Response to Grimes and Kwoka

Mary Coleman and Joseph J. Simons

Warren Grimes' and John Kwoka's article, *A Study in Merger Enforcement Transparency: The FTC's Ocean Cruise Decision and the Presumption Governing High Concentration Mergers* (Grimes & Kwoka),[1] observes that the antitrust agencies should strive for transparency. As the record reveals, the Federal Trade Commission agrees with this principle, though with perhaps a more realistic view of the amount of transparency that is logistically practicable and legally possible.[2] But it seems to us that the article is less a "study" of transparency than yet another effort by the authors—objectors to the proposed cruise mergers[3]—to bite the apple that eluded them during the actual investigation and argue about the merits of the cruise line decision. While much, if not all, of what they say has been extensively dealt with in publicly available materials provided by the Commission and its staff,[4] we briefly address a few points.

The Guidelines' Presumption Is Rebuttable

Grimes & Kwoka assert that "the Commission did not offer a well-reasoned ground and factual basis" sufficient to overcome the Merger Guidelines' rebuttable presumption of anticompetitive effects. The statement appears to rest fundamentally on the authors' repeated conclusion that whatever evidence the Commission cited was not "enough" to rebut the Guidelines' presumption. Given the array of empirical and qualitative evidence that has been described in various public

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[1] ANTITRUST SOURCE, May 2003, *available at* http://www.abanet.org/antitrust/source/may03/metstudy.pdf.

[2] AmeriSource Health Corp./Bergen Brunswig Corp. *See, e.g.*, Statement of the Federal Trade Commission (Aug. 24, 2001), *available at* http://www.ftc.gov/os/2001/08/amerisourcestatement.pdf; Statement of the Federal Trade Commission, Phillips Petroleum/Tosco Corp. (Sept. 17, 2001), *available at* http://www.ftc.gov/os/2001/09/phillipstoscostmt.htm; Press Release, Investigation of Kroger/Raley's Transaction Closed (Nov. 13, 2002), *available at* http://www.ftc.gov/opa/2002/11/krogerraley.htm; Statement of the Federal Trade Commission Concerning Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corp.//P&O Princess Cruises plc (Oct. 4, 2002), *available at* http://www.ftc.gov/os/2002/10/cruisestatement.htm; Statement of the Commission, Sunoco Inc./Coastal Eagle Point Oil Co. (Dec. 29, 2003), *available at* http://www.ftc.gov/os/caselist/0310139/031229stmt0310139.pdf; Statement of the Federal Trade Commission, Caremark Rx, Inc./AdvancePCS (Feb. 11, 2004), *available at* http://www.ftc.gov/os/caselist/0310239/040211ftcstatement0310239.pdf; Statement of the Federal Trade Commission, RJ Reynolds Tobacco Holdings, Inc./British American Tobacco, p.l.c. (June 22, 2004), *available at* http://www.ftc.gov/os/2004/06/040622batrjrstmt.pdf; Statement of Chairman Timothy J. Muris, Genzyme Corp./Novazyme Pharmaceuticals, Inc. (Jan. 13, 2004), *available at* http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf; DOJ and FTC Merger Challenges Data, Fiscal Years 1999–2003 (Dec. 18, 2003), *available at* http://www.ftc.gov/opa/2003/12/mergereffects.htm; FTC Horizontal Merger Investigation Data, Fiscal Years 1996–2003 (Feb. 2, 2004), *available at* http://www.ftc.gov/opa/2004/02/horizmerger.htm.

[3] Professor Grimes chaired, and Dr. Kwoka was a member, of a committee formed by the American Antitrust Institute (AAI) to review the cruise mergers. The AAI opposed both mergers, making public comments to that effect on its Web site and to the FTC. *See* Grimes, Hawker, Kwoka, Lande & Moss, The FTC's Cruise Lines Decisions: Three Cheers for Transparency (Nov. 18, 2002), *available at* http://www.antitrustinstitute.org/recent2/217.cfm.

