



A Newsletter from Shumaker, Loop & Kendrick, LLP

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## **The Ubiquitous Most Favored Nations Clause:**

## Old Wine in New Bottles

or literally centuries, buyers of goods and services have relentlessly attempted to impose upon sellers of those goods and services "Most Favored Nations" ("MFN") or Competitor Parity

clauses in their contracts: "Thou shalt not give my competitors a better deal, and if thou doeth, thou shall either grant unto me the same favor or answer to the axe." In an apparent effort to satisfy procurement due diligence and what they may believe to be competitive parity, many modern buyer procurement officers have adopted this practice either in an effort to be

by Michael M. Briley

thorough (i.e., to leave "nothing on the table") or, perhaps sometimes, in an effort to avoid the hard work connected with their job description. Also, some

buyers (particularly some very large ones) are just arrogant and cannot stand to even contemplate the idea that anyone else would get a better price. In any event, historically these provisions have been reluctantly accepted by sellers



who either lack the market leverage to insist upon their removal or who simply have adopted the attitude that either the buyer will not actually enforce the provision or, alternatively, that no one will ever really care. Unfortunately, and albeit not commonplace, lawsuits to enforce these provisions have been brought and they are normally successful. However, several noteworthy lawsuits and governmental investigations have placed into question the legality and enforceability of MFN provisions, thus making them risky for buyers in certain circumstances. The efficacy as well as the legality of these provisions under the antitrust laws has

recently come into serious question in the U.S., Canada and the E.U.

The recent American Express case<sup>1</sup> is an example of the current trend by antitrust enforcement agencies to look at vertical agreements between powerful buyers and sellers that may have the effect of restraining competition in the buyer's market resulting from restraints upon seller's ability to offer competitive alternatives to its customers. In that case, Amex was found to have significant "market power" (even though it was shown to enjoy only 30% of the credit card market) and was prohibited from using a contract



provision that required its credit giving merchants to "push" Amex cards and to "steer" retail customers away from the cards of competitive credit card companies. Albeit not strictly an MFN clause, the impact of the initiative was to impose a vertical market restraint on retailers designed to impact competition horizontally at Amex's market level, akin to an MFN provision that prevents the seller from offering better discounts to the buyer's competitors. Even absent proof of any consumer harm, the court perceived a harm to competition created by control of Amex over retail merchants. Similarly, in a recent decision against Hotel Reservation Service ("HRS"),<sup>2</sup> the German Federal Cartel Office ("FCO") found Hotel Reservation Service's ("HRS") use of a most favored nations pricing provision specifically to be unlawful notwithstanding HRS' modest market share of just over 30%. The FCO's concern was centered around a belief that the MFN provision would have a negative impact on small and medium sized hotels.

The focus of the U.S. antitrust enforcement agencies and the EU's antitrust concern about traditional MFN's is that they tend to discourage sellers from lowering prices in response to competition at the seller's market level (thereby preventing competitors of the MFN authors from gaining better prices), as well as stifling procurement price competition at the buyer level. In other words, they have the effect of establishing a "floor" on prices because the seller will be concerned that offering lower discounts (or base prices) will require them to then also have to lower prices to the MFN buyer. MFN buyers, of course, tend to be more powerful buyers with leverage over sellers and therefor, often higher volume purchasers.

Competing firms have also used MFN's to promote collusive agreements designed to stabilize prices. A good example of this was U.S. v. Apple,3 where Apple entered into e-book MFN agreements with five of the six largest book publishers requiring each publisher to lower its retail price to match the lowest price offered by any other retailer with the purpose of creating a "price floor" in order to enable them to increase retail prices and to exclude competitive e-book publishers like Amazon. Both effects create economic price "stability" (a bad thing in antitrust economics) and eliminate <u>cost competitiveness</u> in buyer markets and price competitiveness in seller markets.

