

## A Vertical Challenge May Have Fared Better In Sabre Merger

By James Fishkin and Dennis Schmelzer (May 20, 2020, 11:40 AM EDT)

On April 8, Judge Leonard Stark of the U.S. District Court for the District of Delaware denied an injunction requested by the antitrust division of the U.S. Department of Justice to block Sabre Corp. in its \$360 million acquisition of Farelogix Inc.<sup>[1]</sup> The court concluded that the DOJ had failed to meet its burden of proving that the transaction would harm competition in a relevant product and geographic market.

On the surface, the court's opinion leaves the impression that the DOJ may have made some basic errors in presenting its case. A closer look, however, reveals the extent to which the DOJ struggled to present a viable case for a horizontal challenge despite strong objections to the merger from Farelogix customers in the U.S.

Because Sabre-Farelogix followed the DOJ's first vertical merger challenge in decades — its failed attempt to enjoin the AT&T Inc. acquisition of Time Warner Inc.<sup>[2]</sup> — the DOJ may have been reluctant to frame Sabre-Farelogix as yet another vertical challenge. The court's decision, however, suggests that it may have been more inclined to view Sabre-Farelogix in vertical terms. As such, the DOJ missed a good opportunity to test the principles in the new vertical merger draft guidelines in practice.

Ultimately, the Sabre-Farelogix transaction will not go forward. Instead, following an adverse ruling in the United Kingdom, Sabre and Farelogix agreed to terminate their transaction and DOJ has asked the U.S. Court of Appeals for the Third Circuit to vacate Judge Stark's opinion in its entirety. Nevertheless, it is worth asking what lessons can be learned from DOJ's failure to obtain an injunction against this acquisition based on horizontal theories of harm.

### DOJ Fails to Define a Relevant Product Market for a Horizontal Challenge

Defining a relevant product market is a basic first step for a government agency in any merger challenge. As demonstrated by the Federal Trade Commission in the recent Evonik-PeroxyChem trial, the failure by an agency to properly define a relevant product market can prove fatal to a merger challenge.<sup>[3]</sup> Without a viable product market for analysis, the court cannot find anticompetitive harm sufficient to enjoin the proposed merger.



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In Sabre-Farelogix, the DOJ alleged that the transaction would harm competition in a market for booking services sold to online and traditional travel agencies.[4] The court found it relevant, however, that neither Sabre nor Farelogix actually sold booking services independent of other services and that, as a result, the DOJ's expert economist could not identify basic features of this product, including the price or value of the booking services offered by either Sabre or Farelogix.[5]

With a proposed product market that did not align with commercial realities, the court concluded that the DOJ could not establish that the merger was likely to harm competition.

### **The Proposed Market Reflected a Deeper Problem with the DOJ Case**

While antitrust agencies often focus on narrow markets where the merging parties are close, if not the closest, competitors offering very similar products or services, Sabre-Farelogix posed a particular challenge precisely because the parties were firms that offered distinct products and services to different customers.

Sabre, as a global distribution system, or GDS, operates a platform designed to connect a large number of travel suppliers, including airlines, hotels and car rental companies, with a large number of travel agencies.[6]

Rather than merely connecting individual suppliers with buyers, GDS platforms comb raw fare, scheduling and availability information provided by multiple airlines to assemble offers that each airline or group of airlines can provide in response to any request, allowing travel agents to compare flight options from multiple airlines to provide their clients with the best options and to manage travel agency bookings once placed.[7]

Global distribution systems combine offerings from hotel and car rental suppliers with airline offers. Sabre's primary competitors for these services are Amadeus and Travelport, which operate rival GDS platforms.[8]

Farelogix, by contrast, sells IT solutions that allow airlines to distribute directly to customers through their own websites and to reach travel agencies through one of three paths, including direct connections, non-GDS aggregators or GDS platforms like Sabre.[9]

Farelogix is not a GDS. Farelogix does not aggregate content or allow travel agencies to compare fares from multiple airlines; instead, it only enables airlines to sell their own content to various distribution points through dedicated single-airline connections.[10] Farelogix does not deal with travel agencies as customers or offer other GDS services.

