

Most-Favored Nation Clauses: A Business Need But Unresolved Topic in Mexico



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I. INTRODUCTION

Most-favored nation clauses (“MFN”) — a commonly used contractual mechanism — have become a topic of concern for competition authorities worldwide. Competition authorities around the world have rendered some decisions as to what extent those clauses could harm competition and if sanctioned whether they should be analyzed under a per se rule or rather under a rule of reason.

New technological platforms have revamped traditional channels through which products or services are offered (e.g. online stores, online booking services, e-books, comparison price sites, etc.) and, therefore, competition authorities around the globe have tried to meet with current rules those new challenges brought by technology.

MFN clauses³ have sound business reasons to exist in contractual relationships. These clauses have their origin in international investment and trade law whereby a MFN treatment allows that an investor or its investment would necessarily be treated “no less favourably” than another investor or inversion⁴. This “no less favourably” concept aims to equalize the terms between two parties not only on their strict negotiation but also based on the terms that are offered to third parties.

From a competition perspective, MFN clauses are basically those agreements whereby a seller agrees that a purchaser will benefit from the terms and conditions that are at least as favourable as those offered to third parties. This kind of agreements allows that a buyer would automatically benefit from a most favourable term or condition that the seller agrees with any other party in order to equalize conditions among them. In

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³ MFN clauses are also referred as “price parity clauses,” “most-favored customer clauses,” “meeting competition clauses,” “price parity clauses,” “prudent buyer clause” and “non-discrimination clause,” among many others.

⁴ OECD (2004), *Most-Favored-National Treatment in International Investment Law*, OECD Working Papers on International Investment, 2002/02, OECD Publishing. Available at: http://www.oecd.org/daf/inv/investment-policy/WP-2004_2.pdf





short, a MFN clause “entitles a customer to obtain the most favorable terms that a supplier offers to any other customer”⁵ and although MFN clauses typically refer to price commitments, they are also related to other terms and conditions.⁶ Thus, MFN clauses are a formal-contractual presentation of long-time standard business practices⁷ whereby a buyer will request a seller to lower prices or modify certain terms of their agreement, if he learns that such seller has given such benefit to another customer.

Literature on the subject has agreed⁸ that MFN clauses can be a result either of bilateral negotiations or unilateral impositions. Moreover, a distinction of MFN clauses has been recently identified by the United Kingdom’s Competition Markets Authority (“CMA”) when conducting an investigation in the private motor insurance (“PMI”) sector. During this investigation,⁹ the CMA reviewed if MFN clauses contained in the agreements executed among PMI providers and certain car insurance price comparison websites might be anticompetitive. On a report published on September 2014 related to such investigation, the CMA identified and distinguished between narrow and wide MFNs.¹⁰ Narrow MFNs seem to be acceptable under a competition scenario but wide MFNs did not. For the specific case, the CMA resolved that:

- Narrow MFNs, which provided that the price on the PMI provider’s own website will never be lower than the price on the PCW, were unlikely to raise a competition concern as such clauses would only limit the competitive constrain exerted by the own-website channel on PCW’s that would eventually allow consumer trust in the services offered; and
- Wide MFNs, which provided that the price through any other sales channel, including other PCWs, would never be lower than the price on a given PCW, should be considered as anticompetitive as they aimed to soften price competition between PCWs in relation to PMI.

Despite the aforementioned distinction, authors like Whish and Bailey have expressed that those MFN clauses can restrict competition as they could aim to or have the effect of marking resale price maintenance conducts more effective or by transforming a recommended or maximum resale price into a minimum price.¹¹ Yet, although MFN clauses are generally analyzed as vertical restrain conducts¹² — as such provisions are implemented in different stages of the commercialization and distribution chain —, it seems that the imposition and execution of MFN clauses might also produce horizontal consequences. To this we turn.

⁵ Whish R. and Bailey, D. *Competition Law*, Eight Edition, Oxford Press University 2015, page 688.

⁶ See: Vandenborre, Ingrid and Frese, Michael J. *Most Favored Nation Clauses Revisited*. *European Competition Law Review*, pages 588 to 593.

⁷ See: Vandenborre, Ingrid and Frese, Michael J. *Most Favored Nation Clauses Revisited*. *European Competition Law Review*, pages 588 to 593.

⁸ See: (i) González-Díaz and Bennett, “*The law and economics of most-favored nation clauses*,” *Symposium: parity clauses*. *Competition Law & Policy Debate*, Volume 1, Issue 3, 2015 and (ii) Vandenborre, Ingrid and Frese, Michael J. *Most Favored Nation Clauses Revisited*. *European Competition Law Review*, pages 588 to 593, among others.

