Dissenting Statement of Commissioners Sheila F. Anthony and Mozelle W. Thompson

Royal Caribbean/Princess and Carnival/Princess

File No. 021-0041

The Commission today has voted to close its investigations into the potential acquisition of P&O Princess Cruises ("Princess") by either Royal Caribbean Cruise Lines ("Royal Caribbean") or Carnival Corporation ("Carnival"). We respectfully dissent because we believe that there is a substantial likelihood that either merger will significantly lessen competition in violation of the Clayton and FTC Acts, and that this risk must be assessed in the context of a full administrative trial on the merits. Within the limits of confidentiality considerations, this statement explains our views.

Cruising is the Relevant Market in Which to Assess Competitive Harm

Some of the parties in this case have argued that cruises are merely a small fraction of a much larger vacation market. However, we agree with the majority that the relevant product market in which to assess competitive harm is cruises marketed to North American consumers. First, this market definition comports with what we believe to be consumers' common sense view of cruises as a market unto themselves. Second, it is borne out by the evidence. For example, the evidence shows that the cruise companies view each other as one another's major competitors and that they closely monitor and at times react to one another's prices and capacity announcements. Pursuant to the *Merger Guidelines*, a market is the smallest set of potentially competing products that a hypothetical monopolist could exploit.[(1)] As the majority notes in its statement: "we have concluded that a hypothetical monopolist [in cruises] could likely raise average prices profitably." We agree.

High Concentration Levels Raise a Presumption of Anticompetitiveness the Parties Fail to Rebut

The North American cruise market is highly concentrated, and the significant increase in this concentration resulting from either proposed transaction raises the presumption that both mergers would result in anticompetitive effects.[(2)] A market is considered highly concentrated when the Herfindahl-Hirschman Index, or HHI, exceeds 1800.[(3)] In such a case, unless entry is easy, "it will be presumed" that a merger that significantly increases concentration is "likely to create or enhance market power or facilitate its exercise" in violation of the antitrust laws.[(4)] If Royal Caribbean succeeds in its offer for Princess, the post-merger HHI will increase from a highly-concentrated 2,800-plus to over 3,700. If Carnival is successful in its bid for Princess, the HHI likewise will rise to close to 3800. Either merged entity would control nearly half of North American cruise capacity.

In order to overcome the presumption of anticompetitiveness raised by unquestionably high concentration levels, the parties are obliged to demonstrate that the cruise market is characterized by a set of practices and circumstances rendering the unilateral or coordinated exercise of market power unlikely. In our opinion, they have failed to do so.

The Combined Company Could Engage in Anticompetitive Unilateral Behavior

The majority dismisses the prospect of unilateral effects based upon conclusions that neither of the mergers involves uniquely close competitors and that competition sufficient to constrain unilateral action will still exist following either merger. We disagree.

We believe it is likely that the merged firm, with a near 50 percent market share, would have sufficient strength to engage in anticompetitive unilateral behavior. Rather than taking the form of across-the-board price increases or unilateral reductions in capacity, a unilateral exercise of market power could be targeted toward various niche markets where the merger consolidates the two best alternatives in various cruise products.[(5)] For example, Carnival's Holland America and Princess are the longest-established competitors in the Alaska trade with a very high combined share of that niche market. These two firms have certain advantages over Royal Carribean and other firms that also offers Alaska cruises, in terms of land facilities, port access, and park permits.

The Proposed Transactions Would Facilitate Coordination on Price and Capacity

Although we believe that unilateral effects may result from the proposed mergers, our primary concerns in this matter arise from the potential for coordinated interaction among the remaining market participants with regard to both pricing and capacity issues. In this post-merger market, the merged firm, with nearly half the market, and its next largest competitor will control over 80 percent of the market, and the top three will control over 95 percent.

While many elements play into the pricing decisions made throughout the cruise sales cycle, a relevant factor in many decisions is pricing by competing cruise lines. Both documentary and testimonial evidence indicate that the parties expend a substantial amount of effort toward monitoring each other's prices, and have at times adjusted their prices in response to price changes by cruise competitors. Travel agents, who book the vast majority of cruises, also facilitate price competition by communicating competing offers to rival cruise lines.

With only two major competitors remaining after either of the mergers, existing price competition likely will be threatened. To the extent "a rising tide lifts all boats," less vigorous competition will benefit the top firms and all of the remaining competitors. While it is axiomatic that more explicit forms of price fixing are rendered significantly easier when a market is reduced to only two major players,[(6)] the coordination in this post-merger market is likely to be tacit and subtle.[(7)] The market leader can set slightly higher prices than it might have otherwise, and the other firms, diligently gathering information on a host of prices, will have every incentive to follow.[(8)] Admittedly, pricing in this industry is complex, but the parties are sophisticated enough to have mastered this arcane art, and, if moved to do so, they likely would be able to exploit the reduction in competition to the detriment of consumers.[(9)] The weight of the evidence reflects that the parties monitor and at times react to each other's prices, and we believe that the likelihood that price coordination may indeed be facilitated in a post-merger market is an inquiry that, at the very least, warrants full explication at trial.

Either of the proposed transactions also would create the incentive to collectively reduce the rate of industry capacity growth. Until September, 2001,[(10)] the relatively new cruise market had been growing at an average rate of approximately 8 percent annually for several years. Huge ships, now commonplace in the market, require roughly 18 to 24 months each to build. Their cost approximates $400,000,000 each, and orders are placed well in advance. Based upon firm orders already placed, the industry growth trend seems preordained to continue for the short term.

