Contracts That Reference Rivals As an Antitrust Category

Jonathan M. Jacobson and Daniel P. Weick

Some vertical arrangements affect more than the terms of dealing between the contracting parties themselves; they also affect, directly or indirectly, the terms available to a contracting party's competitors. So, for example, an agreement between a supplier and a customer that the customer will purchase from that supplier exclusively necessarily means that, for the duration of the agreement, rivals of the supplier will be unable to contract with the customer in question.

Policymakers at the Department of Justice's Antitrust Division have recently focused on a wide variety of these "contracts that reference rivals" (CRRs) as a source of potential antitrust concern, at least when deployed by firms with market power.[1] The policymakers recognize that various efficiency justifications exist for the many different types of contracts in issue. Because, however, all types of CRRs affect, in some respect, the contract terms that may be available to the contracting party's rivals, these agreements may each, in theory, both diminish the ability of rivals to compete and provide a vehicle for firms to learn their rivals' terms of sale. In some instances, these effects may create or enhance market power or otherwise lead to consumer harm. This is the concern that appears to have informed recent DOJ enforcement actions against "most-favored nations" (MFN) clauses (which require one party to guarantee the other that it is receiving contractual terms as good or better than any arrangement made by its rivals[2] and "non-discrimination" rules or clauses (NDR) (which require a party to guarantee that it will not disfavor the contracting party's products relative to those of its competitors).[3] There seems to be an insufficient appreciation, however, of the important differences between the various varieties of CRRs, and the fact that these differences may contribute to both the competitive effects and the justifications for the provisions' use. These differences should therefore be taken into account in deciding whether or not CRRs violate the antitrust laws.

CRRs can be deployed as a mechanism for raising rivals' costs. However, as with all practices that raise rivals' costs, it is often difficult to distinguish between efficient contracting activities and truly exclusionary practices. Few things raise rivals' costs more than intense competition, but that does not mean that anything wrong is afoot. Practices that raise rivals' costs are anticompetitive

■ ***Jonathan M. Jacobson*** *is a partner, and* ***Daniel P. Weick*** *is an associate, in the New York office of Wilson Sonsini Goodrich & Rosati. The authors note their participation in a number of matters raising issues addressed in this article. In particular, the authors represent American Express in certain matters, although they are not counsel in the government enforcement case or the related private case discussed* infra *notes 25–28, 49, and accompanying text. The views expressed in this article are those of the authors alone. They may not and should not be attributed to any of the authors' clients, including American Express.*

[1] Deputy Assistant Attorney General Fiona Scott Morton coined the "CRR" phrase to cover certain types of vertical contracts that require and convey horizontal information, indirectly, from one rival to another. *See* Fiona Scott Morton, Deputy Asst. Att'y Gen. for Econ. Analysis, U.S. Dep't of Justice, Contracts that Reference Rivals, Remarks at the Georgetown University Law Center Antitrust Seminar 2 (Apr. 5, 2012), http://www.justice.gov/atr/public/speeches/281965.pdf [hereinafter *Remarks*]; *see also Interview with Fiona Scott Morton, DAAG for Economic Analysis at the DOJ*, ANTITRUST, Spring 2012, at 14, 17–18 [hereinafter *Interview*] (discussing CRRs).

[2] *See, e.g.*, Complaint, United States v. Blue Cross Blue Shield of Mich., 809 F. Supp. 2d 665 (E.D. Mich. 2011) (No. 2:10-cv-15155-DPH-MKM) (challenging Blue Cross Blue Shield of Michigan's use of MFNs), *available at* http://www.justice.gov/atr/cases/f263200/263235.pdf.

[3] *See, e.g.*, Complaint, United States v. Am. Express Co., No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011) (challenging non-discrimination provisions), *available at* http://www.justice.gov/atr/cases/f262800/262864.pdf.

only when they do not reflect competition on the merits and artificially create or enhance power over price or output.[4]

Correspondingly, many types of contracts reference rivals, at least implicitly, and the analysis of each type of contract will depend highly on factual context—even when deployed by dominant firms. This becomes clear when the varieties of CRRs are disaggregated and the differences in their justifications and potential pitfalls are considered. There is no question that the CRR categorization can provide valuable insights into some of the potential effects of contractual provisions. But a close look into the specific type of provision and the actual factual context in which it is used is still required even after identifying an agreement as a CRR.

Some Varieties of CRRs

Many contracts contain at least an implicit reference to rivals. As noted above, exclusive dealing provisions imply that the party agreeing to exclusivity will not deal with the other party's competitors for the agreement's duration. Loyalty discounts provide that buyers will purchase, at a minimum, a stated percentage of their requirements in return for the discount, which means that they cannot purchase that portion from anyone else. Even a simple purchase of, say, an automobile in most cases implies that the buyer will not purchase a car from a rival dealer for at least a year or two.

Impairment of rivals is a necessary condition for anticompetitive effects to arise, but it is not a sufficient condition.

Unsurprisingly, these contracts are ordinarily lawful. To the extent competitive concerns exist, they arise when a firm with market power uses contractual terms that may impair materially the ability of rivals to enter and expand. Impairment of rivals is a necessary condition for anticompetitive effects to arise, but it is not a sufficient condition. The traditional rule of reason still governs to determine whether the net effect of the arrangement is materially harmful to consumers, because entry or expansion by rivals can be deterred by either exclusionary conduct or aggressive but legitimate competition. Although the former harms consumers, the latter does not.

