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Most Favored Nation Clauses: A Review of Enforcement Activity

By Alysha Manji-Knight
Davies Ward Phillips & Vineberg LLP

Introduction

Most favored nation ("MFN") clauses in vertical agreements are essentially arrangements between buyers and sellers, pursuant to which one party guarantees that the other will receive the best price or terms for a product or service. MFNs are ubiquitous and have become increasingly popular in a variety of industries, including health care, payment cards, online travel and retail. Antitrust authorities have engaged in the interplay of MFNs and competition for decades; however, recently we have seen increased MFN enforcement in a number of jurisdictions.

Jurisprudence

United States

While MFN enforcement is an important area of focus for the Department of Justice – Antitrust Division (the "Division"), generally such arrangements are benign and raise antitrust concerns in only limited circumstances. The Division has brought approximately 10 MFN enforcement actions over the last two decades, the most significant of which, include the *Delta Dental of Rhode Island* ("Delta") and *Blue Cross & Blue Shield* ("BCBS") cases.

In 1996, the Division challenged the use of MFNs by Delta, the largest dental insurer in Michigan, alleging that the MFNs effectively set a minimum fee that participating dentists could charge to non-Delta patients. The contracts permitted Delta to audit and verify dentist compliance with the MFN clauses and Delta had a history of enforcing such MFNs in cases where it found that other dental insurer rates were "demonstrably" significantly lower than Delta's rates. The use of these MFNs raised a number of concerns, including whether they (i) prevented other insurers from offering narrower insurance options at a lower price; (ii) discouraged dentists from offering discounts to selected patients; and (iii) enabled a single company to set a floor for dental fees across the entire state. The case was resolved by consent decree after the court denied Delta's motion to dismiss.

More recently in 2010, the Division brought an enforcement action against BCBS, the largest non-governmental provider of health insurance. BCBS instituted two types of MFNs in its contracts with hospitals – regular MFNs pursuant to which BCBS would always get a

price no higher than the lowest price the hospital offered to other insurers, and "MFN+" which required BCBS to receive at least a 23 percent discount compared to other insurance providers. The Division alleged that the BCBS contracts effectively required hospitals to freeze competing insurer discounts at their current level for the entire term of the BCBS contract. The use of these MFNs raised a number of concerns for the Division, including whether BCBS was effectively (i) preventing entry and expansion by lower cost rivals; (ii) restricting hospitals from signing different contracts with rival firms (as doing so would risk the hospital's compliance under its contract with BCBS); and (iii) creating a perverse incentive to encourage hospitals to deal with a smaller number of insurers. The case was resolved before the court rendered a final decision by legislative change to Michigan's insurance laws, which prohibited the use of MFNs by health insurers.

To date, all of the Division's MFN enforcement actions have been resolved by consent decree. As a result, no court has found a company liable under antitrust laws simply for using MFNs.

Europe

Generally, the European Commission Guidelines on Vertical Restraint, in particular the Vertical Agreement Block Exemption ("VABE"), is the most relevant legislation governing the use of MFNs in Europe. VABE sets out the following safe harbor: (i) market shares of each of the parties to the vertical agreement must be below 30 percent and (ii) there must be no "hardcore" restrictions in the agreement (e.g. resale price maintenance). Typically, vertical agreements that meet the conditions of VABE are exempt from competition law scrutiny (although competition authorities can still intervene if there is evidence of anticompetitive effects). Generally, the consensus in Europe is that MFN clauses may be protected by VABE so long as the agreement relates to a direct supply relationship. The recent *Amazon* and *Hotel Booking Platforms* cases provide some insight into when European authorities will investigate and challenge MFN clauses.

Amazon's business model involves sales directly to end-consumers as well as to other sellers through its Marketplace platform. Amazon's agreement with Marketplace sellers included an MFN which restricted Marketplace sellers' ability to offer lower prices on competing platforms, including the sellers' own online stores. The UK and German authorities investigated Amazon's MFN policy and concluded that while it was a vertical agreement, it also included a horizontal dimension as both Amazon and Marketplace sellers sold to end-consumers. The authorities concluded that this horizontal dimension of the agreement resulted in price-fixing between competitors. Following the investigation, Amazon dropped its Marketplace pricing parity clause.

