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BLOG

Antitrust 101: "Most Favored Nation" Clauses

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"Most Favored Nation" (MFN) provisions have increasingly drawn the attention of both government enforcement agencies and the business community. Notably, recent litigation involving the use of MFN provisions by Valve Corporation in connection with its popular PC-gaming platform, Steam,[1] has spotlighted this increased government scrutiny. Additionally, a number of lawsuits targeting the use of MFN provisions by technology giants like Amazon and Apple indicate that the government is taking a closer look at the use of these provisions. While most businesses have nothing to fear from contracts containing MFN provisions, companies should be aware that there are certain circumstances that may give rise to antitrust scrutiny.

BACKGROUND

An MFN provision is a term included in a contract for products or services that prevents the seller from selling its products or services to the buyer's competitors for a lower price, or on better terms, than the seller sells the products or services to the buyer. Agreements containing MFN provisions may benefit sellers by reducing uncertainty about price fluctuations, thereby reducing bargaining transaction costs. Additionally, MFN provisions can mitigate risks associated with the seller acting opportunistically. By including an MFN provision, a buyer can invest resources in a product or service without risking the possibility that a seller will subsequently damage the value of that investment by selling to one or more of the buyer's competitors on more favorable terms.

All agreements restrain trade in some manner. But courts generally use one of two methods to determine whether an agreement unreasonably restrains trade in violation of U.S. antitrust laws. *First*, certain categories of agreements are presumed to violate antitrust laws per se, such as price fixing or group boycotts. If a court determines that an agreement is a per se antitrust violation, no further inquiry is needed, and the agreement is deemed illegal.

Second, courts use the "rule of reason" in determining whether an agreement unreasonably restrains trade. To do this, courts first consider the alleged anticompetitive effects of an agreement and weigh them against proffered procompetitive benefits, as well as the possibility of less restrictive alternatives.

Importantly, to date, no U.S. court has found that an MFN provision violates antitrust law. But courts have approved consent decrees by enforcement agencies that enjoined the use of MFNs. Additionally, although the District of Colombia Superior Court recently dismissed certain MFN-related claims against Amazon, similar claims have recently been permitted to advance in the Western District of Washington. *See Frame-Wilson et al. v. Amazon.com, Inc.*, Case

No. 2:20-cv-00424-RAJ, ECF No. 48 (W.D. Wash. Mar. 11, 2022) (finding that "Amazon's argument that its pricing provision has procompetitive justifications may be used" for burden-shifting purposes under full rule-of-reason analysis). While still relatively rare, the use of MFN provisions can potentially raise questions about price collusion or the unfair exclusion of competitors. So in order to avoid potential antitrust scrutiny, businesses that use, or wish to use, an MFN provision should understand the following principles.

FIRST: AN MFN PROVISION SHOULD NEVER RESULT IN A PRICE-FIXING ARRANGEMENT AMONG COMPETITORS

Avoiding the use of—or the appearance of using—an MFN provision to facilitate a per se illegal agreement is the most important thing that a business can do to avoid agency scrutiny and potentially costly antitrust litigation. When government enforcement agencies scrutinize arrangements that include MFN provisions, the most common allegation raised is that MFNs are a tool to facilitate price-fixing. Allegations of explicit collusion have also been central to the only major cases involving MFN provisions brought by civil plaintiffs over the past decade. In such cases, competitors are alleged to collude to set a floor price and use an MFN provision as an enforcement mechanism to illegally fix prices.

In many cases, businesses with MFN provisions in their agreements take no action to actively enforce the agreements, which results in limited potential for antitrust scrutiny. But the potential for scrutiny increases when a business more actively enforces its MFNs. Businesses that opt for actively enforcing MFN provisions generally do so through attestation by an MFN seller, where the seller periodically attests to the buyer that the seller has not violated any terms of their agreement. Alternatively, a business can seek to enforce an MFN provision through the review of a competitor's records. In the latter case, a buyer may require that the seller obtain certain (redacted) records from the buyer's competitors to prove that it is complying with their agreement. But this type of enforcement is riskiest from an antitrust perspective because it may provide the buyer information about its competitors, and could be used to accuse the buyer of entering into illegal horizontal pricing agreements with competitors.

SECOND: BUSINESSES WITH LARGER SHARES OF A RELEVANT MARKET FACE GREATER ANTITRUST RISKS IN USING MFN PROVISIONS

Depending on the size of the relevant markets in which it operates, there are other nuances to the types of MFN provisions that a business should consider. A "neutral" MFN provision that merely ensures that the buyer is treated *no worse* than its competitors in terms of price, or other material terms, is the most common. An "MFN-Plus" provision, on the other hand, guarantees that a buyer is treated *better* than its competitors. For example, the buyer in an MFN-Plus arrangement may require that all of its purchases be priced 10% lower than the next-lowest price offered to a competitor.