[4] Joseph J. Simons, Merger Enforcement at the FTC (Oct. 24, 2002), *available at* http://www.ftc.gov/speeches/other/021024mergeenforcement.htm; Cruise Investigation: Empirical Evidence & Financial Investigation (Nov. 2002), *available at* http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf; Mary Coleman, David Meyer & David Scheffman, Empirical Analyses of Potential Competitive Effects of a Horizontal Merger: The FTC's Cruise Ships Mergers Investigation (2003), *available at* http://www.ftc.gov/be/riocruise0703.pdf.

materials—many available prior to the Grimes & Kwoka article—explaining why the Commission majority and a unanimous staff believed that the presumption was rebutted, one wonders what evidence the authors would ever find to be "enough."[5] The authors' real argument seems to be that the presumption should be conclusive without regard to the evidence concerning the likelihood of a competitive effect. But the Commission (and mainstream antitrust jurisprudence) long ago progressed beyond any such simplistic and formalistic approach to merger analysis. For example, the Pitofsky Commission closed without challenge its investigations of at least seven mergers (not including health care cases) with concentration indices and market shares of the merging parties equal to or higher than those of the merging parties in the cruise matters.[6]

In his response to this article, Warren Grimes suggests that we and the Commission place no weight on the rebuttable presumption and that in a merger with high concentration and a significant increase in concentration, it should be the proponents of the merger who need to provide credible information as to why there are not likely to be competitive effects from the merger. However, this is exactly what the parties did in this case. They provided the Commission with extensive data and other information that demonstrated conclusively that neither coordinated interaction nor unilateral effects were likely. In fact, the extensive and disaggregated data provided to the Commission showed that such effects were highly unlikely, and that if the presumption was not rebutted in this case, the presumption would effectively be irrebuttable. In a closing statement, one would expect the Commission to explain either why it did not find that a rebuttable presumption existed or if it did, why the Commission found that the evidence rebutted the presumption. That is what the majority's statement did in this matter.

The Evidence Showed that Neither Unilateral or Coordinated Theories nor "Strategic Behavior" Justified Enforcement Action

Having denied that the Commission offered grounds for rebutting the presumption, Grimes and Kwoka spend much of the rest of their article attempting to refute the grounds that were in fact provided. Largely ignoring the facts and analyses involved in the Commission's decision, they instead discuss a number of superficial critiques, mostly by proposing theories of anticompetitive harm without discussion of proof or evidence related to these theories. Their critiques can be loosely grouped around what they describe as "three possible theories of anticompetitive effects from the cruise mergers:" unilateral effects, coordinated effects, and so-called "strategic behavior." A few words suffice for each.

Unilateral Theories. Grimes & Kwoka's primary concern about unilateral effects derives from their belief—contrary to the evidence before the Commission—that the cruise industry's products are sufficiently differentiated from each other that one or both mergers (they are not clear which) would combine sufficiently close competitors to allow the merged firm to increase prices. Rather than provide evidence to support this asserted differentiation, they posit a contradiction between two points made by the Commission: (1) that the cruise companies each compete on so many levels and with so many products that no two are particularly close substitutes for each other; and (2) the cruise industry's products are too highly differentiated to permit effective coordination.

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[5] In his reply to this article, Warren Grimes states that the analyses done by the Commission appear to have been based on "aggregate" data. We find this claim to be curious because the analyses described in the various materials listed in note 4 above clearly focus on analyses conducted at a very disaggregated level, frequently comparing information across individual sailings.

[6] Simons, *supra* note 4.

No contradiction, however, exists. The Commission's two points are essentially the same. Each cruise line offers so many different products, overlapping with each other cruise line at so many different levels, that the cruise lines are *neither* "uniquely close substitutes" *nor* capable of coordination on price.[7] Given the high demand elasticities and low critical loss facing each cruise line, the lack of uniquely high diversion between individual cruise lines, and the complexity revealed by the actual transaction prices, the Commission majority concluded that unilateral theories were not supported.[8]

Coordinated Theories and "Strategic Conduct." Grimes & Kwoka assert that the Commission has not provided convincing evidence explaining why neither of the proposed mergers would be likely to result in coordinated effects. They offer little by way of countervailing analysis to support this view, except to reiterate their opinion that, given the high concentration, the proposed mergers must somehow enhance the likelihood of coordination. The Commission, however, focused on whether the evidence supported the likelihood of a competitive harm rather than simply focusing on the level and change in concentration. The fundamental point of the Commission's analysis was that the evidence, particularly the empirical analyses, showed no mechanism by which either merger would alter the industry dynamics to offset the powerful economic forces already making the industry highly competitive and coordination difficult.[9]

This conclusion was true not only for prices and amenities, but also for capacity, where (once again) Grimes & Kwoka's belief that they caught the Commission in a contradiction rests instead on a misunderstanding of the Commission's conclusion. The Commission found that the substantial capacity changes required to "move the price needle" in the face of high elasticities would likely render any such strategy by the merged entity (with or without the other major cruise lines) unprofitable, even if other competitors made no response whatsoever.[10] Such large capacity movements out of North America—expensive in themselves—would necessarily require capacity movements to much smaller markets (because all the other markets are markedly smaller), which would cause prices in those markets to drop more than any rise in price in North America. And because the major players were already quite active in the other markets, the loss of profits outside of North America would likely swamp any profits from raising price inside. Further, there is no reason to believe that other competitors would sit idly by in the unlikely event that anticompetitive redeployment was attempted and price raised. Thus, a theory of coordinated capacity reduction was untenable.

