Mitigating Antitrust Risk in Most Favored Nation, Non-Discrimination and Anti-Steering Contract Provisions

THURSDAY, AUGUST 29, 2013
1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:

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Thursday, August 29, 2013
1:00 p.m. Eastern

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Squire Sanders, Washington, D.C.

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Ronald Drennan, Chief**
U.S. Department of Justice, Washington, D.C.

** Not an author of slides unless otherwise indicated. Where indicated, the views expressed in this presentation are the author’s and are not purported to reflect those of the United States Department of Justice.
Introduction

- A most favored nations clause ("MFN") is a promise obtained by a buyer from seller that the seller will not give a better price to anyone besides that buyer
  - Typically ensures that a buyer’s competitors will not get a cost advantage
  - But not just about price—increasingly related to access and content

- MFNs are not unlawful
  - Some courts have rejected challenges on facts alleged
    - Ocean State Physicians Health Plan, Inc. v. Blue Cross Blue Shield of R.I., 883 F.2d 1101 (1st Cir. 1989)
      - “[A] policy of insisting on a supplier’s lowest price—assuming that the price is not ‘predatory’ or below the supplier’s incremental cost—tends to further competition on the merits.”

- Have recently been subject of high-profile enforcement cases
Introduction

- MFNs arise in different industries
  - Use of MFNs in the health care context first arose during the healthcare reform proposals in the early 1990s
    - In health plan network contracts, MFNs are often commitments procured by a market-leading health plan from a provider that the provider will not give any other plan as good or better a price
  - Prevalent in digital media contracts
    - Music industry
    - Right to digital content
      - DOJ investigation into cable industry use of MFNs
  - Credit card industry

- Various permutations of MFNs are commonly used
  - Equal-to MFNs
  - “MFN-plus” clauses, or “buffers”
  - Retrospective versus Prospective operation
  - Automatic versus Right-to-Negotiate
Other Contracts Referencing Rivals (CRRs)

- Contracts with material terms contingent on terms between one of the parties and competitors of the other
  - Could include price terms or non-price terms

- **Exclusive dealing**
  - Purchaser agrees to purchase all requirements from particular seller (or vice-versa)

- **Loyalty discounts**
  - Agreements to sell at a lower price to customers who purchase all or most purchases from the seller

- **Non-discrimination rules (NDRs)**
  - Require buyer to refrain from steering customers to competing alternatives

- **Retail preference agreements**
  - Used to secure access to best retail promotions
History of MFN Enforcement

- DOJ and FTC filed 7 enforcement actions in the 1990s:

- All involved use of MFNs by payors with large market shares
- All resulted in consent decrees ending or restricting the practice
Which Cases and Policies Give Rise to Concern Over MFNs?

- **Formation of the Comcast – NBC Universal Joint Venture**
  - FCC Order, January 18, 2011
  - Contracts between Programmers (content) and Cable Companies include MFNs
  - Most Favored Customer Clauses
  - Aggravates anticompetitive incentives of vertical merger and potentially extends impact to customers with which the vertically-integrated firm does not compete
  - Reportedly a subsequent DOJ investigation

- **Auto Insurance allegations**
  - DOJ-FTC workshop on MFNs, September 2012
  - MFNs in agreements between insurers and collision-repair shops
  - Claim of “monopsony harm”
  - Allegedly incents competitors to demand low rates

- **Credit Cards**
  - Challenging nondiscrimination rules that require a merchant not disfavor AMEX’s products relative to those of its competitors
Which Cases and Policies Give Rise to Concern Over MFNs?

  - DOJ sued Apple and 5 book publishers alleging use of agency agreements for sale of eBooks in the i-Bookstore and beyond
  - Case not primarily about MFNs, but MFNs in Apple/publisher contracts were found to have “facilitated” the conspiracy
  - MFN at issue was a price parity provision
    - According to the Court, “Apple included the MFN, or price parity provision, in its Agreements both to protect itself against any retail price competition and to ensure that it had no retail price competition.”
    - The MFN “stiffened the spines of the Publisher Defendants to ensure that they would demand new terms from Amazon.”
  - Focus on the price charged to customers of competing distributors
Which Cases and Policies Give Rise to Concern Over MFNs?

  - All about MFNs
    - Complaint alleged that dominant health plan BCBS agreed to pay higher rates to hospitals in exchange for MFNs
  - Alleged anticompetitive effects of BCBS MFNs included:
    - Both “establishing” and “raising” a “price floor” for hospital services
    - Raising the price of commercial health insurance
    - “Depriving consumers of hospital services and commercial health insurance of the benefits of free and open competition”
  - Decision on motion to dismiss DOJ case: August 12, 2011
  - Insurance Department Order prohibiting MFN enforcement: February 1, 2013
  - Michigan Statute prohibiting MFNs passed in 2013
  - DOJ/BX voluntary dismissal: March 28, 2013
  - DOJ press release on dismissal of Michigan litigation:
    - The Division “continues to investigate the use of MFN clauses in health plan contracting in other areas.” (emphasis supplied)
State Legislative Response

- Legislatures in at least 22 states have limited or restricted the use of MFNs in health care contracts
  - 17 states have enacted comprehensive ban on MFNs in health care contracts:
  - 5 other states have limited the use of MFNs in particular contexts:
Example:

“No contract with a health care provider shall do any of the following:

(1) Prohibit, or grant a health insurance carrier an option to prohibit, the provider from contracting with another health insurance carrier to provide health care services at a rate that is equal to or lower than the payment specified in the contract.