⁹ Further information about the investigation is available at: <https://www.gov.uk/cma-cases/private-motor-insurance-market-investigation>

¹⁰ The distinction between MFNs has also been referred to as wholesale MFNs and retail-price MFN or could also be distinguished to MFN clauses applicable to unit prices or clauses that refer to a total purchase value, among many other several variations. The CMA concluded that narrow MFNs not necessarily would raise a competition concern but that wide MFNs were more likely to soften or reduce competition.

¹¹ See: Whish R. and Bailey, D. *Competition Law*, Eight Edition, Oxford Press University 2015, pg. 688.

¹² See: *The European Commission Guidelines on Vertical Restraints* [2010], OJ C130/1, 48.





II. MFNs AND HORIZONTAL CONSEQUENCES

Since 1995, Jonathan B. Baker¹³ has already claimed that the “vertical good, horizontal bad” antitrust maxim constituted an oversimplification of each sort of conduct.¹⁴ In order to sustain his argument, Baker explained that horizontal consequences might be generated from vertical restraints and used as an example MFNs. The reason behind such argument relies on the fact that MFN clauses, as it occurs with other vertical restraints, could incentive explicit or tacit collusion that could eventually affect horizontal competition by directly dampening competition.

For instance, by implementing MFN clauses, cartel members could use these agreements as credible mechanisms to monitor and ensure other cartel members do not cut prices given that a possible deviation will easily be detected. Moreover, MFN clauses can also allow encourage horizontal competitors to tacitly coordinate or dampen competition as cartel members would have little incentives to deviate from an agreement if they cannot provide different terms and conditions to its customers given the MFNs. Furthermore, it seems that MFNs could also be used to set or coordinate a minimum price that could also be used as a tacit agreement to fix certain prices.

III. MFNs AND VERTICAL CONSEQUENCES

MFN clauses can also generate other anticompetitive effects than just incentivizing collusion. Although several factors¹⁵ should be taken into consideration when reviewing MFNs, the following vertical effects might raise from their imposition:¹⁶ (i) they could reduce seller’s incentive to lower prices to new buyers; (ii) limit the scope of price discrimination; (iii) increase market power on the downstream market for dominant firms; (iv) create barriers to entry when MFNs are imposed by dominant firms; (v) make vertical price-fixing more effective;¹⁷ and/or (vi) raising rivals’ costs and excluding other firms. These effects would significantly raise competition concerns as they would only allow increasing market power for dominant firms and imposing barriers to entry markets and/or excluding competitors.

¹³ Jonathan B. Baker served as the Chief Economist of the Federal Communications Commission from 2009 to 2011, and as the Director of the Bureau of Economics at the Federal Trade Commission from 1995 to 1998. He also worked as a Senior Economist at the President’s Council of Economic Advisers, Special Assistant to the Deputy Assistant Attorney General for Economics in the Antitrust Division of the Department of Justice.

¹⁴ See: Baker, Jonathan B, “Vertical restraints with horizontal consequences: competitive effects of most-favored-customer” clauses,” Business Development Associates, Inc., Antitrust 1996 Conference, Washington, D.C. 1995. Available at: <https://www.ftc.gov/es/public-statements/1995/09/vertical-restraints-horizontal-consequences-competitiveeffects-most>

¹⁵ Such as (i) if the firm adopting MFNs has substantial market power or a dominant position; (ii) whether the market has barriers to entry; (iii) market concentration; (iv) the coverage scope of the MFNs and (v) market transparency.

¹⁶ For further analysis of such effects refer to: (i) Vandenborre, Ingrid and Frese, Michael J. *Most Favored Nation Clauses Revisited*. European Competition Law Review, pages 588 to 593, (ii) González-Díaz and Bennett, *The law and economics of most-favored nation clauses*, Symposium: parity clauses. Competition Law & Policy Debate, Volume 1, Issue 3, 2015, (iii) Baker, Jonathan B, *Vertical restraints with horizontal consequences: competitive effects of most-favored-customer” clauses*, Business Development Associates, Inc., Antitrust 1996 Conference, Washington, D.C. 1995 and (iv) Baker, Jonathan B and Chevalier, Judith A., *The Competitive Consequences of Most-Favored-Nations Provisions*. Antitrust Vol. 27, No. 2, spring 2013, among others.