The most commonly disputed types of CRR provisions, including exclusive dealing, loyalty discounts, and bundling, have been discussed many times elsewhere.[5] With the notable exception of the outlier *LePage's* case on bundling,[6] the general approach to these types of vertical agreements, as used by dominant firms, tracks the D.C. Circuit's opinion in *United States v. Microsoft Corp.*[7] Courts recognize that "imposing upon a firm with market power the risk of an antitrust suit every time it enters into [an exclusive] contract, no matter how small the effect, would create an unacceptable and unjustified burden upon any such firm."[8] They therefore apply the rule of reason to determine whether the restraints have a plausible procompetitive justification and, if so,

---

4 *See, e.g.*, Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 Yale L.J. 209, 211–22 (1986) (noting difficulty of defining standards for exclusionary conduct).

5 Commentary and case law on these types of agreements are discussed, for example, in Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 Antitrust L.J. 311 (2002) [hereinafter *Exclusive Dealing*]; Jonathan M. Jacobson, *Exploring the Antitrust Modernization Commission's Proposed Test for Bundled Pricing*, Antitrust, Summer 2007, at 23 [hereinafter *Bundled Pricing*]; Jonathan M. Jacobson, *A Note on Loyalty Discounts*, Antitrust Source, June 2010, http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Jun10_Jacobson6_24f.authcheckdam.pdf [hereinafter *Loyalty Discounts*].

6 LePage's Inc. v. 3M, 324 F.3d 141, 154–57 (3d Cir. 2003) (en banc) (condemning above-cost bundled discounts). *Contra, e.g.*, Cascade Health Solutions v. PeaceHealth, 515 F.3d 883, 900–03 (9th Cir. 2008) (rejecting *LePage's* and requiring proof of below-cost pricing to condemn bundled discounts); Antitrust Modernization Commission, Report & Recommendations 94–100 (2007) (criticizing *LePage's*), *available at* http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

7 253 F.3d 34 (D.C. Cir. 2001) (per curiam).

8 *Id.* at 70; *accord, e.g.*, Bayou Bottling, Inc. v. Dr Pepper Co., 725 F.2d 300, 304 (5th Cir. 1984).

whether their procompetitive benefits outweigh their anticompetitive effects.[9] Importantly, the burden of proof stays with the plaintiff. The burden of presenting justifications will shift to the defendant only if the plaintiff demonstrates anticompetitive effects. But even with that shifting, the burden of proof remains with the plaintiff to show the net effects of the restraint.[10]

This article focuses on three less commonly challenged arrangements: MFNs, NDRs, and retail preference agreements. MFNs are used by buyers to ensure that they receive equally favorable prices from sellers on their purchases and by sellers to make sure that their buyers are not paying others more. Their use is prominent in the health care sector, where health care insurers have frequently required a health care provider to guarantee that they receive the lowest rates the provider offers.[11] NDRs typically require a buyer to refrain from steering its customers to a competing alternative. One prominent example of such an NDR clause has been in agreements between credit card companies and merchants, where the credit card companies require merchants who accept the card to refrain from disparaging their cards, from steering consumers to other payment methods, or from charging a fee for the use of their cards.[12] Lastly, retail preference agreements are used to secure access to the best shelf placement, promotional periods, or types of promotional treatment. Many of the cases involving these agreements arise from arrangements between food or beverage suppliers and food retailers to ensure that the supplier's products are promoted and displayed more prominently than those of its rivals.[13]

The common question addressed here is whether agreements of this sort should be treated differently from other (non-CRR) types of vertical agreements. As discussed below, there is no one-size-fits-all answer. There are significant differences in the respective effects and efficiencies of these agreements. Care must be taken to ensure that these differences are considered individually and that these agreements are not lumped into a single CRR category for antitrust analysis. Otherwise, courts and agencies might find themselves condemning practices without real proof of anticompetitive harm.

Judicial Approaches

MFNs. MFNs have been the subject of a number of antitrust challenges, and a fairly substantial body of case law has developed around them. While most government suits have ended in con-

---

9 *See* 253 F.3d at 70–71 (condemning Microsoft's exclusive contracts in light of Microsoft's market power and its lack of procompetitive justifications).

10 *See* Jacobson, *Exclusive Dealing*, *supra* note 5, at 367.

11 *See, e.g.*, Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1415 (7th Cir. 1995) (Posner, C.J.) (approving HMO's MFN agreements).

12 *See, e.g.*, Amended Complaint ¶¶ 28–29, United States v. Am. Express Co., No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), ECF No. 57 (describing American Express's nondiscrimination provisions), *available at* http://www.justice.gov/atr/cases/f265400/265401.pdf.

