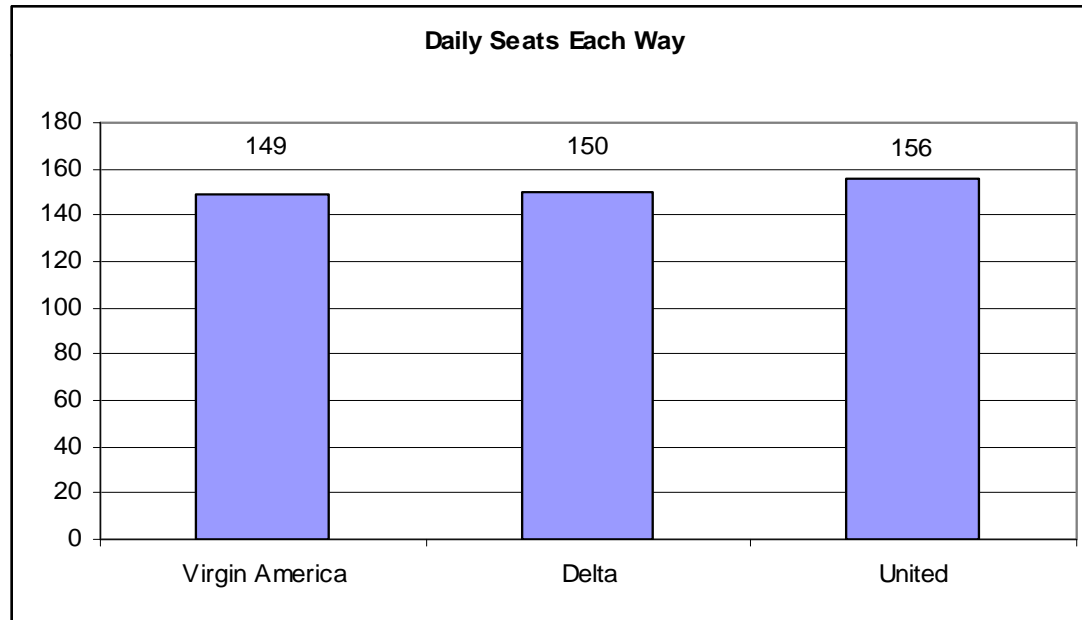
Source: February schedules data via APGDat, www.apgdat.com; Western US defined as west of the Mississippi River.

*Applications in this proceeding

Capacity Differences Between the Three Applicants, After Appropriate Adjustments, are Negligible and Not of Decisional Significance



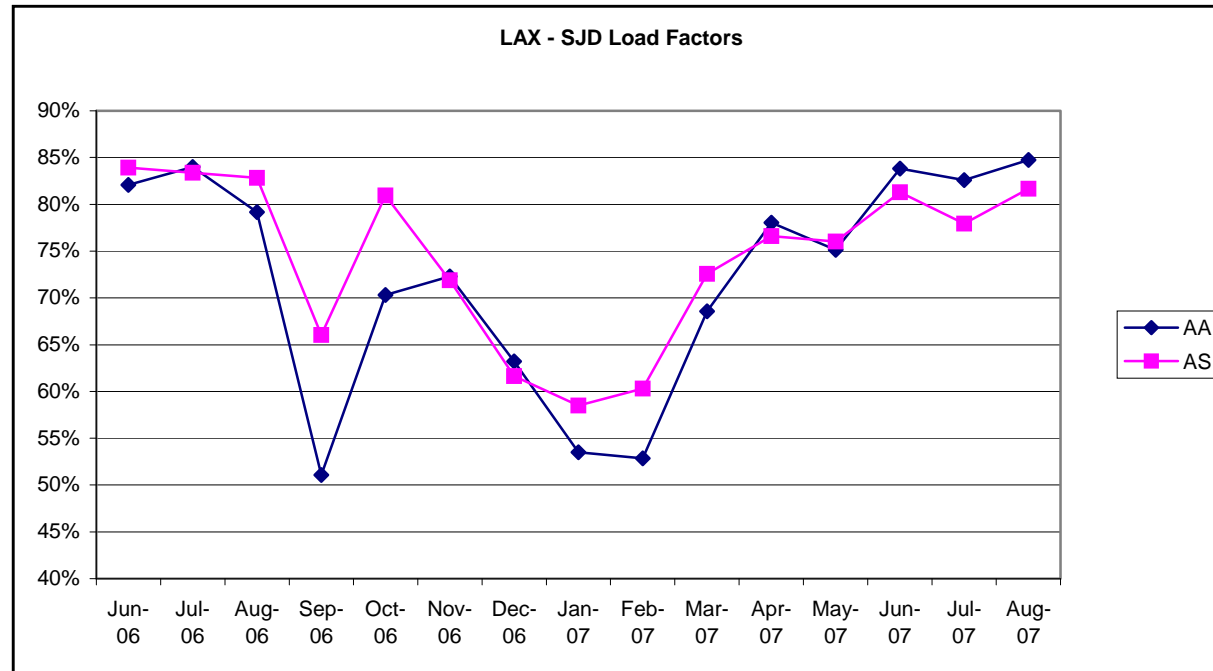
- Delta's and United's capacity proposals, after appropriate adjustment, are substantially and functionally equivalent to Virgin America's proposal.