Traditionally, and at least in the U.S., it was maintained by antitrust economists that the negative, anticompetitive consequences of MFN's could only occur when the buyer has sufficient economic power as a buyer, to effectively coerce MFN's with less powerful sellers, thus restraining procurement cost competition in the markets of powerful buyer and secondarily price competition in seller markets. A good example of this concern can be found in U.S. Department of Justice Complaint against Blue Cross/Blue Shield of Michigan, where Blue Cross/Blue Shield (with a significant market share of + 70% as a buyer of medical services in the State of Michigan) contractually obligated doctors and hospitals in Michigan to agree to grant to Blue Cross/Blue Shield any lower price (rate for services) granted to any other medical insurance company or payor. The gravamen of the Complaint was that this practice artificially kept medical costs high and prevented emergent managed care plans from entering the market in competition with Blue Cross/Blue Shield.

In the ensuing years immediately following the Blue Cross/Blue Shield case it was believed that MFN's were suspect under the antitrust laws only when the buyer had very significant market power in its own market. Recent opinions, however, strongly suggest that the "bar is being lowered" and MFN's and competitive parity provisions (as in the *Amex* case) may be risky even in markets where the buyer has a smaller market share (e.g., 30% or less) than what was traditionally viewed as "dominant" (+60%). Interestingly, none of the decisions turning down MFN's have focused on potential harm to the consumer – the ultimate victim of efforts to prevent discounting that is inherent in MFN clauses.

In the late 1990's there was a number of federal enforcement consent decrees entered by the DOJ and the FTC that prohibited enforcement of MFN's by large health care payor companies. These cases included U.S. v. Delta Rental Plan (I)<sup>5</sup> (barred enforcement of an MFN by a health plan that signed up 85% of the dentists in Arizona), U.S. v. Medical Mutual of Ohio<sup>6</sup> (barred enforcement of an MFN by a large health insurance company that discouraged pharmacists from joining other networks) (similar to the more recent Amex case (infra.), U.S. v. Oregon Dental Services<sup>7</sup> (barred enforcement of an MFN provision that discouraged dentists from discounting) and FTC v. RxCare of Texas<sup>8</sup> (barred enforcement of an MFN clause designed to discourage pharmacists from joining other networks that promised additional business but offered lower reimbursement rates). Perhaps the most interesting of these cases was *U.S.* v. Delta Dental (II),9 which involved a "penalty MFN clause." In a consent decree entered into with the DOJ, the defendant agreed to cease and desist

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## insights

use and enforcement of an MFN that operated to cause an actual reduction of reimbursement fees to participating dentists who joined other (competitive) health plans which promised more business in exchange for lower reimbursement rates.

The situation in the EU is currently even more risky with attacks in several cases against OTA's (on line travel agencies) for violating Articles 101 and 102 of the Treaty on the Functioning of the European Union ("TFEU") and individual country competition laws. Defendants like Expedia had been using MFN's to prevent hotels from offering lower prices to competitive booking channels in order to protect the OTA's commissions and their ability to represent to the public that they would get (by using the OTA), the "lowest rate available." Knowing that their room rates offered to customers will be in line with that of their competitors, the OTA's will "have little (if any) incentive to compete against one another on commission rates charged to hotels."10 In other words, the OTA's could raise commission without losing business because the room rate will go unchanged (at the expense of hotel margins). If a hotel did raise rates, per operation of the MFN the rates then would have to be equally increased to all other OTA's. The EU has also recently opened an investigation of Amazon's MFN clauses in its e-book publisher's contracts whereby Amazon, which is the largest e-book publisher in the EU, has insisted on MFN's with virtually all of its publishers requiring them to offer Amazon the best terms and prices offered to any other on-line

The upshot of these developments is that antitrust enforcement agencies worldwide and most courts no longer view MFN's superficially as "procompetitive" tools simply designed to get the lowest price for buyers and will look carefully at likely anticompetitive effects in both the buyer and the seller's market. Old presumptions by sellers that MFN's only present antitrust issues in markets where the buyer has a monopoly or dominant market power (e.g., in excess of 60%) are no longer valid and have become risky. The old belief that MFN's ultimately inure to the benefit of consumers is universally met with cynicism by today's economists and enforcement personnel. Rather, each transaction and each market represented by each transaction should be carefully considered, including an analysis of:

