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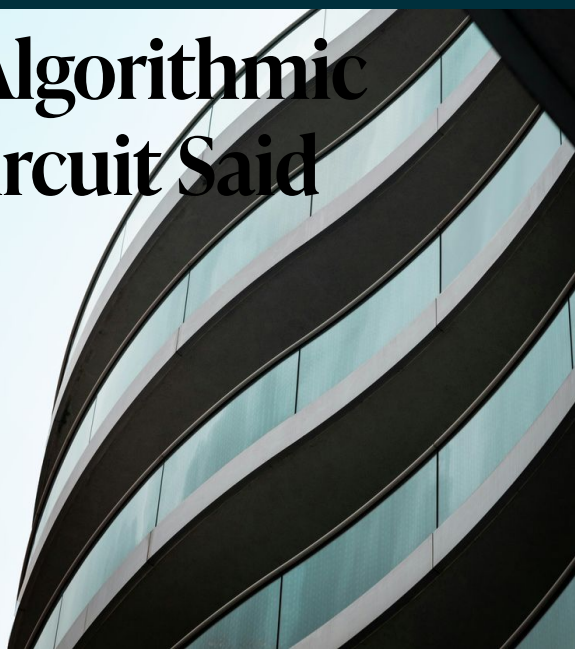
First Appellate Ruling on Algorithmic Pricing: What the Ninth Circuit Said Versus What It Did



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August 27, 2025, 10:21 AM
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In *Gibson v. Cendyn Group*, the U.S. Court of Appeals for the Ninth Circuit became the first federal court of appeals to evaluate an antitrust claim based on algorithmic pricing. The plaintiffs-appellants brought suit under Section 1 of the Sherman Act, challenging agreements between the provider of algorithmic revenue-management software and the hotels that used that software's recommendations to price room rentals. The court affirmed dismissal of the complaint, concluding that the parties' relationship was neither horizontal nor vertical in the relevant sense and therefore their agreements were not subject to the rule of reason at all. Nevertheless, the court went on to apply what amounted to a "quick look approval" version of the rule of reason. The court suggested that its analysis might have been different if the complaint had alleged that the hotels had delegated pricing decisions to a third party or if the software had shared competitors' current, granular pricing data.

Background

The plaintiffs are regular visitors to the Las Vegas Strip who frequently rent hotel rooms there. They allege that many hotels on the Strip license revenue-management software from Cendyn. The software integrates with each hotel's property-management system and

collects daily pricing and occupancy data from the hotels. Its algorithm then recommends pricing for individual hotel room stays for each hotel customer. Critically, the algorithm uses only public data and the hotel's own data for each hotel's recommendations. It does not pool, share, or use other hotels' non-public information when making recommendations. By default, the integrated software offers the algorithm's recommended price as the hotel's sales price, although that feature may be turned off with the necessary permissions.

Originally, the plaintiffs claimed that there was a hub-and-spoke conspiracy through which the hotels had agreed with each other to purchase the Cendyn software and to follow its pricing recommendations. But the plaintiffs abandoned that claim on appeal, leaving only their challenge to the agreements that each individual hotel had with Cendyn. The plaintiffs argued that, in the aggregate, these agreements harmed competition. As proof, they cited Cendyn's marketing materials stating that hotels followed Cendyn software's recommendations 90% of the time and alleged that, as a result, hotel room rental prices on the Strip were artificially inflated.

Analysis: Algorithmic Pricing

Although the plaintiff's hub-and-spoke claim was not before the court, the Ninth Circuit panel opined that it would "undoubtedly" violate Section 1 for "competing hotels to agree among themselves to abide by a third party's pricing recommendations when pricing their own hotel rooms." The question in algorithmic-pricing cases, of course, is often whether the common use of the same algorithmic software or service is evidence of an agreement among competitors. On this point, the court stated that the consciously parallel use of the same algorithmic software is not enough; antitrust law "does not require a business to turn a blind eye to information simply because its competitors are also aware of that same information." But the court noted that its analysis might have been different if Cendyn had "shared the confidential information of each competing hotel among the licensees."

Key Takeaway for Algorithmic Pricing: According to this Ninth Circuit panel, competitors' consciously parallel use of the same algorithmic revenue-management software is not problematic when the software keeps each competitor's confidential data siloed.