13 *See, e.g.*, El Aguila Food Prods. Inc. v. Gruma Corp., 301 F. Supp. 2d 612, 628–32 (S.D. Tex. 2003), *aff'd*, 131 Fed. App'x 450 (5th Cir. 2005) (upholding the legality of Gruma's "customer marketing agreements" for tortillas); Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co., 94 F. Supp. 2d 804, 813–16 (E.D. Ky. 1999) (finding no antitrust violation in Pepsi's "calendar marketing agreements"); Coca-Cola Co. v. Harmar Bottling Co., 218 S.W.3d 671, 688–91 (Tex. 2006) (same for Coke). Retail preference agreements are not "exclusive dealing" agreements because the retailer is always permitted to sell competing wares and, in most cases, to promote them in all but the featured package. These agreements are correctly viewed as a type of CRR, however, because a key term in each is that rivals will not be promoted (at least in the promoted package) during the designated period of the preferentially treated supplier's promotion. Although different from MFNs and NDRs, retail preference agreements share the characteristic that a rival will be likely to learn about (from the retailer), and ultimately condition its own deal on, a competitor's terms. As an example, if Coke has contracted with a retailer to run a special on 12-pack can during the week of July 4, Pepsi will learn that it cannot promote the same package during that week and will have to vie for some alternative promotional period.

sent decrees prohibiting enforcement of the challenged MFNs,[14] several private cases and a few government proceedings have gone through trial court and appellate litigation. Early cases tended to dismiss challenges to MFNs out of hand.[15] In *Ocean State*, for example, the First Circuit held that "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 and, as a matter of law, is not exclusionary."[16] The Seventh Circuit similarly indicated that "[m]ost favored nations' clauses are standard devices by which buyers try to bargain for low prices"—although, on rehearing, it did allow that "[p]erhaps, as the Department of Justice believes, these clauses are misused to anticompetitive ends in some cases[.]"[17]

Several more recent cases, however, have gone the other way. One important case was the DOJ's challenge to MFNs used by an insurer in the *Delta Dental* case.[18] The concern there was that, through the use of MFNs, the insurer blocked entry by lower-cost, lower-premium insurers. The MFN provided that, if dentists offered lowered prices to other insurers (or even to uninsured patients), the same lower prices would have to be offered to Delta. Delta represented the dominant portion of dentist revenue. So saying that Delta would get the same lower prices meant that dentists had no incentive to reduce their prices to others to encourage entry or expansion by another insurer. Doing so would decrease the dentist's revenues across the board.[19] The district court distinguished *Ocean State* on this basis, denied the defense's motion to dismiss,[20] and the case settled soon afterward.[21]

Early cases tended to dismiss challenges to MFNs out of hand. . . . Several more recent cases, however, have gone the other way.

The most important recent development is the DOJ's suit against Blue Cross Blue Shield of Michigan (BCBSM), still pending. The claim is that the insurer used a combination of standard MFNs and "MFN-plus" clauses (requiring that health care providers charge competing insurers more than they charge BCBSM) to enhance its market power in various local health insurance

[14] *See, e.g.*, United States v. Or. Dental Serv., No. C95-1211 FMS, 1995 U.S. Dist. LEXIS 21042 (N.D. Cal. filed July 17, 1995); RxCare of Tenn., Inc., 121 F.T.C. 762 (1996).

[15] For a comprehensive survey of the cases prior to 1995, see Anthony J. Dennis, *Most Favored Nation Contract Clauses Under The Antitrust Laws*, 20 U. DAYTON L. REV. 821, 825–43 (1995).

[16] Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of R.I., 883 F.2d 1101, 1110 (1st Cir. 1989); *see also* Kartell v. Blue Shield of Mass., Inc., 749 F.2d 922, 929 (1st Cir. 1984) (Breyer, J.) ("[E]ven if the buyer has monopoly power, an antitrust court . . . will not interfere with a buyer's (nonpredatory) determination of price."). *But see* United States v. Delta Dental of R.I., 943 F. Supp. 172, 176–80 (D.R.I. 1996) (denying motion to dismiss and distinguishing *Kartell* and *Ocean State* on the grounds, *inter alia*, that the government alleged the MFNs at issue increased consumer prices whereas the prior cases involved lower consumer prices).

[17] Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1415 (7th Cir. 1995) (Posner, C.J.). The latter phrase was added to the opinion after the DOJ and the Federal Trade Commission filed an amicus brief in support of rehearing. Brief for the United States and Federal Trade Commission as Amici Curiae in Support of Petition for Rehearing, filed Oct. 2, 1995, Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406 (7th Cir. 1995) (Nos. 95-1965 & 95-2140), *available at* http://www.justice.gov/atr/cases/f0400/0421.pdf. That amicus brief, in hindsight, appears to have been a turning point in the judicial treatment of MFNs.

[18] *Delta Dental*, 943 F. Supp. 172.

[19] *See* Complaint ¶¶ 16–18 & 31, *id.* 943 F. Supp. 172 (No. 96-113-P), *available at* http://www.justice.gov/atr/cases/f0500/0594.htm.

[20] *Id.* at 179–80.

[21] United States v. Delta Dental of R.I., No. 96-113-P, 1997 U.S. Dist. LEXIS 11239 (D.R.I. July 2, 1997). Similarly, in *Reazin*, the Tenth Circuit treated the use and effect of MFNs as supporting evidence of market power and left open the possibility that use of MFNs may justify imposition of antitrust liability. Reazin v. Blue Cross & Blue Shield of Kan., Inc., 899 F.2d 951, 971 & n.30 (10th Cir. 1990) (observing "[t]here was also considerable testimony on the effect of Blue Cross' most favored nations clauses, and the jury could reasonably have concluded that that clause contributed to Blue Cross' power over price" and reserving judgment on the question "of whether use of the most favored nations clause could itself violate section 2").

markets.[22] The problem identified in the DOJ's complaint is that, if a dominant insurer can insist on the use by all or most health care providers of MFNs that prevent them from giving more favorable rates to new entrants or smaller firms seeking to expand—as in *Delta Dental*—competitive entry and expansion will be impeded and the dominant firm will be protected from the prospect of competition. The district court denied the defendant's motion to dismiss, finding "it is plausible that the MFNs entered into by Blue Cross with various hospitals in Michigan establish anticompetitive effects as to other health insurers and the cost of health services in those areas."[23] A competing insurer, Aetna, has filed a follow-on suit mirroring the DOJ's allegations.[24]

In contrast to the relatively substantial (if divided) case law on MFNs, there have been few challenges to NDRs, and no court has ever found the use of an NDR unlawful under the antitrust laws.