Virgin America's System Load Factor Reflects Seasonal Trends



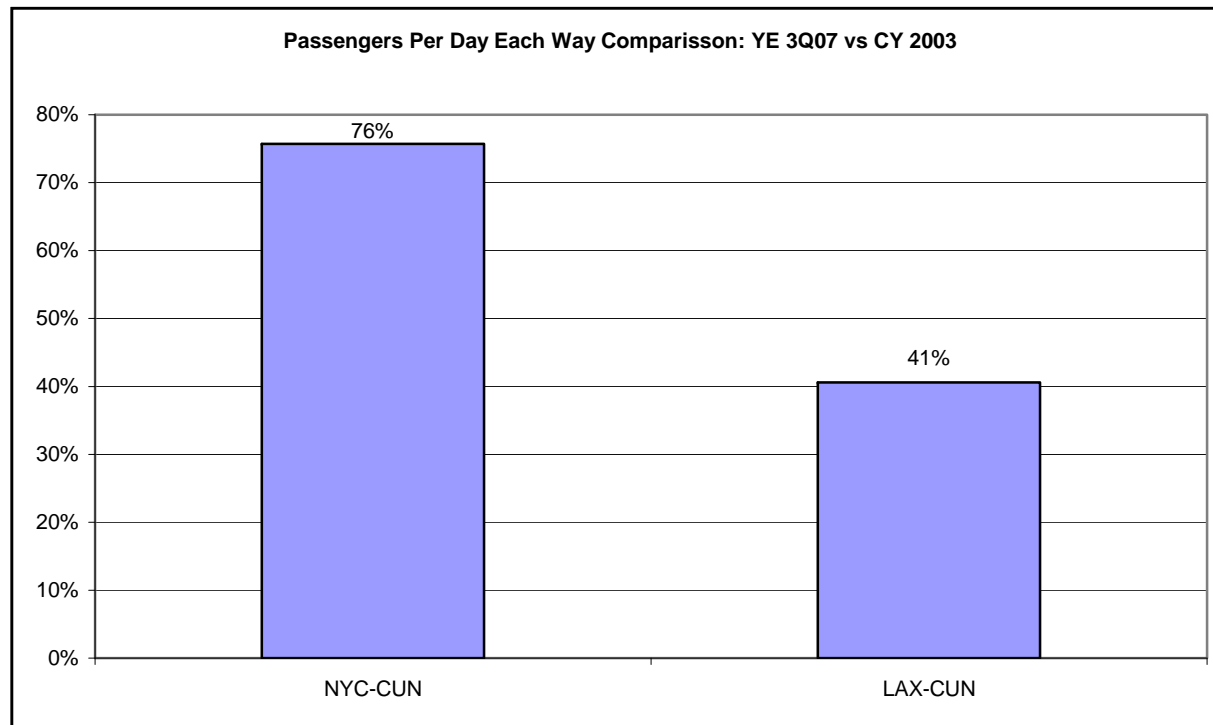
- Contrary to United's exhibit, Virgin America's August 2007 load factor – its first month of operations – was an impressive 79%.
- August 2007 was Virgin America's only peak month to date.
- Like other carriers, Virgin America's monthly load factors reflect seasonal demand.
- Virgin America's load factor trend between September and November 2007 is similar to that of American and Alaska on the LAX-SJD route.



