A Study in Merger Enforcement Transparency:
The FTC's Ocean Cruise Decision and the Presumption Governing High Concentration Mergers

Warren S. Grimes and John E. Kwoka

When a divided Federal Trade Commission (3–2) closed its investigation of two proposed acquisitions involving the three largest firms in the ocean cruise industry, it took the unusual step of issuing a statement explaining its decision. That statement, together with the dissenting statement of two Commissioners and subsequent analysis provided by the Directors of the Bureaus of Competition and Economics, offers unique and welcome insights into the bases for an important merger enforcement decision.[1] These comments explore both the implications of providing greater transparency to key enforcement decisions and also the reasoning and consequences of the Commission's decision not to pursue either of the two very large proposed mergers in an already concentrated ocean cruise industry.

Greater transparency is a necessary step toward achieving responsible and comprehensible agency merger enforcement. Transparency is needed because it contributes to greater understanding and predictability in the law and because it nurtures public debate about, and effective oversight of, agency merger enforcement policy. Part I of these comments describes the need for transparency. Part II describes the FTC's experiment in transparency in the cruise merger investigation. In the spirit of carrying forward public debate and discussion, Part III offers comments on the adequacy of the Commission's reasons for closing this investigation. Our major conclusions are twofold: (1) that further concrete steps are needed to foster transparency, particularly when a federal agency closes an important merger investigation; and (2) that the Commission's proffered explanation in this instance did not justify departure from the presumption in the Merger Guidelines that a large merger in an already concentrated industry is likely to have substantial anticompetitive effects.

__Warren S. Grimes and John E. Kwoka__ are senior research fellows for the American Antitrust Institute. Each served on the AAI's Committee of Experts that developed an AAI position on the cruise mergers. Warren Grimes is on sabbatical leave from Southwestern University School of Law. John Kwoka is a professor in the Department of Economics at Northeastern University.

Fostering Transparency in Merger Enforcement

A full measure of transparency might require that an agency operate in a fish bowl, revealing every investigative step that is taken and opening itself to interference from parties with conflicting interests. This degree of openness might well paralyze law enforcement. The Commission chose a far

[1] Statement of the Federal Trade Commission Concerning Royal Caribbean Cruises, Ltd. /P&O Princess Cruises plc & Carnival Corporation/P&O Princess Cruises plc., FTC File No. 021 0041 (Oct. 4, 2002) (FTC Cruise Lines Statement), *available at* http://www.ftc.gov/os/2002/10/cruisestatement.htm; Joseph J. Simons, Director, Bureau of Competition, Merger Enforcement at the FTC, Remarks to the Tenth Annual Golden State Antitrust and Unfair Competition Institute (Oct. 24, 2002), *available at* http://www.ftc.gov/speeches/other/021024mergeenforcement.htm; Bureau of Economics, FTC, Cruise Investigation: Empirical Economic and Factual Analysis (Nov. 22, 2002), *available at* http://www.ftc.gov/be/hilites/ftcbeababrownbag.pdf.

more limited and rational sort of transparency when it issued a short but comprehensive statement explaining its decision to drop the investigation of the cruise mergers. Publishing a timely explanation of the outcome of an important merger investigation has much to commend it. For example, the mere knowledge that a decision will have to be explained in public can encourage disciplined inquiry and decision making at the agency. After publication, the decision can provide the bar with better understanding of the agency's interpretation of the law and can foster legitimate discussion and oversight of the agency's decision.[2]

Concern with transparency in antitrust enforcement is not new. Legislation, such as the Tunney Act, governs the Justice Department's settlement of litigated antitrust cases and is designed to promote, among other goals, transparency in agency enforcement decisions.[3] But different rules, or no rules, govern merger investigations that produce no litigation, and the same approaches are not applied at the DOJ and the FTC. There is, in short, no comprehensive and well-conceived approach to transparency for merger investigations.[4]

This is unfortunate given the importance of merger enforcement to a well-functioning economy. The agencies have the power to preserve a premerger industry structure that is conducive to competition, or at least more so than the structure that would be created by the unchallenged merger. No other area of enforcement offers the agencies a comparable opportunity for preventative structural medicine. Because of its importance, agencies should not be asked or allowed to conduct merger policy in secrecy. The agencies do, of course, offer guidance by publishing merger guidelines, but the process remains fact intensive and often highly complex. Without an adequate flow of information, it is difficult to understand and meaningfully critique merger enforcement policy. Attorneys advising clients also need information about agency decisions in order to advise clients accurately. Yet publicly available information on agency enforcement decisions is often inadequate.

Under current U.S. practice, when a federal agency challenges a merger, its reasoning can be announced through the proposed federal court complaint, explanatory documents required by statute or regulation, and a motion for a preliminary injunction that the agency files.[5] This information often falls short of what is required for needed transparency (or what is offered by the European Commission in a typical explanatory statement). However, if the agency chooses not to challenge an acquisition, or if the Department of Justice employs a "fix it first" approach that does not require the filing of a court complaint, there is no requirement that any explanation be made public, and a comprehensive disclosure is the exception. The Commission has offered explanations on occasion, as in the statements in 1997 when the agency decided not to pursue the Boeing/McDonnell Douglas acquisition.[6] Perhaps the Commission chose to issue statements in

---

[2] For a more comprehensive examination of the benefits and costs of transparency in the context of agency antitrust enforcement, see Warren S. Grimes, *Transparency in Federal Antitrust Enforcement* (Study to Be Presented at Annual Conference of the American Antitrust Institute (June 2003) and to be published in the BUFFALO L. REV.) (on file with the author).