DOJ attempted to bridge these differences by carving out the aspects of Sabre's services that most closely resembled Farelogix's products and then defining a single amorphous booking services market around those functions. With this proposed single market, DOJ framed the case as a horizontal merger challenge.

There was some evidence to support this approach. The court recognized, for example, that some customers viewed Sabre and Farelogix products as substitutes.[11] Farelogix had even previously attempted to establish itself as a new GDS entrant before abandoning that model by 2009.[12]

At the same time, even basic price comparisons between Farelogix and Sabre were difficult; while

Farelogix offered lower prices, those prices covered far fewer services than those provided by Sabre.[13] These price differences suggested that the firms were not really selling the same product. There also was evidence that Sabre had twice tried and failed to sell services similar to those sold by Farelogix,[14] but the court only viewed this as further proof that Sabre and Farelogix offer different products.[15]

Within its proposed product market, the DOJ recognized that Farelogix's market share — as a horizontal competitor with Sabre and other GDS platforms — was low. Nevertheless, the DOJ expressed concern that Sabre, as a dominant firm, was trying to "take out a disruptive competitor that has been an important source of competition and innovation," which "would likely result in higher prices, reduced quality, and less innovation for airlines and, ultimately, traveling American consumers."[16]

As a result, this challenge was widely seen as protecting a nascent competitor, a description that fit with the image that Farelogix had projected a decade earlier but was somewhat at odds with how its business model had evolved since 2009.

In the end, the DOJ struggled to convince the court that its theoretical concerns were supported by the record.[17]

### **The Looming Shadow of AT&T-Time Warner**

Aside from what it failed to establish, the DOJ did have some success in Sabre-Farelogix.[18] For example, the court accepted the DOJ's view that Farelogix is unlike other competitors for the services that it provides.[19] Indeed, while the DOJ's complaint largely focused on Sabre as a dominant GDS platform, the DOJ also persuaded the court that Farelogix is a dominant provider for the services it provides to airlines.[20]

Given the perceived dominance of Sabre and Farelogix in their core business areas, and the stated plans of Sabre to vertically integrate Farelogix into its own products, good questions can be asked about why the DOJ proposed a combined single product market in which Farelogix was a small but growing competitor over separate, vertically related product markets in which both Sabre and Farelogix were dominant firms. If the DOJ had chosen the latter option, the combination could have been grounds for a more robust vertical challenge.

Of course, challenges of vertical mergers are exceedingly rare and the DOJ had just recently failed to enjoin AT&T's \$85 billion acquisition of Time Warner — the first vertical merger challenge litigated in decades — when it moved to enjoin Sabre-Farelogix. Unlike Sabre-Farelogix, there was never any allegation that AT&T and Time Warner were horizontal competitors. There are, however, other distinct parallels between the cases.

In AT&T-Time Warner, for example, the DOJ raised concerns that AT&T would use Time Warner's "must have" television content to either raise its rivals' costs or drive those rivals' customers to its subsidiary, DirecTV.[21] As a result, the DOJ alleged that "consumers nationwide would be harmed by increased prices for access to Turner networks," even if the DOJ conceded that AT&T's customers would actually see cost savings.[22]

It is not difficult to compare how the DOJ similarly depicted Farelogix's services as "must have" content for airlines in the evolving travel industry.

There also are notable differences between the cases. In AT&T-Time Warner, for example, the DOJ

introduced third-party competitors of DirecTV as witnesses complaining that the acquisition would hurt their ability to compete.[23] These competitor complaints gave rise to the theory that the merger would harm competition by raising rivals' costs. By contrast, there is little mention in Sabre-Farelogix of opposition to the deal from Amadeus or Travelport, Sabre's primary GDS competitors.