(2) Require the provider to accept a lower payment rate in the event that the provider agrees to provide health care services to any other health insurance carrier at a rate that is equal to or lower than the payment specified in the contract.

(3) Require, or grant a health insurance carrier an option to require, termination or renegotiation of an existing health care contract in the event that the provider agrees to provide health care services to any other health insurance carrier at a rate that is equal to or lower than the payment specified in the contract.

(4) Require, or grant a health insurance carrier an option to require, the provider to disclose, directly or indirectly, the provider’s contractual rates with another health insurance carrier.

(5) Require, or grant a health insurance carrier an option to require, the non-negotiated adjustment by the issuer of the provider’s contractual rate to equal the lowest rate the provider has agreed to charge any other health insurance carrier.

(6) Require, or grant a health insurance carrier an option to require, the provider to charge another health insurance carrier a rate that is equal to or more than the reimbursement rate specified in the contract.”

Private Cases

- Follow on lawsuits to BCBSM case:
  - *Aetna, Inc. v. BCBSM,* Case no. 11-15346 (E.D. Mich. 2011)
  - Multidistrict litigation against Blue Cross Blue Shield Association and individual plans
    - 2/7/2012: First case filed (*Cerven v. BCBS of North Carolina and BCBS Association*)
      - Challenges Territorial license restriction and MFN
    - 12/12/12: Southeast districts
      - Judicial Panel on Multidistrict Litigation consolidates 9 cases (7 in Alabama, 1 in NC, and 1 in TN) before Judge Proctor [ND Ala.] for pretrial proceedings

- Other cases:
    - Adoption of similar MFNs by record labels representing more than 80% of the sales of digital music as evidence useful to support a Section 1 claim
    - Allegation that online travel agents entered agreements with hotel defendants in which hotel defendants ensure that no other online retailer offers rooms at lower rates
Discussions of MFNs Involving Antitrust Agencies

- Improving Health Care: Dose of Competition
  - Report by FTC & DOJ [July, 2004]

- Contracts Referencing Rivals
  - Scott-Morton [April, 2012]

- FTC/DOJ MFN Workshop
  - [September 2012]

- Lear Report prepared for OFT
  - Can ‘Fair’ Prices be Unfair? A Review of Price Relationship Agreements [September, 2012]

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Types of Potential Harm

- **Exclusionary**
  - Raising Rivals’ Costs
  - Deter Entry

- **Facilitate Collusion/Coordination**

- **Other**
  - Enhanced bargaining leverage (inter-temporal)
  - Softer competition

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Parties Affected by MFNs

Input
Maker A

MFN

Output
Maker X

Input
Maker B

Output
Maker Y

Consumers

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## Input Maker’s Decision **without** an MFN

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<th>Possible Price to Y</th>
<th>Quantity to X</th>
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<th>Total Quantity</th>
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## Input Maker’s Decision **with** an MFN

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Factors Affecting Likelihood of Exclusionary / RRC Harm

- Share of purchases by the MFN buyer(s)
- Rivals’ difficulty in substituting away from MFN seller(s)
  - Product Differentiation
  - Barriers to entry in the input market
- Premiums paid to obtain MFN
- Range of Prices in Compliance (MFN+)
- Retroactive
- Enforcement
- Possible Efficiency Justifications

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Factors Affecting Likelihood of Collusive Harm

- Share of purchases by the MFN buyer(s)
- Strength of commitment device [?]
- Importance of the committing seller(s) to the collusive scheme
- Terms & Use of MFN (scope, circumstances)
- Retroactive
- Enforcement
- Possible Efficiency Justifications

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Possible Efficiencies

- Lead to a New or Better Product
  - Facilitate Long Term Contracts that allow pro-competitive investments
  - Solve Free Rider Problems
- Reduce Transactions Costs?
- Lower Prices & Higher output?
- Send an early signal of high quality?

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Litigating MFNs

- Defense side:
  - No market power
  - Unconcentrated market
  - In exchange for investment or sunk costs
  - Fosters new entry {?}
    - argument did not carry the day in eBooks litigation

- Plaintiffs’ side:
  - Dominant firm
  - Joint horizontal adoption
  - Limit new entry
  - Reduce seller’s incentive to discount

- MFNs in settlement agreement
  - Typically used to prevent plaintiff hold-outs in multi-party settlements
  - In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation
Some Counseling Points

- What circumstances suggest heightened antitrust risk?
  - Dominant firms
  - Collective action and broad industry coverage
  - Barriers to entry

- Factors That Mitigate or Aggravate the Risk
  - Business Justification
    - General Theory v. Specific Circumstances
  - Over--reaching v. Tailored Use
    - Tied to justification
    - Limited to necessary parties
    - Specific provisions not unduly broad
      - Audits and Reporting
      - Penalties

- Application in Fact
  - Prices Increased to Rivals
  - Benefit of MFN