[3] The Antitrust Procedures and Penalties Act, 15 U.S.C. §16(a).

[4] The applicable laws and regulations governing the Federal Trade Commission and the Antitrust Division of the Department of Justice, as well as procedures governing the FCC, FERC, and the European Union, are described in Grimes, *supra* note 2.

[5] These statutes and procedures are described in Grimes, *supra* note 2.

[6] Boeing Co., [1997–2001 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 24,295 (July 1, 1997). On other occasions the Commission has chosen to disclose far more than required, underscoring the discretion that it has and sometimes chooses to employ. *In re* General Motors Corp., No. C-3132, 1984 WL 565376 (FTC Apr. 11, 1984).

that matter because of the parallel EU investigation and the media attention to the issues. The Commission's cruise mergers statement (signed by three Commissioners) and the separate dissenting statement (two Commissioners) are a second example of such disclosure, perhaps not surprisingly in a case involving merger investigations by both the EU and the United Kingdom that were widely reported in the press.

The FTC statements in Boeing and cruise lines tend to undermine claims that such explanations are precluded by confidentiality rules or will unduly restrict the agency's flexibility. The FTC pointed out that its decision not to pursue either of the proposed cruise lines acquisitions was based on specific and complex circumstances of this particular industry and should not be read as indicating that large mergers in highly concentrated industries would be permitted in another case.[7]

Statements Explaining Agency Decisions for Important Merger Investigations. The need for public disclosure of the results of important U.S. merger enforcement decisions goes beyond responding to short term media pressures that may be generated by parallel (and more transparent) investigations outside the United States. Systematic transparency is needed if oversight and accountability are to be meaningful. The most obvious need for information occurs when an agency decides not to pursue an acquisition after conducting an in depth investigation. As FTC Bureau of Competition Director Joseph Simons has said: "it seems obvious that explaining why the Commission decides not to take action in a particular case may well provide at least as much useful information as an explanation of why the Commission decides to take action in other cases."[8] Obviously, the great bulk of merger transactions raise no genuine antitrust issues. But when an agency devotes substantial resources to investigating a proposed acquisition (the cruise mergers were investigated by the FTC for ten months), an explanation of the agency's decision should be provided, regardless of the final disposition. It would be an enormously helpful change in current practice for the agencies systematically to provide such disclosures.

The FTC statements in Boeing and cruise lines tend to undermine claims that such explanations are precluded by confidentiality rules or will unduly restrict the agency's flexibility.

One way of achieving needed transparency would be for the Antitrust Division of the Justice Department and the FTC to issue statements explaining a decision to close a merger investigation whenever the agency requests additional information from one or more of the merging parties. The issuance of a second request is not an infallible measure of the importance of an agency investigation. Until a better measure is identified, however, the second request should be the trigger mechanism for requiring an agency explanation. The statement should identify the issues of concern and provide the agency's response to the major points in contention during the investigation. That should include information about the relevant market (often in dispute), the degree of overlap among participating firms, and at least the general range of concentration figures (if confidentiality prevents more precise disclosure).[9]

Legislative action to provide for transparency may be required, particularly if overreaching laws designed to protect business secrets unnecessarily undermine legitimate transparency goals. There would be advantages, however, if the agencies took the initiative. By doing so, the agencies could forestall legislation that might create an overly rigid or cumbersome mechanism. In the near term, a solution to the transparency problem might be for each agency to set its own standards,

---

[7] FTC Cruise Lines Statement, *supra* note 1.

[8] Simons, *supra* note 1.

[9] The Commission's cruise merger statement failed in several respects to meet this standard. For example, the Statement failed to address the strategic conduct issues raised by persons commenting on the proposed mergers. *See* discussion *infra* Part III.

or establish standards that are jointly agreed upon, based on the importance of the investigation and the amount of agency resources devoted to it, for determining when a public statement of explanation should be issued.

The Cruise Merger Case as a Case Study in Transparency

The unusual transparency in the FTC's cruise merger determination provides a model for transparency efforts. It also permits a more informed critique of the FTC's decision than could have been undertaken in the absence of disclosure. More informed oversight is a primary benefit of transparency.

Beginning in December 2001, the largest firm (Carnival Corp.) and the second largest firm (Royal Caribbean Cruises, Ltd.) in the ocean cruise industry battled one another to acquire the industry's third largest firm (P&O Princess Cruises plc). The FTC investigation of these dueling merger proposals gave rise to intense advocacy by the merging parties and to an active role by the American Antitrust Institute (AAI), which urged the Commission not to approve either transaction as proposed.[10]

From the outset of this matter, there was an unusually high degree of public visibility of these transactions because officials from each of the two would-be acquiring firms were anxious to tell their side of the story. In addition, the parallel investigations by competition authorities in the United Kingdom (investigating the proposed Royal Caribbean joint venture with Princess) and the European Union (investigating the proposed Carnival acquisition of Princess) generated additional information and interest in the proposed transactions. The FTC's investigation involved an unusually comprehensive collection of data, which was used by Commission staff to conduct various analyses.[11] The investigation moved through a number of phases. Early contacts between the would-be acquiring firms and the AAI suggested that the key issue was whether the market consisted only of North American cruise offerings, or whether all vacation opportunities should be included in the market. Later, after the European Union decided that a market definition limited to cruising was required, the parties focused their attention on various possible anticompetitive effects of an acquisition of Princess Lines by either of the suitors.