NDRs. In contrast to the relatively substantial (if divided) case law on MFNs, there have been few challenges to NDRs, and no court has ever found the use of an NDR unlawful under the antitrust laws. In 2010, the DOJ brought suit against American Express, Visa, and MasterCard challenging the credit card companies' separate NDRs,[25] and the clauses have also been the subject of private litigation.[26] The core of the allegations made by the DOJ is that an NDR may increase total acceptance costs to retailers by preventing retailers from steering consumers to lower-cost methods of paying.[27] No dispositive motion or other opportunity for a judicial discussion of the merits has been filed. MasterCard and Visa both entered into consent decrees to resolve the DOJ suit.[28] American Express, however, continues to defend against the government and private cases.

Retail Preference. Retail preference agreements, like MFNs, have been the subject of multiple antitrust suits, despite (or perhaps because of) their ubiquity in promotional efforts. Courts have generally upheld them as procompetitive, and no court has imposed antitrust liability for such agreements.[29] For example, in *Coca-Cola Co. v. Harmar Bottling Co.*,[30] litigated under Texas antitrust law, the Texas Supreme Court found that Coke's "calendar marketing agreements," which required, inter alia, that retailers provide Coke products with preferential advertising, displays, and shelf space during key selling weeks of the year, did not violate the antitrust laws because they did not have a proven anticompetitive effect. Specifically, the court found that the plaintiffs had

---

[22] *See* Complaint ¶¶ 1–6, United States v. Blue Cross Blue Shield of Mich., 809 F. Supp. 2d 665 (E.D. Mich. 2011) (No. 2:10-cv-14155-DPH-MKM), *available at* http://www.justice.gov/atr/cases/f263200/263235.pdf.

[23] *Id.* at 674.

[24] Complaint ¶¶ 18–19, Aetna Inc. v. Blue Cross Blue Shield of Mich., No. 2:11-cv-15346-BAF-RSW (E.D. Mich. Dec. 6, 2011). A motion to dismiss is pending. *See* Defendant Blue Cross Blue Shield of Michigan's Motion to Dismiss Aetna's Complaint, *id.*, No. 2:11-cv-15346-BAF-RSW (E.D. Mich. Jan. 27, 2012), ECF No. 11.

[25] Complaint, United States v. Am. Express Co., No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), *available at* http://www.justice.gov/atr/cases/f262800/262864.pdf.

[26] *E.g.*, *In re* Am. Express Anti-Steering Rules Antitrust Litig., 764 F. Supp. 2d 1343 (E.D.N.Y. 2011) (No. 1:11-md-02221) (ordering coordinated or consolidated pretrial proceedings for four pending private antitrust actions filed in the Eastern and Southern Districts of New York).

[27] Amended Complaint ¶¶ 1–4, United States v. Am. Express Co., No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), ECF No. 57, *available at* http://www.justice.gov/atr/cases/f265400/265401.pdf.

[28] *Id.*, No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (entering final judgment as to MasterCard and Visa).

[29] *Sun-Drop Bottling Co. v. Coca-Cola Bottling Co.*, 604 F. Supp. 1197 (W.D.N.C. 1985), involved a clause requiring Coca-Cola's products to be the "lowest" price in the store. Although "it appeared obvious to the court" that this was a form of vertical price fixing, "admittedly illegal" under the then-current per se rule, the requested preliminary injunction was nevertheless denied for failure to demonstrate irreparable harm because the clause had been removed with Coca-Cola's representation that it would not be reinstituted, and the case eventually settled. *Id.* at 1199. In the wake of *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), however, the concern raised by the *Sun-Drop* court should no longer be an issue today.

[30] 218 S.W.3d 671 (Tex. 2006).

failed to demonstrate "harm to competition in the market," notwithstanding allegations that Coke had a market share in excess of 75 percent.[31] The court held that "[the] existence of the CMAs alone cannot prove Coke engaged in predatory or anticompetitive conduct."[32]

The Seventh Circuit, in an opinion authored by Judge Easterbrook, reached a similar conclusion. In *Menasha Corp. v. News America Marketing In-Store, Inc.*,[33] the court rejected an antitrust claim based on preferential and exclusive positioning agreements entered by the largest provider of in-store coupon dispensers. The court found that retailers—"the consumers of couponing services"—preferred to have such deals in place, and observed that "[w]hen the consumers favor a product or practice, and only rivals squawk, the most natural inference is that the complained-of practice promotes rather than undermines competition."[34] Similar claims were also rejected by the Fourth Circuit in *RJR v. Philip Morris*,[35] and by the Fifth Circuit in the *Gruma* case.[36]

Can these disparate practices (e.g., MFNs, NDRs, and retail preference agreements) usefully be grouped under one CRR heading for purposes of antitrust analysis? Although it is true that all CRRs are subject to a rule-of-reason analysis, that is as far as the similarity goes.

