Antitrust Chronicle

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MFN Clauses, Loyalty Programs & Fidelity Rebates

CPI COMPETITION POLICY INTERNATIONAL

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LETTER FROM THE EDITOR

Dear Readers,

For this edition of the CPI Antitrust Chronicle, we turn our focus to the antitrust treatment of MFN clauses, loyalty programs, and fidelity rebates.

All three types of practices are "classics" in the antitrust canon, but the advent of digital platforms has raised novel questions.

To take just a few: When are MFN clauses efficient? Should MFNs be permissible for dominant platforms? Should MFNs be limited in scope depending on the industry at hand or a business' market power? Are new safe harbor provisions warranted? How should MFNs be viewed when used in combination with loyalty or rebate programs?

As ever, in such a fast-moving environment, these questions have produced divergent approaches from enforcers and courts. In the meantime, businesses must continue to adapt their practices while complying with competition rules in a state of flux.

We have assembled a timely group of articles from a diverse range of authors that assess these practices in light of recent developments around the world. Each article makes a valuable contribution to the lively debate on how both enforcers and practitioners can approach these questions in a rapidly evolving enforcement environment.

Lastly, please take the opportunity to visit the CPI website and listen to our selection of Chronicle articles in audio form from such esteemed authors as Maureen Ohlhausen, Herbert Hovenkamp, Richard Gilbert, Nicholas Banasevic, Randal Picker, Giorgio Monti, Alison Jones, and William Kovacic among others. This is a convenient way for our readers to keep up with our recent and past articles on the go, in the gym, or at the beach.

As always, thank you to our great panel of authors.

Sincerely,

CPI Team

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WHAT'S NEXT?

For October 2019, we will feature Chronicles focused on issues related to (1) **CRESSE**; and (2) **EU Competition Reports**.

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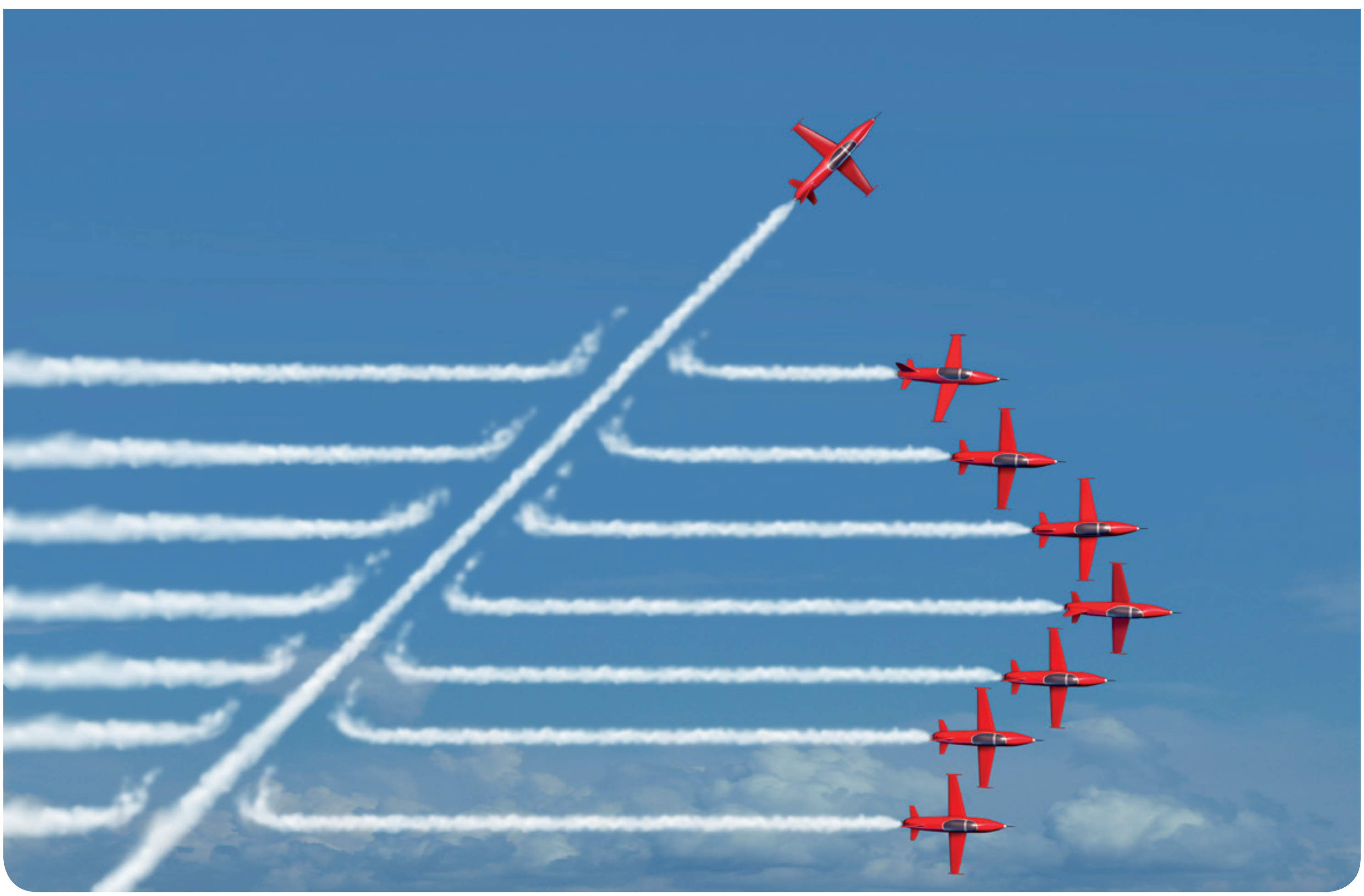
CPI ANTITRUST CHRONICLES NOVEMBER 2019