¹⁷ See: Vandenborre, Ingrid and Frese, Michael J. *Most Favored Nation Clauses Revisited*. European Competition Law Review, pages 588 to 593. Also see: *The European Commission Guidelines on Vertical Restraints* [2010], OJ C130/1, 48 and the European Commission Guidelines on Vertical Restraints, paragraph 48.





Despite that international experience demonstrates that MFNs can produce horizontal or vertical effects, there is commercial rationality behind MFNs that is generally analyzed under the market efficiencies they might create. Several authors¹⁸ have agreed that MFNs can also generate procompetitive effects and efficiencies that could support their use under a rule of reason analysis. Such efficiencies aim to mitigate (i) “hold-up” and “free-rider” problems, (ii) counteract incentives to avoid contracting delays and (iii) reduce transaction costs and recoup sunk costs in certain investment and long-term relationships. The efficiencies or justifications could support that the imposition of MFN clauses is not necessarily anticompetitive.

Europe and the U.S. have had recent experiences on the subject¹⁹ due to the investigations related to e-books, online booking services and Amazon’s price parity policy.

Between 2011 and 2013, the European Commission undertook an investigation for the use of MFN clauses between Apple and five significant publishers.²⁰ In January 2010, five significant book-publishers²¹ in the United States entered into agency agreements through which each publisher celebrated an agreement with Apple for the sale of e-books where each publisher would set the price at which Apple was supposed to sell them. Such agreements contain retail-price MFN clauses through which publishers had to lower e-books prices to match the lowest price at which another e-book was sold. Yet, in 2011, the European Commission began a formal investigation against the publishers and Apple.

During its proceeding, the European Commission considered that MFN clauses served as a commitment mechanism to align the publishers and force Amazon to also enter into agency agreements with them as Amazon was facing a possible exclusion of the market. Moreover, the European Commission considered that a possible turn from Amazon to an agency agreement could only be the result of a concerted practice aiming to raise retail-prices of e-books or at least avoiding the appearance of lower prices. Nevertheless, in the following years, the European Commission closed its investigation as a result of commitments presented by the liable parties that included, among others, new agency models and a five-year ban of MFN clauses.

¹⁸ Further specific analysis of the efficiencies and justifications of MFNs is addressed in (i) Vandenborre, Ingrid and Frese, Michael J. *Most Favored Nation Clauses Revisited*. *European Competition Law Review*, pages 588 to 593, (ii) González-Díaz and Bennett, *The law and economics of most-favored nation clauses*, Symposium: parity clauses. *Competition Law & Policy Debate*, Volume 1, Issue 3, 2015, (iii) Baker, Jonathan B, *Vertical restraints with horizontal consequences: competitive effects of most-favored-customer" clauses*, Business Development Associates, Inc., Antitrust 1996 Conference, Washington, D.C. 1995 and (iv) Baker, Jonathan B and Chevalier, Judith A., *The Competitive Consequences of Most-Favored-Nations Provisions*. *Antitrust* Vol. 27, No. 2, Spring 2013, among others.

¹⁹ Some of the most relevant cases are: (i) Case No. COMP/38427 *PO Pay Television Film Output Agreements*; (ii) Case COMP/AT.39847 *E-BOOKS*; (iii) Amazon price parity policy and e-books distribution; (iv) HRS-Hotel Reservation Service, *Bundeskartellamt* decision of December 20, 2013; (v) online booking services investigations performed by national competition authorities (NCAs) in such market in Austria, Denmark, France, Hungary, Ireland, Italy and Sweden along with Switzerland and the United Kingdom; (vi) MFN between E.ON and Gazprom (EC PR IP/05/710), (vii) MFN between Hollywood Studios and producers of cinema digital equipment (EC PR IP/11/257), (viii) EU merger case between Universal/EMI (Case M 6458), among many others.

²⁰ Case COMP/AT.39847 *E-BOOKS*, Public version of the European Commission’s decision is available at: http://ec.europa.eu/competition/antitrust/cases/dec_docs/39847/39847_26804_4.pdf

²¹ The five publishers under investigation were Penguin, Simon & Schuster, HarperCollins, Hachette and Holtzbrinck/Macmillan.