Policy Analysis

Can these disparate practices (e.g., MFNs, NDRs, and retail preference agreements) usefully be grouped under one CRR heading for purposes of antitrust analysis? Although it is true that all CRRs are subject to a rule-of-reason analysis, that is as far as the similarity goes. Each of the three kinds of agreements discussed above has its own set of potential efficiencies and potential pitfalls, and focus on the individual features of the agreement is therefore important when applying the rule of reason.[37]

MFNs. MFNs can carry a potential for serious consumer harm. When used by dominant firms or collectively by the leading firms in an industry, MFNs can stabilize prices at elevated levels by removing seller incentives to discount to other buyers, as in *Delta Dental*[38] and *duPont/Ethyl*.[39] They can also inhibit competitive entry by preventing entrants from gaining access to the more favorable terms they may need to compete, as alleged in *Blue Cross of Michigan*.[40] The clauses

---

31 *Id.* at 688–90.

32 *Id.* at 690. To the same effect, see Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co., 94 F. Supp. 2d 804 (E.D. Ky. 1999); Beverage Mgmt., Inc. v. Coca-Cola Bottling Corp., 653 F. Supp. 1144 (S.D. Ohio 1986).

33 354 F.3d 661 (7th Cir. 2004).

34 *Id.* at 663. There have been a number of cases filed against News America advancing similar allegations. One of them, brought by Valassis, generated a nine-figure jury verdict before settling. *See* Valassis Commc'ns, Inc. v. News Am. Inc., No. 06-10240, 2011 U.S. Dist. LEXIS 63495 (E.D. Mich. June 15, 2011) (order adopting the report and recommendation of the panel of special masters).

35 R.J. Reynolds Tobacco Co. v. Philip Morris Inc., 199 F. Supp. 2d 362 (M.D.N.C. 2002) (promotional program giving retailers funding incentives to display Marlboro and other Philip Morris cigarettes not unlawful; rivals could gain display space through continuous bidding), *aff'd*, 67 Fed. App'x 810 (4th Cir. 2003).

36 El Aguila Food Prods. Inc. v. Gruma Corp., 301 F. Supp. 2d 612 (S.D. Tex. 2003), *aff'd*, 131 Fed. Appx. 450 (5th Cir. 2005).

37 For a discussion of justifications for exclusive arrangements generally, see Jacobson, *Exclusive Dealing*, *supra* note 5, at 357–60.

38 United States v. Delta Dental of R.I., 943 F. Supp. 172 (D.R.I. 1996) (prices stabilized by dominant firm use of MFNs).

39 E.I. du Pont de Nemours & Co. v. FTC, 729 F.2d 128 (2d Cir. 1984) (MFNs used collectively but without conspiracy by three leading firms, stabilizing market prices; *held*, no violation of FTC Act § 5, reversing the FTC). As the facts of the *duPont/Ethyl* case make clear, MFNs can have anticompetitive, price-elevating effects, even when used by firms without market power, if the agreements are used by multiple firms in an interlocking (albeit noncollusive) manner. The Second Circuit held, however, that the existence of those effects was not sufficient to establish an antitrust violation, even under Section 5 of the FTC Act. That holding has been questioned. *See* David H. Marks & Jonathan M. Jacobson, *Price-Fixing: An Overview*, 30 ANTITRUST BULL. 199, 225–26 (1985).

40 Complaint ¶ 47, United States v. Blue Cross Blue Shield of Mich., 809 F. Supp. 2d 665 (E.D. Mich. 2011) (No. 2:10-cv-14155-DPH-MKM), *available at* http://www.justice.gov/atr/cases/f263200/263235.pdf. Also significantly, an insurer that may seek to offer a low-cost, limited network plan by contracting with a single hospital would be prevented from doing so if the hospital had to give a dominant incumbent the same discounts. *See* Scott Morton, *Interview*, *supra* note 1, at 16.

can be especially problematic when, as also alleged in *Blue Cross*, the MFN goes beyond merely requiring that the buyer receive the best deal and instead requires that all other buyers pay substantially more for the covered services.[41]

MFNs are not without competitive justifications. Perhaps the most prevalent justification is the one described by Judge Posner, namely that "'[m]ost favored nations' clauses are standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers."[42] Correspondingly, it is argued, by ensuring the buyer's access to the lowest supplier price, MFNs provide an inducement for increasing output and enhancing consumer choice. Using health care again as an example, a dominant insurer may be reluctant to provide coverage in its broad network for a provider's services if that provider can help the insurer's rivals compete more effectively against it by offering them lower prices. Without the MFN serving as a safeguard against such a scenario, a small provider may not be able to get coverage in the large insurer's network at all. So MFNs in this context can broaden provider access to subscribers by inducing a dominant insurer to include the provider in its broad network.