For November 2019, we will feature Chronicles focused on issues related to (1) **Compliance**; and (2) **Consumer Welfare**.

Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.



MFN CLAUSES AND ANTITRUST ENFORCEMENT: ON A SLOW PATH TO CONVERGENCE?

BY INGRID VANDENBORRE & CAROLINE JANSSENS[1]

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I. INTRODUCTION

Parity clauses, also known as "most favored nation" or "MFN" clauses, used by online platforms to prevent their business users from offering their goods or services for better terms elsewhere, recently returned to the antitrust spotlight. MFNs had attracted scrutiny from competition authorities across the European Union ("EU") between 2010 and 2015. That scrutiny led to divergent approaches and outcomes in different jurisdictions, ranging from the prohibition of all, or only wide forms of MFNs, to restrictions based on the market power of the MFN's beneficiary. Recent developments are reopening the debate on the competitiveness (or lack thereof) of MFNs and whether it is appropriate to allow narrow versions of these clauses.

On April 4, 2019, advisers appointed by outgoing EU Competition Commissioner Margrethe Vestager to explore how EU competition policy should evolve in the digital age reported that, because large platforms have an important advantage, strict scrutiny of MFNs applied by platform businesses is appropriate.[2] We have already seen the report's impact on legislative fronts. On June 20, 2019, the EU Parliament and Council adopted a Platform-to-Business Regulation requiring platforms to justify restrictions imposed on their business users regarding offering better terms elsewhere.[3] Moreover, in the context of its review of its Vertical Block Exemption Regulation – which exempts vertical agreements that meet certain conditions from the prohibition on anticompetitive agreements – the European Commission is exploring ways to possibly streamline provisions on MFNs.[4]

Attention is also focusing on MFNs at the Member State level. On May 9 and June 4, 2019, the Stockholm Patent and Market Court of Appeal[5] and the Düsseldorf Higher Regional Court,[6] respectively, confirmed the lawful use by large incumbent online travel agents ("OTAs") of narrow MFNs that prohibit hotels from offering better rates on their own websites than they do on the platform. On June 11, 2019, the Danish hotel booking platform Nustay filed a complaint with the European Commission against Booking.com and Expedia for allegedly enforcing a new type of wide rate parity clause by imposing penalties on hotels if Nustay or other platforms are able to offer more competitive prices for accommodation.

These recent developments underscore the need for a clearer and more consistent approach to the application of competition rules to MFNs.

II. "WIDE" MFNS V. "NARROW" MFNS

Two types of MFNs have been examined by competition authorities in the context of online platforms: first, MFN clauses imposed by a platform requiring its business users not to offer or list lower prices or better terms on their own websites than they do on the platform ("narrow MFN clauses") and, second, MFN clauses imposed by a platform requiring its business users not to offer or list lower prices or better terms elsewhere – on their own websites, on other competing platforms, or on any other online or offline sales channels ("wide MFN clauses"). MFN clauses may also be non-price related, for example requiring a business user to offer the same (or at least equivalent) product range, customer services, or conditions on the platform than on its own website and/or elsewhere.