Virgin America's Low Fares Will Significantly Expand the LAX-SJD Market



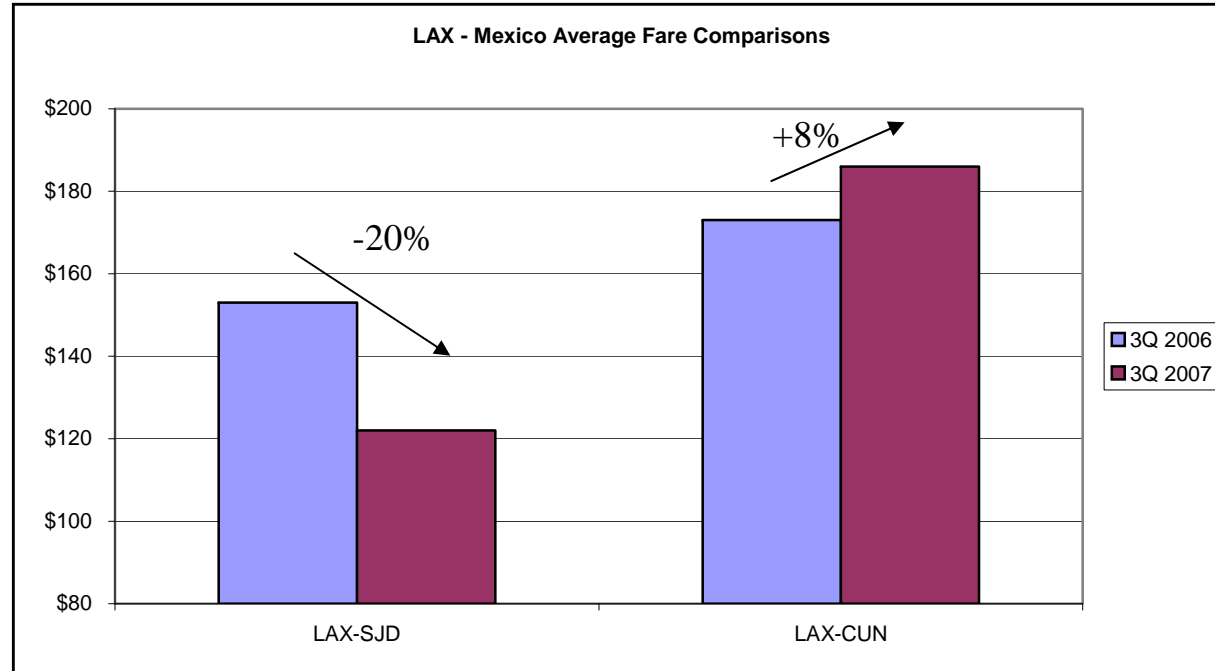
- JetBlue's low fares expanded the New York City – Cancun market by 76% between 2003 and YE 3Q 2007.
- On the other hand, the LAX – Cancun market, with no LCC competition, only grew 41% during the same period.
- Like this Cancun example, only Virgin America would provide the fare and service competition needed to grow the LAX-SJD market to its full potential.