In Sabre-Farelogix, by contrast, the complaints came directly from Farelogix customers. American Airlines and United Airlines — two of Farelogix's largest customers and its only customers in the United States — publicly raised objections to the acquisition.[24]

Indeed, the DOJ presented evidence that Sabre and Farelogix executives thought Sabre could and would raise the prices paid by customers for both Farelogix and Sabre services after the transaction.[25] These price increases, if viewed as unilateral pricing effects on customers, may have been sufficient to support a vertical challenge if not offset by the elimination of double-marginalization or any other efficiencies.

In a vertical case, the DOJ also could have described Farelogix's airline customers as competitors for GDS services, since airlines increasingly rely on Farelogix to compete with global distribution systems for direct sales to travel agencies. To the extent that the transaction might raise prices to airlines for Farelogix's services, those price increases could have been described as raising Sabre's rivals' costs. Finally, the DOJ might have argued that the transaction would foreclose this essential technology from other airlines that might otherwise directly compete with Sabre.

## Conclusion

It is not clear that the DOJ would have prevailed if Sabre-Farelogix had been presented as a vertical challenge. Vertical challenges in court are exceedingly rare and notoriously difficult for antitrust agencies. Moreover, the court was persuaded in Sabre-Farelogix that, despite some contrary evidence, "the most likely impact on pricing [from the transaction] is that prices will remain the same or be reduced following the transaction."<sup>[26]</sup> A vertical challenge would not have been likely to succeed unless the DOJ could have convinced the court on this critical point that customers would, in fact, pay higher prices following the transaction.

Still, vertical theories of harm would have likely been a better match for the commercial realities of the industry. As a result, a vertical case would have been less likely to come down to market definition issues. Moreover, given the parties' unique strengths in their core business areas, the matter arguably offered the DOJ a perfect opportunity to test the principles in the new draft vertical merger guidelines. By couching the transaction purely in horizontal terms, however, DOJ missed that opportunity, and also failed to enjoin a transaction with which it had serious competitive concerns.

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***Disclosure: The authors represented PeroxyChem at trial in this matter.***

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[1] United States v. Sabre Corp., Civil Action No. 1:19-cv-01548-LPS (D. Del. Apr. 8, 2020) [hereinafter Sabre-Farelogix].

[2] United States v. AT&T Inc., 310 F. Supp. 3d 161 (D.D.C. 2018), aff'd, 916 F.3d 1029 (D.C. Cir. 2019) [hereinafter AT&T-Time Warner].

[3] Federal Trade Commission v. RAG-Stiftung, Civil Action No. 1:19-cv-02337-TJK, at 1-2 (D.D.C. Jan. 24, 2020) (explaining that the Federal Trade Commission's failure to properly define a market all but precluded a judgment in its favor).

[4] Sabre/Farelogix at 1, 74.

[5] Id. at 75-76.

[6] Id. at 12.

[7] Id. at 12-13.

[8] Id. at 13.

[9] Id. at 20-22.

[10] Id. at 23.

[11] Id. at 31-32.

[12] Id. at 33.

[13] Id. at 32.

[14] Id. at 77.

[15] Id.

[16] Press Release, U.S. Department of Justice, Justice Department Sues to Block Sabre's Acquisition of Farelogix (Aug. 20, 2019), <https://www.justice.gov/opa/pr/justice-department-sues-block-sabres-acquisition-farelogix>.

[17] Sabre/Farelogix at 90.

[18] The court even made a point of emphasizing that "[o]n several points that received a great deal of attention at trial . . . the Court is more persuaded by DOJ than by Defendants." Id. at 91-92.

[19] Id. at 34.

[20] See id. at 34-41 ("Farelogix has won more RFPs than any other NDC API provider . . . and has actually been quite successful in recent years.").

[21] AT&T/Time Warner, 310 F. Supp. 3d at 164.

[22] Id.

[23] Id. at 202-03.

[24] See Sabre/Farelogix at 23 (identifying both airlines as Farelogix customers), 81 (noting that "13 out of 15" Farelogix customers "are airlines located outside of the United States"); 61 (describing opposition to the transaction).

[25] Id. at 62-63.

[26] Id. at 64.