Before the Commission reached its decision, both the UK and the European Union had determined not to challenge these mergers and issued detailed statements explaining the grounds for their decisions.[12] For the North American cruise market, the FTC faced substantially different conditions that threatened greater anticompetitive effects. One obvious difference was the size and the maturity of the markets. In 2001, there had been only 1.9 million European cruise passengers (a penetration rate of 0.4% of the population) compared to 7 million North American cruise passengers (a penetration rate of 2.2%). U.S. passengers constituted 72% of worldwide demand.[13]

---

[10] The AAI is a non-profit research and advocacy organization that occasionally takes positions involving proposed mergers or acquisitions. The AAI's goals and activities are described more fully at its Web site, http://www.antitrustinstitute.org.

[11] Simons, *supra* note 1 (reporting that the FTC received "enormous amounts of data" on capacity utilization, actual transaction prices, and financial data).

[12] Commission of the European Communities, Case No. COMP/M.2706 (Carnival Corporation/P&O Princess) C(2002)2851 (July 24, 2002), *available at* http://europa.eu.int/comm/competition/mergers/cases/ (57 pages); Competition Commission (UK), P&O Princess plc and Royal Caribbean Cruises Ltd: A Report on the Proposed Mergers (June 19, 2002), *available at* http://www.competition-commission.org.uk (115 pages not including the extensive appendices).

[13] *Carnival Corp.*, ¶ 15.

The growth rate for the industry was also higher in Europe than in the United States,[14] suggesting that entry into the U.S. market might be less attractive. Moreover, the concentration levels in the North American cruise market appeared to be substantially higher than figures for Western Europe.[15] For these reasons and others, the UK and EU decisions were not good predictors of the U.S. antitrust posture toward the mergers.

When its decision to close the investigation was announced, the Commission indicated that it was issuing an explanatory statement because of the high degree of press attention and the complexity of the issues. Whatever the motivation, the explanatory statements of the Commission and the dissenting Commissioners are an affirmative step toward needed transparency.[16]

On market definition, the Commission statement emphasized the complexity of the market and the relatively elastic demand for cruises by a significant percentage of customers, many of whom would be taking a cruise for the first time. Although some of these factors pointed toward an "all vacation" market, the Commission nonetheless accepted a narrower definition limited to cruise lines because a hypothetical monopolist in that market "could likely use yield management systems" to raise prices profitably.[17] Yield management is a technique by which sellers in low marginal cost industries, such as airlines and hotels, effect a price discrimination scheme: the firm seeks to charge higher prices to less price sensitive customers while still offering discounts to more price sensitive customers in order to operate at or near maximum capacity. Computerized yield management is used by cruise lines, which adjust prices upwards or downwards based on whether bookings for a particular cruise or types of accommodations for that cruise are above or below levels set by the firm for any phase of the booking cycle.

Both the Commission and the dissenting statements agreed that, in the words of the majority, "either transaction would significantly increase concentration in a market already highly concentrated." After either acquisition, the industry would have a lead firm with nearly 50 percent of the North American cruise market (the top two firms will control over 80 percent and the top three firms over 90 percent of the market). With post-merger Herfindahls in the 3700 range, the agency Merger Guidelines provide that the merger will be presumed "to create or enhance market power or facilitate its exercise."[18] Although the dissenting Commissioners stressed the importance of the presumption, the Commission statement did not mention it. Instead, the Commission stressed language from the Guidelines that market share and concentration data "provide only the starting point for analyzing the competitive impact of a merger." As discussed below, the Commission assessed and discarded as unlikely various theories of anticompetitive effects that might flow from either transaction.

Significantly, the Commission statement did not address possible strategic behavior by the post-merger firm that could disadvantage rivals or raise entry barriers. The dissenting Commissioners did address the issue, in particular indicating that a clear market leader might force key travel

---

[14] *Id.* ¶ 16.

[15] The European Communities statement reported that the market shares of a combined Carnival and Princess would be between 20–30% for Germany and between 25–35% for the UK, the countries for which the overlap raised the most significant competitive issues. *Id.* at ¶ 113.

[16] Warren S. Grimes et al., *The FTC's Cruise Lines Decisions: Three Cheers for Transparency*, FTC WATCH, No. 599, Nov. 18, 2002.

[17] FTC Cruise Lines Statement, *supra* note 1. The European Union had likewise considered and rejected, after considerable analysis, arguments for a broader market encompassing vacation alternatives to cruising. *Carnival Corp.*, ¶¶ 28–68.

[18] U.S. Dep't of Justice and Federal Trade Comm'n, Horizontal Merger Guidelines § 1.51(c) (1992 rev. 1997).

agents to accept exclusive contracts or pressure port authorities to deal with competitors on unfavorable terms.[19]

Overall, the statements document that the Commission and its staff addressed the issues underlying the cruise mergers with a thoroughness that is commendable. Its willingness to disclose aspects of that analysis is also commendable. We find troubling, however, the fact that the Commission did not offer a well-reasoned ground and factual basis for sidestepping the presumption that large mergers in highly concentrated markets are likely to generate anticompetitive effects.

Did the Commission Give Proper Weight to the Presumption of Anticompetitive Effects?