Analysis: Agreements Neither Horizontal nor Vertical

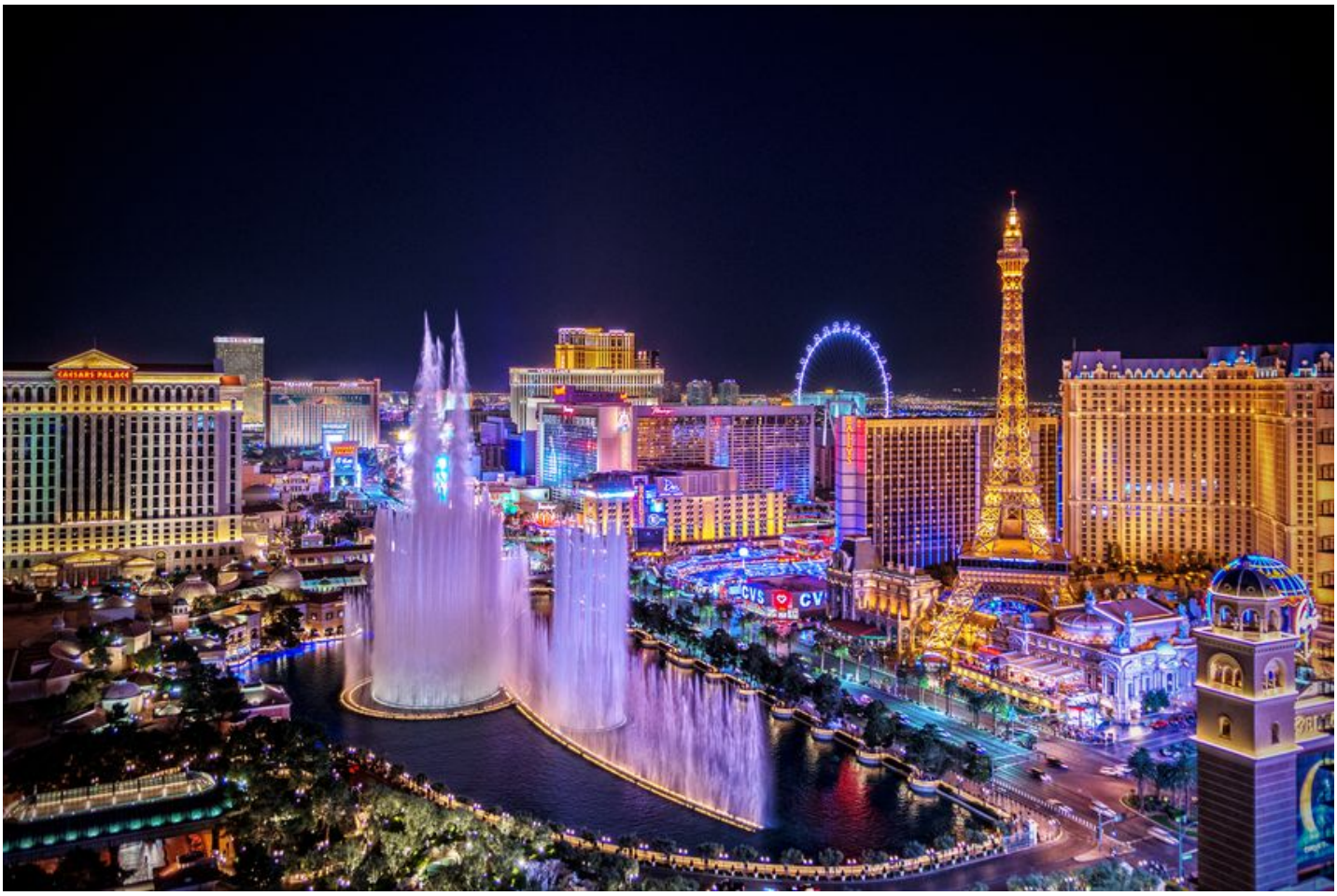
The Ninth Circuit concluded that the plaintiffs' challenge to Cendyn's agreements with the individual hotels did not state a claim under Section 1 of the Sherman Act. In reaching this conclusion, the court took the unusual tack of declaring that these agreements did not constitute a "restraint of trade in the relevant market," "without first applying the rule of reason."

Types of Agreements Subject to Section 1. The Ninth Circuit held that Cendyn and the hotels were not in a vertical relationship with respect to the relevant market because Cendyn's revenue-management software was simply an advisory profit-maximization tool. The court noted that the hotels did not delegate binding pricing decisions to Cendyn and found that advisory services are not an input for the relevant product—here, hotel room rentals. The fact that the parties were not in a relevant vertical relationship mattered because the court determined that Section 1 polices only three types of agreements: horizontal, vertical, and hub-and-spoke (i.e., a combination of the two). According to the court, because the agreements between Cendyn and the hotels fell outside these three categories, the rule of reason did not apply.

Although the Ninth Circuit appeared to categorically exclude certain types of agreements from Section 1 analysis, other portions of its opinion suggest it ultimately rested on a less controversial point about causation. The court recognized the need for "a causal link" between the challenged agreements and the alleged anticompetitive harm in the relevant market, and it concluded the plaintiffs had failed to plead such a causal link in this case.

Quick Look Approval. In determining that Cendyn's agreements with the hotels need not undergo rule of reason analysis, the court explained why the agreements did not qualify as restraints of trade. It found that the agreements did not affect hotels' ability or incentive to compete for room rentals. But this explanation belies the court's rejection of the rule of reason.

An examination of whether an agreement changed competitors' "ability or incentive" to compete in the relevant market is, as the federal antitrust enforcers explained in their now-withdrawn Antitrust Guidelines for Collaborations Among Competitors, exactly the analysis that the rule of reason requires. The rule of reason is flexible enough to take many forms. As the Supreme Court has recognized, in appropriate circumstances, this analysis may be done in the "twinkling of an eye." In short, although the Ninth Circuit disclaimed application of the rule of reason, its evaluation of the challenged agreements' effect on the ability and incentive of hotels to compete in the rental market amounted to so-called "quick look approval" under the rule of reason.



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