Other relevant cases that provide guidance on the matter were the European investigations related to the online booking sector. Since 2010, several local competition authorities²² from the European Union such as Austria, Denmark, France, Germany, Hungary, Ireland, Italy and Sweden along with Switzerland and the United Kingdom initiated investigations regarding several MFN clauses in the online booking sector. In such cases, hotels and online travel agencies (“OTA”) executed several MFN clauses which restricted the OTAs possibilities to provide discounts to room prices, availability and cancellation terms. A general consensus regarding the effect that could arise from the MFNs under investigation consists on that such clauses would limit competition between OTAs and would increase barriers to entry and expansion for other OTAs. Some cases are still under investigation, others have been settled and others have been condemned by the competition authorities²³. Yet, each decision involves specific analysis that is worth of a review for understanding MFNs treatment and application.

Additionally, since 2013, Amazon’s price parity policy has also been under review by the local competition authorities in Germany and United Kingdom and the European Commission. Broadly, the investigation concerns MFN clauses applied to retailers offering products in Amazon’s online trading platform, Amazon Marketplace whereby retailers agreed to offer their products at the most favorable price via Amazon Marketplace compared to their offer either on other online platforms or their own online shops. Yet, Amazon agreed with the authorities to ban such clauses and the case was, once again, settled without further guidance.

Notwithstanding, it is unclear whether MFNs could be allowed or sanctioned under the current Mexican competition policy. A case-by-case analysis would have to be performed and the use of foreign precedents has to be performed with caution. In order to use foreign precedents, we need to understand the legal system and rules where the case was decided.

Moreover, contrary to other jurisdictions, although the Mexican competition legislation sanctions both, horizontal and vertical conducts, the Federal Economic Competition Law (“FECL”) only contains a closed short-list of conducts that could constitute a competition violation. Such short-list ensured that fundamental human rights of legal certainty are protected, and thus, no catch-all provision is contained in our competition statute. Moreover, the FECL sanctions anticompetitive conducts either from the purpose (object) of the conduct or based on the effects it might generate within or having effects in the Mexican territory. However, due to the features and uncertainty regarding MFN clauses, it is not clear to which type of behavior MFN clauses could fall according to the horizontal and vertical conduct segmentation provided by the Mexican legislation.

For example, under the Mexican competition legislation, MFN clauses could be used to establish a cartel agreement if implemented as a mechanism through which competitors fix or manipulate certain prices. Such mechanism would allow fixing a “most-favorable” price in benefit of all buyers, which implies the standardization or coordination of prices that under a normal competition scenario would probably be different. If this was implemented, under this hypothetical, it is possible that such conduct could be understood as an artificial fixation of prices that could be sanctioned under article 53-I of the FECL and 254 Bis of the Federal Criminal Code.

²² Local competition authorities from the European Union are normally referred as National Competition Authorities or NCAs.

²³ See specifically: HRS-Hotel Reservation Service, German National Competition Authority (Bundeskartellamt) decision of December 20, 2013.





On the other hand, based on the vertical consequences previously identified, the imposition of MFN clauses might also constitute a violation of articles 54, 55 and 56 of the FECL. Mexican competition legislation sanctions thirteen specific conducts as vertical restraints only if (i) the firm or firms that implemented such conducts, have individual or joint substantial market power and only if (ii) such conduct has either the purpose (object) or effect of unlawfully displacing competitors, impeding their access to markets or establishing exclusive advantages on their detriment. Among the thirteen short-listed conducts, it is feasible that MFNs could fall within: (i) vertical price-fixing or resale price maintenance conduct (section II, article 56), (ii) could be contrary to the wording introduced in the FECL for sanctioning price discrimination (section X, article 56) and (iii) it's even possible that MFNs could constitute a boycott to pressure or displace competitors or force them to perform certain conducts (section VI, article 56) as it occurred in the first finding of the e-books case in Europe.²⁴

The fact that other jurisdictions have delineated the treatment as how should MFNs be reviewed or sanctioned, it is not necessarily applicable for the Mexican case. Although foreign law and experience could guide on the internal analysis of this contractual mechanism, its application is limited. It would be applied only if Mexican law recognizes or regulates the same conduct. In that regard and based on the fact that the FECL only sanctions specific short-listed conducts, framing the conduct would be a challenging task. In fact, if the effects that MFNs generate were found as cartel violation by the Mexican competition authorities, the per se rule and criminal consequences (5 to 10 years imprisonment terms) could be applicable. If so, competitive behavior could be inhibited by the fear of not being targeted as cartel. The risk will increase in case that corporate criminal liability — a newly created concept under Mexican law — encompasses competition violations. A more conservative approach, unless a naked cartel evidenced on the facts, is to analyze MFNs under a rule of reason.

²⁴ Case COMP/AT.39847 *E-BOOKS*