The Presumption Governing Large Mergers in High Concentration Industries. The presumption that concentration-enhancing mergers in an already concentrated market are likely to create anticompetitive effects has venerable roots in economic theory and in antitrust enforcement. One of these roots is Edward Chamberlin's insight that participants in a tightly oligopolistic market will recognize their interdependence and their mutual interest in a high price, and act accordingly.[20] Today's economic treatises amplify Chamberlin's point about oligopolistic industries: the higher the concentration, the greater the likelihood of anticompetitive effects through collusion or tacit parallel conduct.[21] In addition, higher concentration may facilitate anticompetitive unilateral action (for example, by combining firms in the same or closely related niche markets) and may increase the merged firm's opportunities for strategic conduct involving upstream or downstream markets (vertical effects).

The presumption that concentration-enhancing mergers in an already concentrated market are likely to create anticompetitive effects has venerable roots in economic theory and in antitrust enforcement.

These insights about coordinated interdependent action, unilateral action, and strategic behavior provide the basis for the modern version of the presumption that large mergers in a concentrated industry are likely to be anticompetitive. The Supreme Court first expressly applied the concentration presumption in *United States v. Philadelphia National Bank* in 1963[22] and it has been restated in all four editions of the Merger Guidelines.[23] While this presumption can be overturned in economics and in law by a number of offsetting factors, the presumption serves a very important procedural role. It shifts the burden of persuasion to proponents of a merger when the anticompetitive risks are highest.

In closing the cruise mergers investigation, the Commission majority chose not to honor the presumption. Rather, it conceded only that the rise in concentration is "interest-provoking." Even more notably, the reason that the Commission rejected the presumption was not because of such factors as entry conditions, but rather because it insisted upon, and did not find, "evidence to sup-

[19] Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson, Royal Caribbean/Princess and Carnival/Princess (Oct. 4, 2002), *available at* http://www.ftc.gov/os/2002/10/cruisedissent.htm.

[20] Edward Chamberlin, The Theory of Monopolistic Competition 46–48 (1933).

[21] F.M. Scherer & David Ross, Industrial Market Structure and Economic Performance ch. 6 (3d ed. 1990).

[22] 374 U.S. 321, 363 (1963) ("[W]e think that a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.")

[23] The Guidelines were amended in 1997 without altering the presumption, which appears in Horizontal Merger Guidelines § 1.51(c).

[24] Although the Commission Statement does not directly address the presumption, in a subsequent speech, FTC Competition Director Joseph Simons acknowledged it and offered an explanation as to why the Commission majority chose not to follow it. Simons, *supra* note 1.

port one or more viable theories of antitrust violation."[24] It is indeed the case that the agency staffs are being challenged to offer increasingly specific theories of competitive harm, buttressed with whatever evidence can be marshalled.[25] While this is in principle unobjectionable, even desirable, it should be recognized that in practice competitive harms from mergers are almost always speculative, since mergers are consummated well before any empirical judgment on effects can be rendered. Demanding "proof" or even placing the "evidence bar" very high may seem like good policy, but it is tantamount to reversing the presumption of the Guidelines.

Of course, the Guidelines' presumption can be overcome by a proper showing.[26] In cases like the Boeing acquisition of McDonnell Douglas, the Commission has allowed mergers to very high levels of concentration.[27] The departure from the Guidelines in Boeing was explained because McDonnell Douglas, with only 5 percent of the world market for large civilian aircraft, was deemed unlikely to survive as an independent competitor and, although this was not emphasized in the Commission's statement, perhaps because of the large size necessary to maintain economies of scale and because any market power of the surviving firms could be mitigated by powerful, savvy buyers of the aircraft.

No such factors were cited in the Commission's cruise mergers statement. It cited several matters that could justify disregarding the presumption: (1) "changing market conditions," in particular the rapid growth and evolving service offerings in the industry; (2) the limited "degree of difference between services in this market and those outside" that will allow potential cruise customers to choose among various non-cruise vacation options; and (3) "particular circumstances here that would render either unilateral or coordinated [anticompetitive] effects unlikely." Although there is validity to many of these individual points, at the end of the day, the Commission's statement failed to define principled ground for disregarding the presumption.

Goldilocks Economics: The Commission's View of Cruise Mergers

There are, broadly speaking, three possible theories of anticompetitive effects from the cruise mergers. These are: (1) unilateral effects whereby a single firm takes advantage of its large size or its product niche to extract a price increase by itself; (2) coordinated interactions among the now-smaller number of firms resulting in higher prices for a substantial percentage of customers; and (3) strategic behavior that might increase entry barriers and/or disadvantage rivals, reducing overall competition in the industry. The Commission addressed the first two theories and found them lacking. The third concern was addressed only by the dissenting Commissioners. Under any of the three theories, a large merger in a highly concentrated industry would raise the risks of anticompetitive effects and, accordingly, should be subject to the Guidelines' presumption. Here we discuss each of these in some detail, focusing on the Commission's explanation for dismissing the concern and ignoring the presumption.

Unilateral Effects. Unilateral effects may arise in a number of circumstances. In an industry of differentiated products, company A enjoys some power to raise its prices without losing all its customers to company B or C. But if the price increase is substantial, A will lose too many customers to rivals to make that price increase profitable. A merger between companies A and B, however,

---

[25] This is one reason for the increased emphasis on the unilateral effects theory, which has the trappings of specific and even quantifiable economic analysis—regardless of whether it is the most likely source of competitive harm from a merger.