Only Virgin America Will Keep Low Fares in LAX-SJD



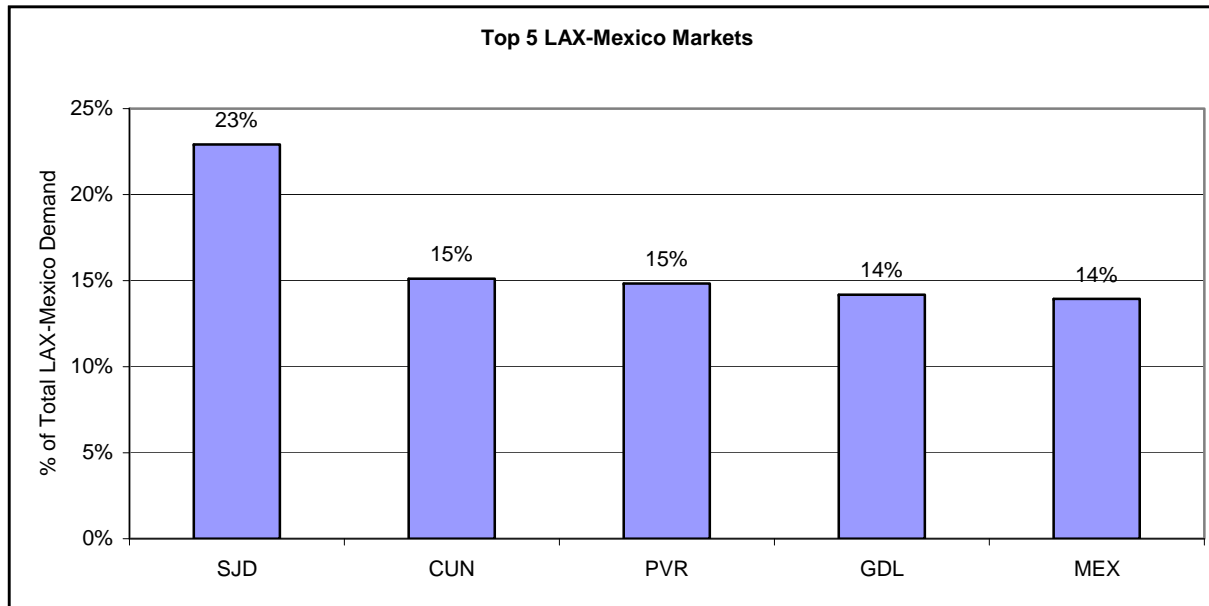
- As a result of Frontier's entry in LAX-SJD, average fares fell 20%.
- On the other hand, average fares *increased* 8% in LAX-CUN due to the lack of low cost carriers.



San Jose del Cabo is the Largest LAX-Mexico Market



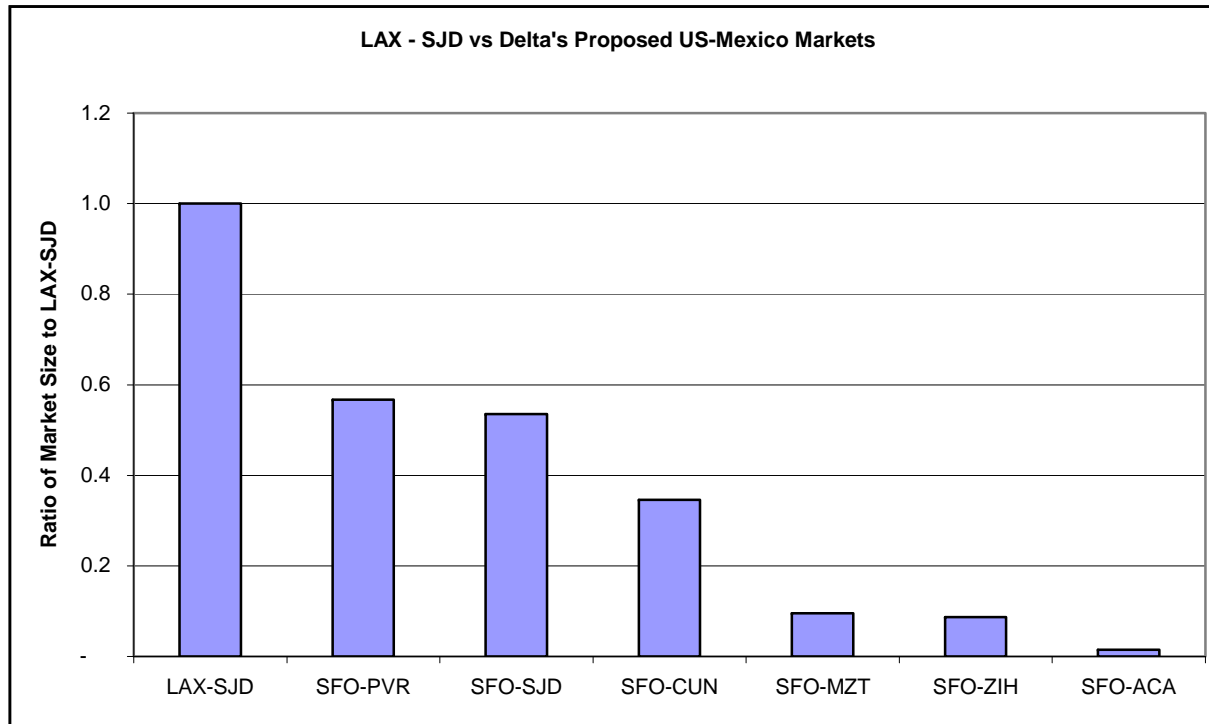
- Just like its domestic network, Virgin America seeks to serve top international markets from LAX.
- SJD is the largest LAX-Mexico market, accounting for 23% of overall LAX-Mexico demand.