And, because U.S. antitrust laws seek to protect market competition, where the business enforcing MFN provisions has a high market share, there is a greater risk that the restraining conduct could have an adverse effect on the relevant market. Given an alleged market share of 50–70%, the enforcement of these provisions may be heavy-handed enough for a court to find that they unreasonably restrict trade. For example, significant market share is partly why Amazon has become the target of several recent lawsuits involving MFN provisions.

THIRD: THE EFFECT OF AN MFN PROVISION SHOULD BE NEUTRAL OR LOWER PRICES FOR THE END CONSUMER, BUT NEVER RAISE THEM

When weighing the pro-competitive effects of an MFN provision against its potential anticompetitive effects under a rule-of-reason analysis, courts have repeatedly noted that MFN provisions generally have a net result of decreasing or stabilizing prices for the end consumer. An MFN provision decreases many of the ancillary costs associated with selling a product, including by, among other things: (i) lowering the transaction costs of bargaining, (ii) reducing the uncertainty inherent in pricing certain products, and (iii) decreasing the risk of sellers acting opportunistically. Additionally, MFN provisions create a rare situation where both the buyer and seller may want a relatively low price for a product. Obviously, the buyer wants to pay as little as possible so that it can increase its profit margin in the end market. Likewise, the seller also wants to keep prices low because it wants to be able to offer its product to as many businesses as possible.

But a nefarious buyer can turn this paradigm on its head. Suppose that a buyer controls a significant share of a relevant market, and includes an MFN provision in its agreement with its suppliers, as well as some other favorable contractual agreements, such as an agreement to purchase significant quantities. The buyer then intentionally allows the price negotiations to trend upwards. The final negotiated price is high enough that new entrants cannot afford the rate, and the seller then cannot decrease the rate without decreasing it for the central market player. Thus, a prospective new entrant is priced out of the market where the seller might otherwise have lowered its pricing to gain a new customer. This type of exclusionary pricing model is one of the major practical concerns with MFN provisions and is the one most likely to invite antitrust scrutiny.

FOURTH: HEALTHCARE BUSINESSES SHOULD BE ESPECIALLY WARY WHEN USING MFN PROVISIONS

The healthcare industry is no stranger to heavy scrutiny and intense regulation, and antitrust regulation is no different. Prior to 2013, approximately ten consent decrees were entered that enjoined MFN provisions, and all but one involved a company in the healthcare industry. Antitrust harms from MFN provisions in healthcare industry agreements can materialize in a couple of ways: (i) a health plan with a dominant market share might raise rivals' costs or abuse monopsony power, which occurs when a buyer is dominant enough to set terms; and (ii) healthcare providers might implement an MFN provision with their members to facilitate group pricing. As of 2020, at least 20 states explicitly restrict the use of MFN provisions from healthcare industry agreements, and many of those states enacted those restrictions following government antitrust litigation against various carriers. Any healthcare company should thus closely adhere to the above principles and should confer with counsel when drafting and implementing MFN provisions.

TAKEAWAYS

MFN provisions are generally acceptable, especially where the parties take less active roles in enforcing the provisions. But to avoid unwanted antitrust scrutiny, businesses should examine their existing and contemplated MFN arrangements to see if they adhere to the above principles.

And since antitrust scrutiny of MFN provisions is on the rise, businesses should ask the following questions when assessing or implementing MFN provisions:

1. How many competitors and buyers/sellers are there? Or, put another way, how concentrated is the relevant market?
2. What share of the market does your business have?
3. How many market participants are bound to the terms of the MFN provision, and how uniform are the terms?
4. Do the MFN provisions affect pricing?
5. What enforcement mechanisms are used or allowed by the MFN provisions, and do those mechanisms allow information sharing or otherwise limit the discretion of competitors?

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[1] *Wolfire Games, LLC, et al., v. Valve Corp.*, Case No. C21-0563-JCC, ECF No. 80 (W. D. Wash. May 6, 2022).

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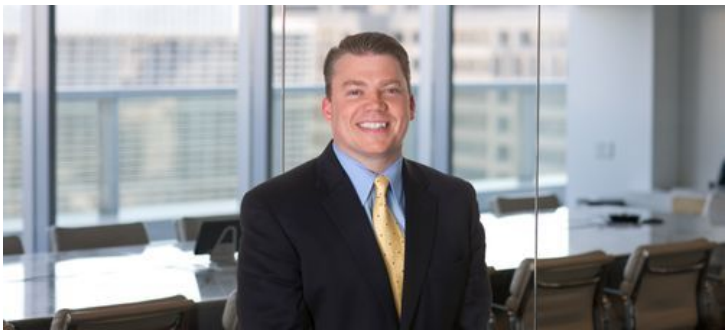

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