[26] Horizontal Merger Guidelines § 1.51(c).

[27] *Boeing Co.*, *supra* note 5.

could recapture some of those losses, in the form of B's increased profits, thereby making the price increase profitable to the merged company. Since this is a decision made strictly by the parties to the merger, it is a "unilateral" effect, that is, not dependent on rivals' cooperation. Another scenario giving rise to unilateral effects involves capacity constraints. If C is constrained in its ability to increase output—whether due to production limitations, government regulation, or other causes—the merged firm (companies A and B) may be able to raise price unilaterally by reducing its output. Closely related to the latter is the case of a "dominant firm," whose output is sufficiently large as to be able to influence market price—again subject to the ability and interest of rivals to alter their production plans so as to undermine the increase.

. . . the Commission advances what might be termed "Goldilocks economics"— an effort to make two contradictory points by asserting there is just enough of one characteristic to sustain the first point but not so much as to undermine the second.

Since the introduction of this theory in the 1992 Merger Guidelines, much analytical work in economics and much (some argue, too much) attention in antitrust have been paid to unilateral effects from mergers. In its statement on the cruise mergers, the Commission dismissed concerns based upon this theory. It contended that no two of the companies are uniquely close competitors, but rather all have products that overlap extensively. That is, there is too much competition among all of them to allow unilateral action from a merger of any two to pay off. Moreover, it argued that rivals could and likely would "replace any lost competition" by such strategies as building new ships and reconfiguring existing ships. This ability to increase capacity, the Commission contended, would prevent any single firm from profiting by unilaterally reducing output or capacity.

These are relevant considerations, but the available evidence in this case is not convincing and the Commission's line of reasoning leaves much to be desired. While it certainly appears true that the cruise companies' offerings have many similarities, they are not identical in destinations, amenities, prestige, and other attributes that arguably matter to customers. Ironically, the Commission makes this very point in the next section where it discounts the risk of coordination because there is supposedly too much differentiation for agreement among the companies. As we shall see, this is not the only instance in which the Commission advances what might be termed "Goldilocks economics"—an effort to make two contradictory points by asserting there is just enough of one characteristic to sustain the first point but not so much as to undermine the second.

Also dismissed by the Commission majority is any concern that constraints on output expansion by rivals might confer unilateral pricing power on the merged company. But here the flaw in the Commission's argument is not a matter of speculation. The dissenting Commissioners noted apparently uncontroverted evidence regarding the Alaska cruise trade.[28] Rivals to a Carnival-Princess merger would face a company with an overwhelming share of the Alaska niche and with "certain advantages in terms of land facilities, port access, and park permits." Rivals, in short, would be hard pressed to expand output to defeat a unilateral price increase by the merged company, because while they might have cruise ships available, they would not have the necessary access to ground and water infrastructure to actually expand their offerings.

The Commission's opinion makes no direct mention of Alaska, but it does assert that rivals could, among other things, "build new ships [and] reconfigure ships" to defeat a unilateral price increase or capacity reduction. But reconfiguring entire ships, much less building new ones, is an expensive and time-consuming activity, and certainly not one to be undertaken without assurance that the relevant market will be a profitable market three or four years hence. Regulatory barriers in the Alaska market might, in any event, prevent a rival's use of ships in the Alaska market. The

[28] Dissenting FTC Cruise Lines Statement, *supra* note 19.

Guidelines are quite clear that delayed and speculative capacity expansion is not an antitrust remedy for output contraction.[29] The Commission's opinion elevates the uncertain prospect of capacity expansion to a status inconsistent with the Guideline's admonition.

Coordinated Effects. Most mergers historically have been evaluated in terms of their potential to improve firms' ability to coordinate their strategies with respect to price and other parameters of competition. A significant reduction of numbers and/or increase in concentration from a merger forms the basis for the longstanding presumption of competitive concerns that underlies the Guidelines. In its statement on its cruise merger analysis, by contrast, the Commission concedes no such presumption but only that its "interest" has been "provoked." This interest-provocation standard would appear to be quite different from the Guidelines' presumption, and indeed the majority immediately makes clear what is required to satisfy its interest: "A viable coordinated interaction theory must establish why either [merger] would likely reorient these powerful [competitive] incentives in a dramatically different direction."[30] As noted previously, this standard is tantamount to reversing the Guidelines' presumption by placing the burden of proof on complainants (staff or injured outside parties), rather than on the parties to a high concentration merger.

That this is the effect soon becomes clear in the Commission's statement. Based on this standard, the majority segues into an enumeration of factors that make coordination arguably more difficult and then, in a flourish, states that coordination theories are therefore not viable. Even before considering those factors, this reasoning is a non sequitur. The fact that some factors are unfavorable does not justify a conclusion that they outweigh those other factors that favor coordination.[31] After all, no real world industry possesses all possible features that facilitate coordination. Moreover, this line of reasoning fails altogether to address the question raised by the merger: Given these considerations, which now seemingly hinder coordination, might a reduction in the number of companies be sufficient to tip the balance and bring coordination about? The majority's discussion casts no light on this question.

