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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**HEARING ON ACROSS PLATFORM PARITY AGREEMENTS**

-- Note by United States --

**27-28 October 2015**

*This document reproduces a written contribution from United States submitted for Item 7 of the 124th OECD Competition Committee on 27-28 October 2015.*

*More documents related to this discussion can be found at [www.oecd.org/daf/competition/competition-crossplatform-parity.htm](http://www.oecd.org/daf/competition/competition-crossplatform-parity.htm)*

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**-- United States --**

1. The United States Department of Justice (“Department of Justice”) and Federal Trade Commission (“FTC”) (together “US Agencies”) recognize that across platform parity agreements (“APPA”), known as a most-favored-nation clause (“MFN”) in the United States, can enable efficiency-enhancing behavior, but can also produce anticompetitive effects.<sup>1</sup> Recognizing the varied effects of MFNs, we believe that each case or situation involving MFNs should be evaluated on its own merits.

2. An MFN is a promise by a seller to treat a buyer on terms no less advantageous than the terms on which it deals with other buyers. There are two key features of MFNs. They arise in dealings between upstream and downstream trading partners, and they set the terms of a transaction in part by reference to other transactions entered into by one of the parties.<sup>2</sup> Although MFNs often relate to price terms, they can govern non-price terms such as product access or product quality.

3. The competitive effects of MFNs vary. They can differ based on the scope of the market they cover, the precise terms of the MFN, the structure of the market, and/or the reasons for MFN implementation. In the United States, we assess the potential competitive effects of MFNs on a case-by-case basis. The first section of this paper addresses U.S. cases in which MFNs raised competitive issues. The second part provides an analytical overview of the potential competitive effects of MFNs.

### **1. U.S. MFN Cases**

4. United States courts have long recognized that MFNs have the potential to undermine competitive markets, and that some MFNs may violate the antitrust laws of the United States.<sup>3</sup> The Department of Justice’s experience with MFNs dates back decades. In 1962, General Electric and Westinghouse were investigated for price fixing and entered into consent orders relating to their turbine pricing practices.<sup>4</sup> In the aftermath of the investigation and consent order, each company separately adopted price protection plans with buyers providing that, if one of the companies were to lower the price for a particular customer that company retroactively would provide any other buyer of its product within the previous six-month period an identical discount.<sup>5</sup> In approving the consent order enjoining this practice, the court noted that the potential impact of such an agreement was to limit price competition, as “each manufacturer was assured that the other would not engage in discounting because of the substantial self-imposed penalty involved.”<sup>6</sup>

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<sup>1</sup> The US Agencies recently held a workshop on MFN antitrust enforcement and policy, see Joint DOJ/FTC “Public Workshop: Most-Favored-Nation Clauses and Antitrust Enforcement and Policy” (Sept. 10, 2012, Washington DC). Materials from the workshop are available at <http://www.justice.gov/atr/events/public-workshop-most-favored-nation-clauses-and-antitrust-enforcement-and-policy>.

<sup>2</sup> Some academic literature limits the definition of APPAs to MFNs in markets that operate on an agency model where the supplier rather than the retailer sets the final consumer price for the product. See, e.g., Lear, Can Fair Prices be Unfair? A Review of Price Relationship Agreements, OFT1438, at 94, available at [http://www.learlab.com/pdf/oft1438\\_1347291420.pdf](http://www.learlab.com/pdf/oft1438_1347291420.pdf). These “agency MFNs” would still fit within the definition of MFN used above.

<sup>3</sup> See, e.g., *United Mine Workers v. Pennington*, 381 U.S. 657, 666 (1965) (A “[seller] would seem best served if [it] retained the ability to respond to each bargaining situation as the individual circumstances might warrant, without being strait-jacketed by some prior agreement with the favored [buyer].”).

<sup>4</sup> *United States v. General Elec. Co.*, 1977-2 Trade Cases ¶ 61,659 at 72,716 (E.D. Pa).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