MFNs can also address a type of free-rider problem. A supplier may benefit from association with a buyer's goodwill and yet it may have reduced incentives to include the buyer in its marketing efforts if the buyer is paying more to another supplier. It has also been argued that, in long-term contracts, MFNs can facilitate efficient price adjustment (as buyers adjust the price paid when the prices of the seller's rivals change), and that, correspondingly, the absence of MFN provisions may deter the parties' entry into stable long-term contractual relationships ex ante.[43]

Each of these justifications may prove valid, even important, in any given case. Still, as efficiency justifications go, none of them seems overwhelmingly powerful in the abstract, particularly given the empirical work documenting the general tendency of MFNs to increase prices.[44] MFNs are useful when used by smaller firms as a device to attract desirable customers (or suppliers) and to provide them with an incentive to do business they might otherwise forgo. But when imposed by dominant firms, the potential for anticompetitive effects can be substantial, and the justifications generally thin. In particular, although nominally ensuring the buyer the lowest available supplier price, MFNs will tend to have the effect of inhibiting price competition that would lead to lower prices marketwide. As to the potential for reduced transaction costs from the use of MFNs (e.g., by expediting the bidding process), this should rarely, if ever, justify a dominant firm's use of MFN. The reduction in transaction costs eliminates the very dynamics that lead to vigorous price competition. The most naked form of price fixing reduces transaction costs in much the same way,

---

41 Complaint ¶ 45, *Blue Cross Blue Shield*, 809 F. Supp. 2d 665 (No. 2:10-cv-14155-DPH-MKM). A significant concern in health care markets is that a dominant health insurer with a large market share may be able to coerce health care providers into accepting barely sustainable rates while, at the same time, charging inflated premiums to employers or other insurance purchasers. This can create a circumstance where the providers must charge smaller insurers seeking to enter rates that are substantially higher to recoup losses incurred from their dealings with the monopsonist—and this can result with or without the use of MFNs. When providers must charge entrants discriminatorily high rates, potential competitors will be unable to challenge the dominant insurer because their cost structure will be higher and they will not have a practical ability to compete with the dominant firm on rates to be charged to subscribers—even if the rates are excessive. The upshot is the classic collection of competitive harms: reduced output and quality of services, higher consumer prices, and illegitimate extraction of monopoly rents. *Accord* Scott Morton, *Remarks*, *supra* note 1, at 13.

42 *See* Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic, 65 F.3d 1406, 1415 (7th Cir. 1995).

43 *See* Keith J. Crocker & Thomas P. Lyon, *What Do "Facilitating Practices" Facilitate: An Empirical Investigation of Most-Favored-Nation Clauses in Natural Gas Contracts*, 37 J.L. & Econ. 297, 298, 301 (1994).

44 *See* Scott Morton, *Remarks*, *supra* note 1, at 12 & n.15 (collecting studies).

but the cost saving from not having to worry about what your rival is charging is never a legitimate defense.[45] Enforcer skepticism about MFNs is therefore not entirely unwarranted.

NDRs. NDRs are commonly viewed as being similar to MFNs,[46] but in fact generally have fewer harmful consequences. In health care, a provider's "no steering" clause does not prevent the payer from negotiating whatever reimbursement rates with the provider it may choose; does not prevent the insurer from bargaining to pay lower (or higher) rates to other providers; and does not prevent the provider from negotiating different rates with other insurers. Similarly, a credit card company's NDR with a merchant prevents the merchant from steering customers to other, possibly lower-priced cards, but it has no effect on the price ("interchange fee" or in some cases "merchant discount") that the merchant pays whenever a customer uses the card.[47] The merchant is free to negotiate higher, lower, or different rates with other card companies as the merchant elects. At the same time, the credit card companies are free to compete in offering different rates to the merchants they seek to sign up.

The justifications for NDRs in the health care industry may be significant. A provider who agrees to be "in network" with a given insurer has granted that insurer the goodwill and promotional benefit associated with the provider's brand and reputation—benefits that will be appropriated without compensation if the insurer then steers patients to other providers. The provider may have also discounted its rates to the insurer in return for an expectation of volume, but the incentive to do so will have been eliminated if the provider then steers the expected volume elsewhere. Cooperative arrangements in the development of new programs and treatments may also be retarded, as a provider will not want to share its proprietary research with an insurer that is funneling the provider's business somewhere else.

The justifications in the credit card industry are similar and substantial. First, there is a free-rider problem whenever a credit card brand attracts a customer into a store. If a store then steers the customer into using a different card, it has benefited from the card company's promotional efforts without paying for it. The upshot is that the card company's incentives to continue investing in activities that bring customers into the store are diminished, with negative effects on interbrand competition and card acceptance market output.[48] Second, and relatedly, notwithstanding the argument that steering to a lower-priced card may facilitate expansion by the lower-priced card company, that very expansion is riddled with other free-rider problems: while the higher-priced card company's promotional efforts encourage its cardholders to enter the store, it is the lower-priced card company that reaps the benefit without payment—with the same negative effects on investment incentives. Third, a merchant's interchange or discount rate may be based on an expectation of a certain volume of transactions; if that volume is not forthcoming, the rate may have to be increased. And, fourth, a smaller credit card company may be vulnerable to the efforts of larger firms to induce merchants to deny acceptance of the smaller rival's brand, in which case

[45] *See, e.g.*, Freeman v. San Diego Ass'n of Realtors, 322 F.3d 1133, 1152 (9th Cir. 2003) (rejecting purported procompetitive justifications for price fixing).

[46] *See* Nicholas Economides, *Competition Policy Issues in the Consumer Payments Industry*, *in* MOVING MONEY: THE FUTURE OF CONSUMER PAYMENT 113, 118–19 (Robert E. Litan & Martin Neil Baily eds., 2009) (lumping MFNs and NDRs together as one mechanism by which credit card networks make it more difficult for merchants to respond to card fee differences).