The factors identified in the discussion of coordinated effects as apparently convincing to the Commission are the following: complex prices due to variety of products, inability to monitor rivals' prices, demand which is mostly very elastic, and the need for complex price discrimination in the industry.[32] This list is notable for what was previously termed "Goldilocks economics." Here we are told that cruising is much too complex and differentiated a product to permit price coordination, whereas previously the majority claimed that cruise offerings overlapped too much and were too similar to permit unilateral pricing action. Which is it? Apparently not too little, not too much, just the right amount of differentiation. This may be possible. But it also becomes increasingly unlikely as concentration levels rise and the risk of unilateral or coordinated anticompetitive effects increases: just enough differentiation to *discourage* coordinated effects may be more than enough to *encourage* unilateral effects.

Similarly, the Commission asserts that cruise firms lack reliable information about rivals' prices and thus cannot coordinate pricing. Yet in support of its earlier argument that cruising is an antitrust market, it asserted that cruise lines "expend significant effort to monitor (to the best of their

---

[29] Horizontal Merger Guidelines §§ 1.32, 3.2.

[30] FTC Cruise Lines Statement, *supra* note 1.

[31] The Commission's argument here would fail its own standard of proof, namely, providing evidence that "establishes" the stated conclusion.

[32] Two other factors are listed earlier as altering the meaning of concentration data: changing market conditions, and the degree of difference between services in this market and those outside. Oddly, neither of these is discussed again in this context.

ability) each other's prices." Apparently, price information also falls into the Goldilocks category—not too hot, not too cold, just right to somehow sustain both arguments. While full information is not available to us, it is noteworthy that the dissenting Commissioners allude to evidence that the cruise lines do in fact engage in actions and counteractions on price—that is, they are knowledgeable about and responsive to each others' prices.[33]

Coordination and Yield Management. The Commission statement goes on to discuss at some length the cruise lines' use of yield management systems as a tool for price discrimination, and also the evidence that it claims refutes the contention that yield management might aid coordination. The cruise industry, like other low-marginal cost industries, such as hotels or airlines, has a strong incentive to operate at full capacity. Indeed, the cruise lines' incentive to fill the ship lies not only in the low marginal costs of the industry, but also in the substantial additional revenue generated by passengers. According to one industry observer, cruise lines generate up to one fifth of their revenues from on-board charges.[34] To maximize fare revenues while still filling the ship, cruise firms use carefully orchestrated price discrimination that adjusts fares based on a variety of factors, including the relative price insensitivity of some customers. Sophisticated computerized yield management programs adjust fares based on the number of bookings at each phase of the booking cycle. When a popular cruise attracts a large number of early bookings, the yield management system raises fares, slowing demand but forcing less price sensitive customers to pay more. Yield management, then, is anything but a random system. For any cruise for which bookings are at or above the norms set by the firm at any stage of the booking cycle, prices will go up (and less price sensitive consumers who book at that particular stage will end up paying more). The percentage of total consumers who will pay higher prices because of this relative price insensitivity will vary with each cruise (or even with the berth accommodations for that cruise). What is clear, however, is that on average there are a substantial number of these customers—without them, the yield management system would not be worth the substantial cost that a cruise line invests in its development and operation.

Whether yield management aids or hinders coordination is an important policy question not only in this industry but also in others that might find sophisticated software useful in managing their pricing. There is no simple answer. Yield management more finely discriminates in price, making coordination more challenging, at the same time that it systematizes pricing strategies, making coordination more feasible. The Commission seeks nonetheless to give a simple answer in this case, and that answer is that, on the evidence, neither merger "would enable the putatively coordinating cruise lines to agree tacitly and successfully implement a price increase based on booking characteristics." And what exactly is that evidence? The majority opinion references "empirical analyses" of "actual transactions" that found (a) prices in some cases rose but in others it fell as the sail date approached, (b) there was "dramatic" variation in the degree of change, (c) the proportion of early bookings also varied "dramatically," (d) there is no consistent correlation among prices on directly competitive cruises, and (e) the prices of different categories of berths vary unsystematically.

---

[33] The Carnival Statement of the European Communities also found that cruise lines were responsive to the pricing of rival cruise lines. *Carnival Corp.*, *supra* note 12, ¶ 59.

[34] Jane L. Levere, *Personal Business; Some Travel Bargains by Air, but Even More by Sea*, N.Y. TIMES, Apr. 6, 2003, at Sec. 3, p. 11 (quoting Credit Suisse First Boston analyst Scott Barry, who stated that because as much as 1/5 of cruise lines' revenue is generated from passengers on-board expenditures, "cruise lines always sail full.").

While the effort at empirical analysis is to be commended, it is not clear that the stated inferences deserve weight. Consider, for example, the first finding, that prices over the booking cycle sometimes rose and at other times fell. While the Commission takes this as evidence of the lack of anticompetitive coordination, this is what one would expect of a well-designed yield management system. Toward the end of the booking cycle, if berths remained unfilled, the cruise line should and—with yield management in its tool kit—would lower prices. If the cruise were nearly full, prices would rise. This uneven and unpredictable variation is yield management at work, without implications for coordination. It is surprising, as well as disappointing, that the Commission would be tempted by this implication when the cited fact simply does not distinguish between competing hypotheses. Similar observations might be made about the Commission's conclusions in other instances. The conclusions have meanings that are ambiguous, so that they could just as easily be cited by advocates of the opposing view, namely, that yield management enhances coordination.