5. The Department of Justice has also initiated antitrust enforcement actions in health care provider and insurance markets against MFNs.<sup>7</sup> As the Department recently noted, MFNs in these markets “potentially distort the competitive process by raising the costs of health insurance and hospital services, preventing other insurers from entering the market and discouraging discounts.”<sup>8</sup> For instance, in *United States v. Delta Dental Plan of Rhode Island*, Delta Dental was the state of Rhode Island’s largest dental insurer, providing insurance to about 35-45 percent of Rhode Island residents covered by dental insurance.<sup>9</sup> Delta Dental had contracts with 90 percent of the dentists in the state. Pursuant to Delta’s agreements with these dentists, each agreed to an MFN clause conferring upon Delta Dental the right to lower its reimbursements to the lowest fee the dentist accepted from any other plan. The effect of the MFN was that “[b]ecause few dentists in Rhode Island are not under contract with Delta, and because Delta’s MFN clause g[ave] its participating dentists strong disincentives to contract with dental managed care plans at fees below Delta’s, other plans [were] unable to form a competitively viable [offering].”<sup>10</sup>

6. The Department of Justice’s 2010 challenge to the use of MFNs by Blue Cross Blue Shield of Michigan (“BCBSM”)<sup>11</sup> highlights the Department’s continuing concern with the potential anticompetitive effects of MFNs. In that case, the Department of Justice challenged Blue Cross Blue Shield of Michigan’s (“BCBSM”) use and enforcement of MFNs in its contracts with seventy Michigan hospitals. The contracts required those hospitals to charge other commercial insurers no less and sometimes significantly more than the hospitals charged Blue Cross. Typically, the difference in price was set by a specified percentage differential, which could be as much as 40 percent.<sup>12</sup> To comply with these MFNs, hospitals raised prices to BCBSM’s competitors by a substantial amount – effectively guaranteeing that BCBSM’s competitors could not obtain hospital services for their subscribers as cheaply as BCBSM.<sup>13</sup> For some of BCBSM’s competitors, the reimbursements were so high that they were unable to compete – effectively excluding them from the market.<sup>14</sup>

<sup>7</sup> See, e.g., *United States v. Medical Mutual*, 7 Trade Reg. Rep. (CCH) ¶ 50,846 (N.D. Ohio 1998); *United States v. Delta Dental Plan*, 1997-2 Trade Cases (CCH) ¶ 71,860 (D.R.I. 1997); *United States v. Vision Service Plan*, 1996-1 Trade Cases (CCH) ¶ 71,404 (D.D.C. 1996); *United States v. Delta Dental Plan of Arizona, Inc.*, 1995-1 Trade Cases (CCH) ¶ 71, 048 (D. Ariz. 1995). The Department of Justice’s enforcement experience with MFNs is by no means limited to healthcare cases. MFNs have featured prominently in enforcement actions in several industries: *United States v. Primestar Partners, L.P.*, 1994-1 Trade Cas. (CCH) ¶ 70,562 (S.D.N.Y. 1994) (consent decree enjoining the enforcement of MFNs in contracts between stakeholder television programming providers and Primestar); *United States v. Lykes Bros. S.S. Co.*, 60 Fed. Reg. 52,208 (Oct. 5, 1995) (consent decree barring enforcement of a “automatic rate differential clause” providing the steamship company’s rate for wine and spirit shipper’s association would always be 5 percent lower than the rate charged anyone else).

<sup>8</sup> Senate Judiciary Subcommittee on Antitrust, “Competition Policy and Consumer Rights,” (Apr. 16, 2013) (Statement of Assistant Attorney General Bill Baer), available at <http://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-testifies-senate-judiciary-subcommittee-antitrust>.

<sup>9</sup> DOJ Competitive Impact Statement, *US v. Delta Dental Plan of Rhode Island*, 1997-2 Trade Cases ¶ 71,860.

<sup>10</sup> *Id.* at 80,048.

<sup>11</sup> *Complaint, United States v. Blue Cross Blue Shield of Mich.*, Case 2:10-cv-15155-DPH-MKM (*E.D. Mich.* 2010), available at <http://www.justice.gov/atr/case-document/complaint-43>.

<sup>12</sup> *Id.* at 3.

<sup>13</sup> *Id.* at 6.

<sup>14</sup> The Department of Justice voluntarily dismissed its case against BCBSM after the state of Michigan passed a law that prohibited health insurers from using MFNs in contracts with health care providers. Stipulated

7. In *RxCare of Tennessee*,<sup>15</sup> the FTC's consent order prohibited a Tennessee-based pharmacy service administrative organization<sup>16</sup> from enforcing MFN clauses in its contracts with pharmacies. At the time, RxCare was the largest pharmacy benefits network in Tennessee. RxCare agreements contained an MFN clause that required its pharmacies that accepted a lower reimbursement rate from another party to provide RxCare with the lower rate as well. The FTC complaint charged RxCare and its trade association parent with an agreement to restrain competition among Tennessee pharmacies by (1) requiring MFN clauses as a condition to joining the network; (2) enforcing the MFN clause against pharmacies that got a lower rate; (3) communicating payor offers that were below the MFN rate with the warning that acceptance of the rate would trigger the MFN; and (4) urging pharmacies not to participate in competing networks with lower reimbursement rates.<sup>17</sup>

