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MOST-FAVORED-NATION CLAUSES

Practical Considerations in the Wake of the *Apple* Decision: How to Handle MFNs Going Forward

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In a highly anticipated decision, Judge Denise L. Cote of the Southern District of New York found that five major book publishers ''conspired with each other to eliminate retail price competition and raise e-book prices, and that Apple played a central role in facilitating and executing that conspiracy.'' *United States v. Apple Inc.*, No. 12 Civ. 2826, 2013 WL 3454986 (S.D.N.Y. July 10, 2013).

According to the opinion, Apple orchestrated the conspiracy by convincing the publishers to move from competitor Amazon's wholesale model—which permitted *retailers* to set retail prices, often at wholesale cost—to an agency model, which permitted the *publishers* to set the retail prices, often at a margin. Critically, Apple's agency agreements negotiated with the publishers contained a Most-Favored-Nation (''MFN'') clause, requiring the publishers to offer Apple the lowest retail price being offered by rival retailers, such as Amazon. So long as Amazon continued to sell at discounted retail prices, the publishers would have to offer these same prices to Apple, reducing the publishers' profit margin. As a result, Judge Cote held the MFN clause was a ''severe financial penalty,'' which ''effectively forced the [publishers] to eliminate retail pricing competition and place all of their e-tailers on the agency model.'' Judge Cote concluded that the orchestrated switch to the agency model raised retail prices of e-books, thereby effectuating a *per se* unlawful conspiracy to fix prices in violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Although the judge found that the MFN clause in this instance was critical to Apple's ability to orchestrate the unlawful conspiracy, Judge Cote explicitly held that MFN clauses are not, in and of themselves, ''inherently illegal.'' Judge Cote explained that ''entirely lawful contracts may contain an MFN .... The issue is not whether an entity . . . used an MFN, but whether it conspired to raise prices.'' This determination, she stated, must be based on consideration of the ''totality of the evidence,'' rather than on the language of the agency agreement or MFN alone. Examining the facts in this particular case, Judge Cote found that Apple's use of the MFN clause to facilitate the e-book conspiracy with

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the publishers constituted a *per se* violation of the antitrust laws.

While Judge Cote did ''not seek to paint with a broader brush,'' the ruling injects new risk into contractual relationships that involve an MFN. The court appears to have adopted the Justice Department's straightforward position that even an MFN that is itself ''competitively benign'' can violate the antitrust laws when it is ''used as a tool to engage in anticompetitive conduct that harms consumers.'' The combination of this standard and the court's application of the *per se* rule, however, may prove challenging for courts and companies alike because the *per se* rule is intended to dispense with any analysis of the actual harm to consumers or market effects. Companies using MFNs may thus find themselves in a Catch-22 between a standard based on the purported ''totality of the evidence'' and the *per se* rule's prohibition on the introduction of evidence demonstrating procompetitive justifications for a particular contract provision. Although the *per se* rule is intended to condemn clearly anticompetitive agreements known to almost always raise prices or decrease output, MFNs can serve many lawful, procompetitive purposes.

The *Apple* decision is the latest in a line of cases that signal increased and more nuanced scrutiny of MFN clauses. Because MFN clauses are vertical restraints of trade, they typically are not analyzed under the *per se* rule. Instead, antitrust agencies have traditionally analyzed MFN clauses under the rule of reason, which weighs procompetitive and anticompetitive market effects. Historically, MFN clauses were indiscriminately accepted because, in form, they were perceived to be procompetitive agreements that lowered prices. More recently, courts and agencies have moved away from rote form analyses towards a highly fact-intensive, effects-based analysis considering the particular markets and parties involved.

MFN clauses have been considered procompetitive where they: (1) lower prices; (2) reduce negotiation costs, particularly in markets where prices fluctuate and in which long-term contracts are desirable; and (3) encourage initial buyers to assume innovation costs by guaranteeing the benefit of price declines over time. *See, e.g.*, *Blue Cross & Blue Shield Unified of Wis. v. Marshfield Clinic*, 65 F.3d 1406 (7th Cir. 1995) (reduced costs); *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of R.I.*, 883 F.2d 1101 (1st Cir. 1989) (reduced costs and was not exclusionary).

On the contrary, MFNs have been considered to be more likely to harm competition where they: (1) facilitate collusion (for example, by increasing the likelihood of detection, and the cost, of cheating on a collusive agreement); (2) increase prices or reduce price competition (sellers are less likely to lower prices to one customer if they have to lower prices to all); (3) exclude rivals and/or potential entrants (if sellers are less likely to lower prices, small rivals cannot obtain the favorable pricing they need to remain in/enter the market); or (4) eliminate the possibility of future discounts (which may enhance a monopolist seller's bargaining power and ability to extract monopoly profits or other negotiating concessions). *See, e.g.*, *United States v. Blue Cross Blue Shield of Mich.*, 809 F. Supp. 2d 665 (E.D. Mich. 2011) (exclusionary); *Starr v. Sony BMG Music Entm't*, 592 F.3d 314 (2d Cir. 2010) (facilitating collusion); *United States v. Delta Dental of R.I.*, 943 F. Supp. 172 (D.R.I. 1996) (exclusionary).

In light of increased antitrust scrutiny of MFN clauses, companies are encouraged to consider and balance the likelihood of procompetitive and anticompetitive effects of their MFN clauses, within the contours of their particular market and in consideration of the particular parties involved. Companies with a large share in any market, companies doing business in highly concentrated markets, and companies that have numerous MFNs with multiple competitors should be especially careful to evaluate antitrust risks posed by their MFN provisions.

Such companies may further wish to consider limiting antitrust exposure by renegotiating high risk provisions. The government's success in the *Apple* trial is likely to lead to even greater MFN scrutiny as private plaintiffs and agencies alike are emboldened to challenge provisions that were previously considered, in effect, to be beyond the reach of the antitrust laws. Companies would therefore be well counseled to take a fresh look at their MFNs.

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