This last point underscores another persistent problem in the Commission's analysis. At best, the cited empirical evidence concerns current industry practice, whereas the relevant policy question is whether the merger will increase the likelihood that yield management can be used in an anticompetitive manner when the number of significant companies is reduced from four to three. As before, the Commission's focus on pre-merger practices seeks to answer a factual question relevant to the past, whereas the real issue concerns conduct in the future.[35]

Other aspects of the Commission's discussion of yield management also raise concerns. There is no explicit recognition that while yield management may help in filling available berths (or airline seats, etc.), that does not imply that the price at which most customers secure berths are somehow more reasonable or closer to competitive levels. If yield management were to work perfectly, the only berth whose price would be at the competitive level—approaching marginal cost—is the last berth sold. Every other berth would be priced higher than the competitive level. Under less ideal (and more realistic) conditions, effective yield management will raise the average fare above the level that could be charged absent this sophisticated tool of price discrimination.

Moreover, any implication that yield management is benign in its impact on coordination is belied by experience in the industry for which sophisticated yield management was invented, namely, airlines. The airline industry has both used its sophisticated pricing software to aid coordination, and at other times readily found ways to circumvent its limitations.[36] While the airlines' experience is not an infallible guide to the effects of yield management in other industries—for example, pricing in the cruise industry may be less transparent than pricing in airlines—neither is there a basis for concluding that yield management generally obviates concern.

Coordination on Amenities and Capacity. Briefer comments on coordination with respect to amenities and capacity will suffice. With up to one fifth of a cruise line's revenue generated from on-board sales, amenities are a vital component in the financial performance of this industry. As noted earlier, the majority statement dismisses concern with coordination of quality ("amenities") by asserting that amenities are important, there are unilateral incentives to cheat, and so coordination would be undermined. Taken at face value, this line of reasoning is tantamount to a blanket denial that

---

[35] Indeed, if the Commission found evidence that yield management aided price setting today, it might then argue that the merger raises no policy concern since it would not make matters worse.

[36] *See* Severin Borenstein, *Rapid Price Communication and Coordination: The Airline Tariff Publishing Case* (1994), *in* THE ANTITRUST REVOLUTION 310 (John Kwoka & Lawrence White eds., 3d ed. 1999).

coordination can ever occur when parties have differing self-interests—a proposition that is demonstrably false, and an altogether inadequate basis for dismissing the concern. This is particularly unfortunate since the coordination of non-price terms will be more easily accomplished in a more concentrated industry. For example, following the lead of the largest firm, the remaining firms in this highly oligopolistic industry could determine to change refund policy in a manner that increases costs to customers. Or they might tacitly follow the lead firm in setting the rules for which services are included in the fare and which services are subject to additional on-board charges. These examples are merely illustrative of the ways in which a concentrated industry might tacitly coordinate non-price terms.[37] Coordination of less transparent policies could have the effect of raising prices for price sensitive as well as price insensitive consumers. At the point of booking, a first time cruise passenger (who may be price sensitive) may be unaware of, or pay little attention to, policies governing refunds or on-board charges for amenities.

As for capacity coordination, the Commission's argument rests on two propositions: (a) the number of ships that would have to be withdrawn is very large, and (b) their redeployment would cause unacceptable profit declines elsewhere. The bases for these claims are not provided, but even if true they would not address the possibility that capacity might be reduced by such strategies as deferring new ship purchases, delaying some already contracted for, or reconfiguring ships under construction for more higher-price berths. In addition, the Commission here employs another variant of its Goldilocks reasoning: Previously we were told that the cruise lines could build and reconfigure ships easily enough to defeat any effort at a unilateral price increase, but the Commission now asserts there are contractual and other impediments sufficient to preclude capacity contraction. This redeployment "mattress" is, the Commission would have us believe, just right: soft enough to defeat unilateral action, but hard enough to counter coordinated effects. Unlike Goldilocks, who could do her own empirical testing of mattresses, the Commission must make its predictions based on ambiguous evidence that three Commissioners interpreted one way, and two Commissioners interpreted another way. This is hardly a reassuring basis for disregarding the presumption governing large mergers in high concentration industries.

Strategic Conduct. Strategic conduct has occupied the economics profession greatly in the past twenty years. Research has shown the possibility of new types of anticompetitive behavior and re-examined some traditional concerns that had been relegated to the dustbin. The result has been a much greater appreciation of the variety of methods by which an aggressive company can secure an advantage over its rivals, ultimately diminishing their competitive force and conferring greater market power on the company that initiated the conduct. While this is not the place to review this body of literature,[38] it is important that these issues be considered in antitrust analysis. The Commission has, for example, given weight to possible strategic behavior in imposing requirements on Time Warner's acquisition of Turner Broadcasting.[39] The Commission's cruise merger statement is, unfortunately, silent on these matters. Here we note two examples of potentially anticompetitive strategic conduct.

---

[37] Robert H. Lande & Howard P. Marvel, *The Three Types of Collusion: Fixing Prices, Rivals, and Rules*, 2000 WIS. L. REV. 941, 949–84 (2000) (describing and analyzing collusion by manipulation of the rules under which competition takes place).

[38] *See, e.g.*, JEFFREY CHURCH & ROGER WARE, INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH (2000); Tefft W. Smith & Hillard M. Sterling, *Challenging Competitors' Mergers: A Real Strategic Option*, 65 ANTITRUST L.J. 57 (1996).