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[7] Professor Grimes continues to assert in his reply that there is a contradiction in the Commission's finding. We are still puzzled by his confusion. There is clearly substantial overlap in the type of products offered by the cruise lines, making unilateral effects less likely. However, the products sold by each cruise line are extremely varied and thus coordination is made more difficult because there are multiple dimensions over which coordination would have to occur.

[8] A more detailed discussion of the unilateral effects analysis is provided in Coleman et al., *supra* note 4. Grimes & Kwoka's speculation that Alaska might offer a unique venue for unilateral capacity effects (predicated on their assumption that the two dissenting Commissioners' concern must rest on "uncontroverted" evidence, although whatever evidence there may have been plainly failed to convince the Commission majority or any part of the Commission staff), merits only the response that the Commission's statement addressed every theory for which there was credible evidence or plausible basis for concern.

[9] That cruise lines try to monitor some of each others' prices may shed some light on whom they view as competitors but is in no way sufficient to show that price coordination is likely or even possible.

[10] In their quest for inconsistencies, Grimes & Kwoka do not appreciate the difference between building or reconfiguring ships or announcing plans to do either of those—none of which requires that contracts be breached—and canceling committed contractual ship orders. That the Commission found the former to be easier than the latter is hardly surprising, let alone an example of "Goldilocks" economics.

Grimes & Kwoka devote several paragraphs of their article to a discussion of yield management. We note that "whether yield management aids or hinders coordination" is not, as Grimes & Kwoka assert, a "policy" question. It is a factual question to be answered by the evidence in each investigation.[11] In this investigation, the extensive economic analyses and evidence showed—among other things—that application of the cruise lines' yield management systems resulted in substantial nonsystematic, unpredictable, and largely unobservable variation in prices, precluding effective price coordination both in the industry as currently constituted and in the post-merger world. Further, Grimes & Kwoka's derisive description of yield management as a "sophisticated tool of price discrimination," under which the prices charged consumers are higher than "competitive levels," ignores the reality that the use of yield management and similar pricing systems is ubiquitous in many industries involving perishable products, including the travel industry. The fact that an industry uses such a system, by itself, cannot be the basis for concluding that current pricing is or is not competitive. Mere price differences in this or any other industry are not conclusive evidence of supracompetitive pricing.[12]

Finally, Grimes & Kwoka turn to their "strategic conduct" theory, under which one or the other merger would, they suggest, somehow enhance the incentives for and abilities of the merged firm or firms to engage in allegedly anticompetitive conduct, such as signing exclusive or "favorable" agreements with some of the nation's thousands of travel agents, or "influencing regulators," or "employ[ing] computer reservation systems to gain advantages over rivals." None of these activities is necessarily (or even likely to be) anticompetitive, and may well be procompetitive. For instance, exclusive or "favorable" agreements with distributors are (as antitrust scholarship has long recognized) likely to be procompetitive. More importantly, in this investigation, there was no credible evidence that either merger enhanced the risk of any sort of "strategic conduct,"[13] and if such conduct were to be realized and produce anticompetitive effects, it could be challenged later, separate and apart from the merger. There was no reason to interfere with either proposed merger due to speculative concerns about possible conduct that might or might not occur, and might or might not be anticompetitive.

Conclusion

Though in part a recognition of the Commission's efforts to improve transparency, much of Grimes & Kwoka's "Transparency" article is a critique of the Commission's decision not to challenge the cruise mergers. We believe that the Commission's conclusions are fully supported by the extensive evidence and analysis cited by the Commission and elsewhere. And we welcome the Commission's decision to explain its thinking publicly, thereby contributing to our understanding of the analytical framework used in merger review. ●

[11] Professor Grimes in his response argues that yield management "should" make target price coordination easier. It is possible that yield management could make coordination easier but that does not mean that the actual way in which yield management is employed in this industry does make coordination easier or that it makes it likely. This possibility was considered in depth in the Commission investigation and the evidence did not support that the use of yield management in this industry made coordination likely.

[12] In this regard, we suggest a review of the important treatment of this issue in the recent *Symposium on Competitive Price Discrimination*, 70 Antitrust L.J. 593 (2003).

[13] Thus, as with the rest of the Commission's analysis, we considred not only if there were a possible theroy of competitive harm but whether the evidence supported the theory. In his response, Professor Grimes seems to indicate that theory is enough.