The hotel bookings industry typically uses two types of MFNs – wide MFNs under which hotels cannot offer hotel rooms at lower prices on other competing portals, and narrow MFNs under which hotels cannot offer hotel rooms at lower prices on their own websites. The German authorities launched an investigation in 2013 against Hotel Reservation Services ("HRS"), one of the largest providers of hotel reservation services in Germany. The authorities determined that the use of wide and narrow MFNs effectively foreclosed entry in the hotel booking industry because new firms that offered lower commission rates or innovative services would not be able to obtain better rates from hotels. Furthermore, it was concluded that these MFNs lead to uniform pricing between hotel reservation portals. The authorities' prohibitions on using wide and narrow MFNs was upheld by the courts.

Following this win, the German enforcers launched a similar investigation into the use of MFNs by Bookings, another large hotel reservation services provider. In the course of the HRS investigation, Bookings had dropped the use of wide MFNs but maintained narrow MFNs. The European Commission was satisfied with an undertaking from Bookings and accepted the argument that narrow MFNs are necessary to prevent hotels from free riding

on hotel booking service providers' marketing efforts and investments. However, the German authorities were not persuaded by this argument, concluded there was no free-riding and issued a second prohibition decision against the use of narrow MFNs by Bookings.

Both HRS and Bookings exceeded the 30 percent market share threshold. Accordingly, the authorities did not consider the applicability of VABE.

Expedia, another hotel bookings platform also discontinued its use of wide MFNs but maintained narrow MFNs. Expedia's market share in Germany is below 30 percent and therefore it may fall within the ambit of VABE. A case involving Expedia is currently before the courts. It will be interesting to see how the court rules on the applicability of VABE and whether any other circumstances warrant intervention.

Economic Analysis

MFN enforcement activity relies heavily on economic analysis to substantiate the anticompetitive effects of the arrangements in the relevant market. However, economic theory has advanced both procompetitive and anticompetitive effects of MFNs. On the procompetitive side, MFNs can reduce negotiation costs, increase price flexibility in long-term contracts, and encourage entry and investment. On the other hand, MFNs can have anticompetitive effects such as facilitating coordination, reducing seller incentive to offer discounts, entrenching a dominant firm, and restricting entry and expansion. Typically, MFNs have both pro and anticompetitive effects and economists assess these effects together to determine which is more significant (e.g. if overall the MFN is procompetitive and efficiency enhancing, the marketplace would likely observe a reduction in price or enhanced quality).

However, this assessment cannot be considered in a vacuum because a number of other factors can impact the potency of MFNs. Such factors may include the parties' market shares, the prevalence of MFNs in a particular industry, the cost of finding MFN-alternatives, and the price disparity among competitors after the introduction of MFNs.

It is important to analyze the effects of MFNs on a market-wide basis and not only specific to a single competitor. Market-wide analysis requires understanding the competitors in the market and their responses to the introduction of MFNs (e.g. if the response is unanimous or almost unanimous, this may indicate a market wide effect).

Practical Guidance

Given the recent focus on MFNs in certain jurisdictions, it is important to consider and address potential issues in multijurisdictional situations. While the approach, analysis and consequences relating to MFNs may vary by jurisdiction, the underlying objective is the same – to determine whether the anticompetitive effects of the MFN outweigh the procompetitive effects. As a starting point an effects-based analysis should be undertaken to better advise clients of possible implications of MFN clauses. An initial inquiry, which includes the following questions, will help determine the likely effects of the MFN:

- Will the MFN clause have an effect on price?
- In which jurisdictions will the MFN clause apply? What is the history of MFN enforcement in these jurisdictions?
- Does the MFN clause result in market power in relation to the product or good at issue? Will a high percentage of buyers or sellers be subject to the MFN?
- Does the MFN clause create a horizontal agreement between competitors?

- Does the MFN clause contain unusual terms (e.g. retroactive MFN, MFN+, etc.)?
- Is there a strong efficiency rational for the MFN clause?
- Will the MFN clause impact the behavior of the firm imposing the MFN (e.g., contracting behavior)?

Generally, responses to these questions will provide high-level insight into whether the MFN will give rise to anticompetitive issues in the relevant market. A deeper dive may be necessary to further elicit a more definitive answer.

The use of MFN clauses to negotiate favorable terms is not a new phenomenon. However, it is clear that certain jurisdictions are increasing MFN enforcement activity. Companies should be cognizant that MFN clauses, particularly those that include unusual terms, may attract the attention of enforcers. To protect against enforcement action, companies are well advised to engage in an effects-based analysis to better understand the MFN clause's procompetitive and anticompetitive effects and overall impact on competition in the relevant market.