[47] *See* Dennis W. Carlton & Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 ANTITRUST L.J. 643, 645–48 (1995) (surveying development of credit card industry payment structures).

[48] *See* Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 52–57 (1977).

NDRs provide a self-preservation mechanism, important as a defensive measure against strong rivals seeking exclusivity.[49]

These efficiencies all serve to increase output on the card acceptance side of the two-sided, credit card market. There are efficiencies on the cardholder acquisition side as well. First, credit card companies have a legitimate interest in preventing the disparagement of their brands from merchants who benefit from accepting the card. A customer steered away from one brand of card is essentially being told that that card is inferior to another card and that the cardholder should not be using it. Second, a card company may reasonably conclude that allowing customers to be steered away from its brand will diminish its ability to provide desirable reward programs and other card features, thus harming its ability to sign new cardholders, and reducing demand for and utilization of its cards overall.

The essence of the argument against NDRs is that discrimination by customers in a lower-priced rival's favor would improve that rival's prospects of expanding more. Preventing that discrimination is harmful, it is argued, because rivals would do better in the absence of the NDR; and merchants would pay less for credit cards if they could freely steer.[50] The argument, however, ignores (i) the negative effects on market output (on both sides of the market) that are likely to occur if these provisions are banned; and (ii) the competition that precedes the implementation of these provisions. Importantly, merchants do not agree to NDRs in a vacuum. An NDR is just one of many components of a contractual relationship with a credit card company, with benefits inuring to, and obligations flowing from, both sides of the contract, including, importantly, the willingness of cardholders to spend more in establishments that accept their chosen brand of card.[51] Except in the truly rare case where a credit card company faces no competition at all, a merchant who does not want an NDR can go elsewhere.

Finally, it seems strange to tell a company it cannot bargain for protection against downstream discrimination. Our country has a long tradition of prohibiting discrimination and, even in the business context, some types of discrimination have long been the focus of specific Con-

---

[49] In the *American Express* case, the NDR protects American Express against opportunistic behavior by its larger rivals, Visa and MasterCard. American Express cards are accepted by far fewer merchants than those that accept Visa and MasterCard, and its network is unusually vulnerable to efforts by those larger firms to induce merchants to decline acceptance of the card. The DOJ's complaint alleges a narrow "travel and entertainment card" submarket in which American Express supposedly has market power, Amended Compl. ¶¶ 41–50, United States v. Am. Express Co., No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), ECF No. 57, *available at* http://www.justice.gov/atr/cases/f265400/265401.pdf, but it also acknowledges the broader "general purpose credit and charge card" market in which American Express is a comparatively minor player. *Id.* ¶¶ 34–40. Visa and MasterCard are significantly larger than American Express in the broader market, and the DOJ has already demonstrated that those companies have significant market power in that broader market. United States v. Visa U.S.A., Inc., 344 F.3d 229, 238–40 (2d Cir. 2003). Even though it may be true that NDRs limit the ability of credit card merchants and retailers to create discounts for the use of particular cards (*see* Scott Morton, *Interview*, *supra* note 1, at 17), such programs can just as easily be used by the more dominant firms to marginalize smaller players. American Express's "self-defense" justification needs to be viewed in that context.

[50] Certain complaints also focus on harm to merchants from consumer rewards programs. *See* Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 U.C.L.A. L. REV. 1321, 1357 (2008) (arguing that NDR provisions "make it impossible for merchants to avoid the externality of rewards programs and other perks offered to card users from which merchants derive no benefit"). That argument does not feature prominently in the DOJ complaint and ignores the two-sided nature of competition in the market. Card companies compete against one another, not just for merchant patronage, but for cardholders. Rewards programs are a central feature of the competition for cardholders, and NDRs are important to ensure that cardholders reap the benefits of that competition when presenting their chosen card to a merchant.

[51] *See* Sujit Chakravorti, *Theory of Credit Card Networks: A Survey of the Literature*, 2 REV. NETWORK ECON. 50, 51–54 (2003) (discussing variety of credit card market participants).

gressional prohibition.[52] In the antitrust context generally, moreover, it is clear that, absent the most unusual circumstances, firms cannot be forced to deal with customers or suppliers who will treat them less favorably.[53] It is therefore difficult to envisage a scenario in which an NDR should be held unlawful.

Retail Preference Agreements. Retail preference agreements are CRRs as well but are quite different from MFNs or NDRs. The proponent does not want equal treatment with rivals; it wants *better* treatment.[54] In a typical arrangement, a supplier will bargain with a retailer for preferential shelf space, promotional displays, inclusion in newspaper ads, and/or a reduced price at retail. The agreements often include provisions requiring that the supplier have the only (or most prominent) ad in its category, that it have the best and/or most shelf space and the largest and most prominent display in the store, and that the promotional activity in issue occur during key sales weeks (such as July 4th or Thanksgiving). They are almost always very short-term. A "calendar marketing agreement," for example, will typically schedule a weekly or monthly promotional calendar over the course of a year, with each week or month contestable before the calendar is set. Promotional activity of this sort is quite valuable and can result in very substantial incremental sales (or "lift"). To get this kind of preferred treatment at retail, suppliers must offer large discounts.