- 1. What is the market structure and how do the parties (especially the buyer) fit into the market? Does the buyer have a significant degree of market power (e.g., 30% or more) for the purchase of the product or service involved?
- 2. What is the purpose for the MFN? Is it simply to insure the lowest price or will it have the purpose or effect of establishing a floor to prices in the market? If the latter, will it prevent or discourage new entry into the market in competition with the buyer?
- 3. What percentages of the buyer's requirements are met by the goods or services subject to the MFN? Will it restrain competition in buyer markets by preventing cost (procurement) competition? Is the seller a dominant player in its market with a high market share? Do competitors of buyer have access to other suppliers who are not subject to the MFN contracts of the MFN author?
- 4. What is the true purpose of the MFN? How strict is it? Does it contain a retroactive clause that may gain the buyer an advantage (not just parity) over its competitors?
- 5. What is the length of the contract?

- 6. Does the provision prevent customers on one side of a two sided market from recovery of their costs? (For example, the MFN's and "steering" provisions used by Amex forced retailers to an "all-or-nothing" dilemma of having to lose significant business if they did not offer Amex cards to customers).
- 7. Will the clause harm consumers? Will the clause prevent sellers from lowering their prices without a dollarfor-dollar capitulation by the seller?
- 8. Are there less restrictive alternatives? For example, two excellent and far less restrictive alternative approaches are:
  - (a) Meet-or release clauses. For example, "if you do not offer us the best price we can cancel the contract, but you are not contractually <u>required</u> to offer us the lowest price;" or
  - (b)"Re-deal" clauses. "If you offer someone else a better deal you, have to let us know and we have the right to re-negotiate our deal."

While both of these alternatives afford to the buyer assurance that the seller will not secretly give better deals to its competitors, they allow the seller to discount or offer a lower price to another buyer without obligating the seller to offer the same price to MFN buyer.

As global competition economics and consumer welfare both continue to loom larger in antitrust analysis, it is my belief MFN's will come under greater scrutiny worldwide and alert buyer counsel should consider ways to protect their procurement position without causing harm to either competitive buyers or consumers.

For additional information, please contact Mike Briley at mbriley@slk-law.com or 1-800-444-6659, ext. 1325.



- <sup>1</sup> *United States v. Am. Express Co.,* 88 F. Supp. 3d 143 (E.D.N.Y. 2015).
- <sup>2</sup> German Federal Cartel Office (12/30/13, B 9-66/10).
- <sup>3</sup> *U.S. v. Apple, Inc.,* 791 F.3d 290 (2nd Cir. 2015).
- <sup>4</sup> U.S. v. Blue Cross/Blue Shield of Michigan, Case No. 2:10 cv-14155-DPH-MKM (E.D. Mich. 2010).
- <sup>5</sup> 1995 U.S. Dist. LEXIS 9752 (D. Ariz. 1995).
- <sup>6</sup> 1998 U.S. Dist. LEXIS 21508 (N.D. Ohio 1999).
- <sup>7</sup> 1995 U.S. Dist. LEXIS 481363 (N.D. Cal. 1996).
- <sup>8</sup> 121 FTC 762 (1996).
- <sup>9</sup> 1997 U.S. Dist. LEXIS 11239 (D.R.I. 1997).
- <sup>10</sup> See, e.g., Konkurrensverket
  [Swedish Competition Authority],
  2015 case no. 596/2013, http://
  www.konkurrensverket.se/
  globalassets/english/news/13\_596
  bookingdotcom\_eng.pdf; and
  European Commission Press Release
  IP/15/4921, Antitrust: Commission
  Launches E-Commerce Sector Inquiry
  (May 6, 2015), http://europa.eu/
  rapid/press-release\_IP-15-4921\_en.htm
- See, European Commission Press
   Release IP/15/5166, Antitrust:
   Commission Opens Formal
   Investigation into Amazon's E-Book
   Distribution Agreements (June 11,
   2015), <a href="http://europa.eu/rapid/press-release">http://europa.eu/rapid/press-release</a> IP-15-5166 en.htm.

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