[39] Time Warner, Inc., 61 Fed. Reg. 50,301 (1996). *See* Stanley M. Besen et al., *Vertical and Horizontal Ownership in Cable TV: Time Warner-Turner* (1996), *in* THE ANTITRUST REVOLUTION, *supra* note 36, at 452.

One important resource for consumers confronted with opaque pricing schemes is the expertise of the independent travel agent. But this resource too may be jeopardized by the tight oligopoly that will result from an acquisition that produces a single firm with 50 percent of the market. Any supplier can be expected to push its downstream resellers for loyalty and favored treatment. The independent travel agent is in a position to resist this pressure (and should have a substantial incentive to provide consumers with neutral advice) as long as booking options are dispersed among a sufficient number of cruise lines. In the post merger world, the leverage of the largest firm will now be substantial, perhaps sufficient to force travel agents to give it favored treatment under circumstances that will not be revealed to the consumer.

Some travel agents may be persuaded to book exclusively for the largest firm, raising the cost of rival firms to obtain bookings. The result must be a further undermining of competition. This means that rival cruise firms will no longer have access (or be denied access on equal terms) to a substantial body of travel agents, increasing their costs of doing business.

These are merely examples of how the post-merger form may exercise power strategically. Other credible theories of strategic abuses include the wielding of influence with regulators who may control access to ports or facilities that could raise costs for rivals. This was a concern of the dissenting Commissioners with respect to the Alaska niche market. Further confirmation of the potential for anticompetitive strategic conduct might be found in the history of such conduct in the airline industry, where large carriers have for many years employed computer reservation systems to gain advantages over rivals.

The Commission's Treatment of Rivals' Submissions. The Commission's statement contains language that may be construed as endorsing second-class treatment of merger-investigation submissions by rival firms. After noting that both the merging parties and competitors have a self-interest in presenting information to the Commission, the statement singles out competitor-supplied information for special comment. Opposition from competitors, the statement suggests, "often indicates that the transaction will increase—rather than decrease—competition." This is so, the statement continues, because higher prices from the anticompetitive effects of a merger would benefit rivals (and rivals would support the merger).[40]

The reasoning in the statement is vulnerable. First, it should be noted, few mergers turn out to have the efficiency benefits that merger parties tout.[41] Even if a merger is efficient, it may not promote competition, so this would not be an incentive for a rival to oppose it. Moreover, whether or not a merger is efficient, there are three ways in which it can be anticompetitive (unilateral effects, coordinated effects, or strategic conduct). Only one of these ways (coordinated effects) would benefit all rivals, and even then only if all rivals are similarly situated. Unilateral anticompetitive effects may benefit some rivals, but would not necessarily benefit others. There would be no benefit if the unilateral price increase occurs in a niche market where rivals play no significant role (e.g., Alaska cruising). Strategic effects, far from benefiting rivals, are usually designed to handicap rivals and can be severely threatening to them. Although it is possible that rivals may oppose a merger because they fear a more efficient post-merger firm, an equally likely explanation for a rival's opposition would be its fear of the strategic behavior of the more powerful merged entity. In the cruise mergers, for example, rivals of the merging firms could well fear the influence that the

---

[40] FTC Cruise Lines Statement, *supra* note 1.

[41] F.M. Scherer, *Some Principles for Post Chicago Antitrust Analysis*, 52 CAS. W. RES. L. REV. 5, 10–22 (2001).

merged firm will exercise over upstream suppliers, downstream travel agents, or even regulatory agencies that control access to vital routes, ports of call, or other land-based facilities.[42]

In the last analysis, enforcement agencies are routinely deluged with biased information and analysis from the merging parties. The information presented by rivals may also be biased but it may be the only expert and in-depth information that can provide a counterweight to the merging parties' submissions. There is every reason to treat this information with at least the same respect and seriousness accorded submissions from the merging parties themselves.

Conclusion

The Commission's issuance of the cruise merger statements is a welcome and highly constructive development. The statements are a concrete demonstration that a public explanation can be issued at the close of a major merger investigation. For all its strengths, the Commission majority's statement was inadequate because it failed to address important objections that had been raised to the acquisitions (such as the risk of anticompetitive strategic conduct) and because its reasoning was superficial or unsupported in addressing the risk of unilateral or coordinated post merger effects.

The most disquieting aspect of the Commission's decision was its bypassing, without an adequate basis, of the presumption governing large mergers in concentrated industries. By permitting the parties to go forward, the Commission is in fact running a market experiment with respect to the presumption. Whether the merged entity succeeds in unilaterally raising price on some routes, coordinating with its two remaining significant rivals, or extracting concessions that disadvantage those rivals will be issues that reveal themselves in the market, albeit intermingled with other causal influences. The upshot may well be further evidence regarding the policy premise underlying *Philadelphia National Bank* and four iterations of the Merger Guidelines that has long and well served U.S. antitrust policy.

The criticism of the Commission's substantive ruling offered here in no way diminishes the importance and value of this effort at transparency. Indeed, these comments could not be offered without that disclosure. It may be hoped that such feedback will aid in improving the precision of future disclosure and, perhaps, future analyses. More generally, transparency fosters not only oversight, informed public debate, and responsive and responsible government—it also aids counselors in their task of understanding and communicating merger policy to clients. Explanatory statements should be the rule, not the exception, when either federal agency closes a major merger investigation. ●

[42] Evan Perez, *Carnival, Winning Princess Bid, Is Poised To Expand Dominance*, WALL ST. J. Oct. 28, 2002, at A 3.