Retail preference agreements are CRRs as well but are quite different from MFNs or NDRs. The proponent does not want equal treatment with rivals; it wants **better** *treatment.*

Retail preference agreements are associated with recognized efficiencies. The inducement for the supplier's steep discount is the preferential treatment over its rivals; without that preference, the discounts would be less frequent. For example, Pepsi is not going to provide a supermarket thousands of dollars in discounts for a promotion if the first thing a consumer sees on entering the store is a large display of two-liter Coca-Cola. Exclusivity (or at least preferential treatment) is key to inducing the investment Pepsi is making. These agreements, moreover, are almost always associated with intense "competition for the contract."[55] Retailers maximize their own returns by playing one supplier off against another to get the best deal, and the implied promise of preferential treatment is their currency.[56] Outlawing retail preference agreements would have the perverse effect of eliminating one of the key ways for stimulating interbrand competition.[57]

---

52 *E.g.*, Robinson-Patman Act, 15 U.S.C. §§ 13–13b, 21a; Telecommunications Act of 1996, 47 U.S.C. §§ 251(c)(2)(C) & (D); Preventing Undue Discrimination and Preference in Transmission Services 70 Fed. Reg. 55,796 (Sept. 23, 2005) (notice of inquiry), *available at* http://www.gpo.gov/fdsys/pkg/FR-2005-09-23/pdf/05-19003.pdf.

53 *See* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko LLP, 540 U.S. 398, 408 (2004).

54 These types of agreements are not addressed in Deputy Assistant Attorney General Scott Morton's taxonomy of CRRs, but are properly viewed as a species of CRR for the reasons addressed *supra* note 13.

55 *See* Paddock Publ'ns, Inc. v. Chicago Tribune Co., 103 F.3d 42, 45 (7th Cir. 1996) (Easterbrook, J.) ("Competition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe, and it is common.").

56 *See* Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433, 447, 448 (2008) ("[W]hen the supermarket informs [two] manufacturers that it will feature only one brand, the supermarket is able to obtain much more favorable terms for its shelf space because it is promising to deliver all of its consumers to the manufacturer of the featured brand. . . . Competition between manufacturers for the exclusive retailer shelf space in our example, therefore, will lead to an equilibrium price of . . . manufacturer marginal cost.").

57 The argument has been made that "the procompetitive effect of exclusive dealing is strongest when firms are symmetric, but weaker (or even absent) if the exclusive manufacturer has substantial market power." Hans Zenger, *When Does Exclusive Dealing Intensify Competition for Distribution? Comment on Klein & Murphy*, 77 ANTITRUST L.J. 205, 211 (2010). However, the argument neglects the ability of retailers (even those without market power) to "shift the share of sales in a product category in favor of one or another supplier" and thus induce competition for the contract. *See* Benjamin Klein & Kevin M. Murphy, *How Exclusivity is Used to Intensify Competition for Distribution—Reply to Zenger*, 77 ANTITRUST L.J. 691, 691 (2011). This, in fact, appears to have been the case in at least one major appellate decision. *See* NicSand, Inc. v. 3M Co., 507 F.3d 442, 453–55 (6th Cir. 2007) (en banc) (noting retailer demands for exclusivity and displacement of once dominant firm as preferred partner).

Conclusion

The concept of CRRs as an antitrust category of restraints has intuitive appeal and some real utility. The impact on rivals of such contractual provisions presents a number of issues common to each case—for example, whether the firm imposing the provision has significant market power. But, consistent with a rule-of-reason approach, there are also key differences from provision to provision in terms of both their effects and justifications. No case seems to warrant requiring the defendant to prove justification before the plaintiff is required to show actual harm to competition. As the D.C. Circuit noted in *Microsoft*, there is a social cost to forcing firms, even dominant ones, to justify every ordinary business agreement they enter.[58] A careful analysis of each practice, including its circumstances and case-specific facts, will always be necessary,[59] and the burden should remain on the party claiming an antitrust violation to prove its case. A blanket rule or categorization for CRRs would likely create confusion and undermine interbrand competition by discouraging firms from using all competitive tools at their disposal. Proper rule-of-reason analysis thus requires disaggregating the various types of CRR. ●

POSTSCRIPT

On April 11, 2012, there was an important new development regarding antitrust enforcement against CRRs. The DOJ filed suit against Apple, Inc. and six prominent book publishers, charging a conspiracy among them to utilize a uniform agency model for retail e-book sales, allowing them to raise retail prices, reinforced through an MFN providing that none of the publishers' e-books could be sold for any less than the price on Apple's iBookstore. The complaint alleged:

> Apple and the Publisher Defendants recognized that coupling Apple's right to all their e-books with its right to demand that those e-books not be priced higher on the iBookstore than on any other website effectively required that each publisher Defendant take away retail pricing control from all other e-book retailers, including stripping them of any ability to discount or otherwise price promote e-books out of the retailer's own margins.[60]

Three of the publishers have settled and entered into a consent decree. The case continues against Apple and the non-settling publishers.

---

[58] United States v. Microsoft Corp., 253 F.3d 34, 70 (D.C. Cir. 2001) ("[I]mposing upon a firm with market power the risk of an antitrust suit every time it enters into such a contract, no matter how small the effect, would create an unacceptable and unjustified burden upon any such firm.").

[59] *See* Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918) ("The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.").

[60] Complaint ¶ 66, United States v. Apple, Inc., No. 1:12-cv-2826 (S.D.N.Y. Apr. 11, 2012), *available at* http://www.justice.gov/atr/cases/f282100/282135.pdf.