August 22, 2013

LEGAL ALERT

Most Favored Nation Clauses: Do they Limit Free Competition or are they Pro Competitive?

Recently, the U.S. Department of Justice ("DOJ") began reviewing a number of contracts which it calls "contracts that reference rivals". One type of such contracts is those containing Most Favored Nation Clauses ("MFN Clauses").

A MFN Clause contains an assurance from one party to another that they are receiving (or will receive) commercial terms that are the same or better than those contained in agreements with competitors.

DOJ´s growing concern has not been without criticism, since there are credible arguments to defend the validity of such clauses.

However, there are also arguments against MFN Clauses. For example, in certain circumstances they represent restrictions or limitations to free competition. This is because they can (when used by a dominant player) increase prices for buyers or exclude potential competitors from entering the market. Moreover, MFN Clauses may facilitate collusion and help stabilize prices in a coordinated manner.

As for collusion, it is argued that MFN Clauses can facilitate coordination among competitors, and thus reducing the incentive for a seller to offer a discounted price to a buyer and for other buyers' incentive to aggressively negotiate with the seller to obtain a lower price.

As for the exclusion of competitors, it is argued that MFN Clauses can increase the costs of entry for new competitors to a level that would prevent the ability to obtain the necessary conditions to enter the market and compete on it, as the dominant player would always offer at least the same or better conditions than those proposed by the entrant.

However, the potential anti-competitive effect of MFN Clauses is debatable, since it is argued that these provisions can also have pro-competition effects, such as minimizing the buyer's risk in a long-term agreement of being adversely affected by downward price fluctuations with respect to which, in the absence of

these clauses, it would not have had access to it. In this context, MFN Clauses would grant some flexibility to the contract which would directly benefit the buyer.

Recently, the DOJ and the State of Michigan filed a claim against Blue Cross Blue Shield for the use of MFN Clauses in health insurance contracts:

“Blue Cross’ use of MFNs has reduced competition in the sale of health insurance in markets throughout Michigan by inhibiting hospitals from negotiating competitive contracts with Blue Cross’ competitors. The MFNs have harmed competition by (1) reducing the ability of other health insurers to compete with Blue Cross, or actually excluding Blue Cross’ competitors in certain markets, and (2) raising prices paid by Blue Cross’ competitors and by self-insured employers. By reducing competition in this manner, the MFNs are likely raising prices for health insurance in Michigan.”

However, the trial ended with a settlement between the parties due to an amendment in the law that banned the use of such MFN Clauses in health insurance contracts as of January 1, 2014.

This issue is still evolving, and the Chilean competition authorities could adopt similar criteria to those of the DOJ in this matter.

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