However, the proposed transactions are likely to disrupt this growth. The evidence reflects an industry-wide desire to limit the rate of capacity growth and ease downward price pressures. With an established market leader, and ship orders and deployments well-known in the industry, the

dominant competitor could easily set a new slower pace that its nearest competitors could be expected to follow. The relevant question, then, is whether industry capacity growth will continue at the same pace that it would have absent the merger, or instead will be slower over the near or long term. We believe that the latter is the more likely course.[(11)]

The Evidence Fails to Establish that Entry Would be Timely, Likely, and Sufficient

Based upon staff's findings during the course of the investigation, it is far from certain that entry or expansion post-merger would occur on a scale sufficient to offset the presumption of anticompetitiveness raised by the high concentration levels present in the industry. While the evidence indicates that entry may indeed be possible, barriers to *de novo* entry are high due to various factors, some of the most significant of which are the required economies of scale, the cost and time required to build new ships, the difficulty of repositioning existing ships as "premium" cruise ships, marketing and distribution requirements, and problems obtaining permits or port access in certain locations.

Similarly, while entry in the form of expansion or redeployment by existing fringe firms may be possible, significant questions remain as to whether it would be timely, likely or sufficient.[(12)] With only a small number of ships in their inventories and business models often based upon niche offerings (*e.g.*, combined cruise and theme park products), fringe entrants may be less interested in expansion opportunities, or less able to take advantage of them.[(13)] Additionally, fringe firms might find it in their best interest to follow price increases and reduced capacity expansion set by the market leader.

Claimed Efficiencies are Vague and Do Not Outweigh Potential Competitive Harm

Finally, claimed efficiencies simply have not been stated with the requisite amount of specificity to weigh them against potential anticompetitive harm.[(14)] Even assuming all the cost-savings claimed by the parties were merger-specific and certain, those efficiencies still would not likely outweigh the presumptive anticompetitive effects resulting from either proposed transaction.

Conclusion

In summary, staff have performed an excellent inquiry into the range and depth of potential anticompetitive effects arising from the two proposed transactions. This was a difficult decision, guided as always by our clearest judgment as to what best protects the interests of American consumers. While each proposed deal is challenging and exceedingly close, we believe that on balance neither party has sufficiently rebutted the presumption of anticompetitive harm that our Merger Guidelines prescribe in concentrated markets such as this one.

Accordingly, we respectfully dissent because we believe that either contemplated transaction is likely to violate the antitrust laws and should be enjoined pending full trial on the merits.

Endnotes:

1. U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines* § 1.11 (1992) ("*Merger Guidelines*").

2. This is at best a four to three merger with a small fringe of competitors. Some commentators have argued that it approaches three to two, because the fourth player, Norwegian Cruise Lines, with only 12 percent of the market, is presently lagging behind the other three in terms of growth. Such characterizations are beside the point. The concentration levels speak for themselves.

3. *Merger Guidelines* § 1.51 at 16-17.

4. *Id. See also* Memorandum in Support of Plaintiff's Motion for Preliminary Injunction, FTC v. H.J. Heinz Company, Civ. No. 1:00CV01688 JR (2000).

5. A clear market leader may also have the power to disadvantage competitors -- with the net impact of increasing prices to consumers -- by various means including, but not necessarily limited to, forcing key travel agents to accept exclusive contracts and pressuring port authorities to deal with its competitors on unfavorable terms.

6. "When the leading four firms control 40 percent or more of the total market, oligopolistic behavior becomes likely." F.M. Scherer & David Ross, Industrial Market Structure & Economic Performance 82 (3d ed. 1990). Here, the top two firms would control over 80 percent of the market post-merger, and the top three would control over 95 percent.

7. *See e.g.*, *Merger Guidelines* § 2.11.

8. Some argue that the cost of adding each additional passenger is very low and that the on-board sales of incidentals - such as drinks and shore excursions - give cruise lines the overwhelming incentive to fill their ships at any fare (*e.g.,* when a ship has excess capacity close to the sail date). Further, it has been argued that this "incentive to sail full" drives fares rather than the competition among rival cruise lines. Though we acknowledge that cruise lines do possess the economic incentive to fill their ships fully with passengers, we are not persuaded that competition is irrelevant to cruise markets. Indeed, while some segment of customers (*e.g.,* those who buy close to the sail date) could still pay low fares regardless of the amount of competition in the market because of the incentive to sail full, a larger share may suffer fare increases from the elimination of competition.

9. Cruise lines may be able to effectively price discriminate among their customers through use of yield management systems. Such discrimination might take the form of both self-selection (some consumers choose to book when prices are high) and active segmentation by the cruise lines of customers based upon a host of characteristics. Moreover, few consumers either attempt to delay booking in an effort to obtain a lower price or follow subsequent prices in an effort to cancel existing bookings and re-book at a lower price. Cruise lines also try to "fence-in" customers who have booked by ensuring that subsequent promotional offerings are conditioned in such manner that booked passengers cannot cancel and re-book. Given these tendencies and tools, tactical price increases are possible.

10. Growth in the cruising industry, as in other industries, has been negatively impacted due to the terrorist attacks of September 11, 2001.

11. Indeed, the very pendency of the contemplated transactions already may have slowed industry capacity growth. Options to build new ships that likely would have been exercised may have been permitted to lapse during the pendency of the proposed transactions.

12. *Merger Guidelines* § 3.

13. Additionally, to the extent those parties who argue that pricing is complex and thus relatively opaque to competitors in this industry are correct, fringe competitors may not be able to readily identify opportunities for entry or expansion.

14. This conclusion is especially true with respect to Carnival. Due to the hostile nature of the proposed transaction, Carnival has not had the benefit of performing any due diligence with respect to its hoped-for efficiencies.