## 2. Competitive analysis of MFNs

8. As a practical matter, MFNs make selective discounting more expensive for sellers. When a seller extends a low price to any person in the market (regardless of volume), that price must be extended to the entire segment of the market with MFN price protection, thus penalizing a seller for discounting. The size of the seller's penalty is dependent on three factors: (i) the volume of sales protected by the MFN, (ii) the difference between the prevailing price and the potential discount, and (iii) the probability the MFN clause will be enforced.<sup>18</sup> If the MFN covers a large portion of the market, it generally will be costly for the seller to discount. If, however, the MFN covers a smaller portion of the market, the MFN is less likely to deter discounting. Thus, under ordinary circumstances, when MFNs cover insignificant portions of the market in aggregate, they are apt to be benign or pro-competitive. In such cases, it may make sense for buyers to seek this type of protection against future events, and for sellers to grant this guarantee in good faith to close a deal.

9. Yet, as our enforcement actions and the economic literature make clear, MFNs can serve anticompetitive purposes. First, MFNs can exclude competitors of the buyer or new entrants.<sup>19</sup> For instance, in certain markets, downstream competitors and market entrants that purchase a given product from a given seller could compete by offering low cost alternatives to the incumbent buyers of that product. A prospective entrant, for example, could agree to adopt lower fees in return for the ability to sell the seller's product at a lower price. However, with an MFN in place, the incumbent buyer is contractually entitled to the lowest price on final goods. Thus, the prospective entrant cannot create a price advantage vis-à-vis the incumbent and entry may be blocked.

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Motion and Brief to Dismiss Without Prejudice, *United States v. Blue Cross Blue Shield of Michigan*, 2:10-cv-14155-DPH-MKM (E.D. Mich. Mar. 25, 2013).

<sup>15</sup> [121 F.T.C. 762](#) (1996).

<sup>16</sup> A pharmacy service administrative organization is a group of pharmacies that offer themselves as a pharmacy network to pharmacy benefits managers and third party payers.

<sup>17</sup> *Id.*

<sup>18</sup> See *Lear*, *supra*, n. 2, at 41.

<sup>19</sup> See Scott-Morton, Fiona (2012) "Contracts that Reference Rivals," Speech at Georgetown University Law Center, at 13; see also Baker, J.B. (1996) "Vertical Restraints with Horizontal Consequences: Competitive Effects of Most-Favored-Customer Clauses," 64 *Antitrust Law Journal* 517, at 523-28.

10. Second, MFNs can facilitate price coordination.<sup>20</sup> MFNs can reduce the incentive to cheat on a price-fixing scheme by increasing the costs of doing so. Under an MFN the low price offered on a particular contract becomes not just a one-time opportunity for the firm offering the discount to gain some incremental sales volume, but rather an occasion for across-the-board revenue losses as many of the firm's contract prices are reset.

11. Despite the potentially anticompetitive effects of some MFNs, the US Agencies recognize that, in some situations, MFNs might serve pro-competitive purposes. For instance, MFNs can be used to prevent discounting opportunism in situations where one of the parties makes relationship-specific investments in order to create a new product or to improve upon existing products or services. For example, a manufacturer might want its online retailers to invest in the functionality of their websites that would make the manufacturer's product more appealing to customers. However, if customers can avail themselves of that functionality and then switch to a cheaper platform to complete the sale, the online retailers would rightly fear that the value of their investment would be difficult to recapture. An MFN might be one tool the manufacturer could use to assure the retailers in this scenario that their investment will not be undermined by other platforms. In such circumstances, an MFN could provide a pro-competitive benefit. Stimulating increased investment in improving a product/service or making a distribution channel more efficient could be worth the protection against some price competition within the same product.

12. In sum, the competitive effects of MFNs can vary, and the US agencies believe they must be assessed on a case-by-case basis.

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<sup>20</sup> See United States (2007) "OECD Roundtable on Facilitating Practices in Oligopolies," DAF/COMP/WD(2007)112, at 6-7; see also Baker, "Vertical Restraints with Horizontal Consequences," at 520-523.