LAX-SJD is Much Larger Than Markets Delta 'Suggests' Virgin America Should Serve



- Virgin America's low fares will therefore benefit more annual travelers than Delta's suggested markets.



Virgin America is Aggressively Working to be in Position to Initiate Los Angeles-San Jose del Cabo Service



The following is a brief overview of the steps which Virgin America has already taken and will, in the future, take to facilitate the initiation of Los Angeles-San Jose del Cabo service.

1. Federal Aviation Administration. Virgin America has already informed the Federal Aviation Administration (“FAA”) that it has applied for Los Angeles-San Jose del Cabo authority with the Department of Transportation and has begun the process of complying with the FAA’s requirements to operate as a U.S. flag carrier in the Los Angeles-San Jose del Cabo market. As Virgin America demonstrated in its direct exhibits (Exhibit VX-101), several of its operational personnel have extensive experience in providing international air service and Virgin America does not anticipate any difficulties in meeting the FAA’s requirements. Additionally, the Los Angeles-San Jose del Cabo operation is, in many respects, very similar to Virgin America’s domestic operations.

2. Aircraft. Virgin America has identified the aircraft that it plans to use for this service (N638VA). It is the 22nd aircraft that will be delivered to Virgin America, and the aircraft will be delivered in May 2008. Once the aircraft is delivered, it will take approximately 35 days for this aircraft to be outfitted with the Virgin America In-Flight Entertainment system. In the unlikely even that this particular aircraft is not available to begin the Los Angeles-San Jose del Cabo service, Virgin America will utilize another aircraft in its fleet to provide this service in a timely manner.



3. San Jose del Cabo Airport. Virgin America has already been in contact with officials at the San Jose del Cabo airport, and is in the process of setting up a meeting with these officials in the very near future. As demonstrated in the Virgin America direct exhibits, Virgin America officials have extensive experience in operating in Mexico. Virgin America does not anticipate any difficulty in establishing a presence in Mexico in general and at the San Jose del Cabo airport in particular.

4. Mexican Corporate Issues. Virgin America has already identified a law firm in Mexico to assist Virgin America in taking the necessary steps to operate in Mexico. It will be following up on these matters next week once this phase of the Department's proceeding is completed.

5. Mexican Government License. Virgin America has already identified persons in Mexico to assist Virgin America in applying for and obtaining the necessary operating licenses for Virgin America. Virgin America will be following up on these matters next week as well.

In summary, Virgin America has identified each of the matters that must be addressed in conjunction with the initiation of Los Angeles-San Jose del Cabo service. Virgin America has officials and company representatives who are experienced in these matters and is confident that it can complete all of the necessary steps in order to begin service within 90 days of the issuance of the Department's final order in this proceeding.