Between 2010 and 2015, several national competition authorities scrutinized both wide and narrow parity clauses imposed in the online hotel booking sector by Booking.com and Expedia. The examined clauses obliged hotels to offer the OTAs the same or better room prices as the hotels made available on all other online and offline distribution channels, effectively preventing hotels from offering their rooms at a lower price or on more favorable terms on their own websites as well as on other sales channels.

The European Commission declined to investigate, which led to diverging approaches and results across the EU member states.

Germany's Federal Cartel Office ("FCO"), for example, pursued a blanket prohibition approach. It prohibited MFN clauses used by German online travel agent HRS on December 20, 2013 – a decision that was confirmed on appeal by the Düsseldorf Higher Regional Court on January 9, 2015. The FCO then prohibited, on December 22, 2015, both wide and narrow MFN clauses used by Booking.com. In both cases, the FCO found that MFNs prevent the offering of lower hotel prices elsewhere, restrict competition between existing platforms, and make market entry for

2 "Competition Policy for the Digital Era," a report by Jacques Crémer, Yves-Alexandre de Montjoye & Heike Schweitzer, 2019.

3 Regulation of the EU Parliament and of the Council on promoting fairness and transparency for business users of online intermediation services, June 20, 2019.

4 Mlex, "EU's vertical agreements review to include RPM, MFN, selective distribution, official says," June 13, 2019.

5 Hotellbranschen förlorar konkurrensmål mot Booking, Svea hovrätt, May 9, 2019 (in Swedish).

6 Higher Regional Court in Düsseldorf, VI Kart 2/16, June 4, 2019 (in German).

new platforms more difficult, as they prevent new platforms from offering hotel rooms at lower prices. In the case of Booking.com, the company had offered to narrow the scope of these wide clauses so as to limit best price restrictions to the hotels' own websites, but the FCO considered narrow MFNs to be equally restrictive of competition and prohibited both the wide and narrow varieties implemented by Booking.com in Germany. However, on June 4, 2019, the Düsseldorf Higher Regional Court adopted a different approach and annulled the FCO's decision to prohibit Booking.com's narrow MFN clauses. The court's press release indicated that narrow MFNs "*are not restrictive of competition*", but instead are "*necessary*" to ensure "*a fair and balanced exchange of services between the OTA and the hotels*," suggesting that the narrow clauses might in fact be ancillary, and thereby necessary, to platform-to-retail agreements. The court added that OTAs may use narrow MFNs to prevent a "*disloyal redirection of customers from the OTA's portal to the hotels' websites.*" The court will allow a further appeal only under strict conditions, which suggests that the ruling is final.

In contrast to the FCO's approach, in mid-2015 the French, Italian and Swedish competition authorities accepted commitments from Booking.com to narrow the scope of its wide MFN clauses. As a result of these parallel investigations, Booking.com changed its clauses across most EU member states beginning in July 2015; Expedia followed suit by the end of 2015. Similarly to the FCO, the three authorities determined that the use of wide parity clauses is likely to reduce competition between competing platforms, as an OTA has less reason to offer hotels low commissions than it would otherwise, leading to higher prices for hotel rooms. The authorities also determined that wide parity clauses may also have an adverse effect on the ability of smaller platforms to compete or enter the market, as they are not able to differentiate their offerings on price. In a joint statement, the authorities said that contrary to wide MFNs, narrow MFNs strike the right balance, as they help restore competition while simultaneously preserving user-friendly free search and comparison services and encourage the growth of the digital economy as a whole. On May 9, 2019, the Stockholm Patent and Market Court of Appeal confirmed the lawfulness of Booking.com's narrow MFN clauses and concluded that there is a lack of evidence that the narrow clauses restrict competition in the sector.

France and Italy, joined by Austria and Belgium, introduced legislation prohibiting all forms of MFN clauses in the online hotel booking sector (France adopted the *Loi Macron* for Economic Growth in August 2015, which renders null and void all parity clauses imposed by OTAs; Austria and Italy amended their competition rules in November 2016 and August 2017, respectively, banning all MFN clauses in the sector; on July 19, 2018, Belgium adopted an act on pricing freedom in the online hotel booking sector banning all MFNs). In all four of these jurisdictions it is now prohibited to restrict hotels from offering better prices and conditions on their own websites as well as on any other online and offline sales channels.

In a joint report[7] on the impact of antitrust enforcement measures adopted in the online hotel booking sector in recent years, issued on April 6, 2017, the European Commission and the national competition authorities of 10 EU member states suggested that the changes made to MFN clauses generally – both the switch from wide to narrow MFN clauses and the prohibition of all MFN clauses in some jurisdictions – improved competition in the sector, and led to more choice for consumers and lower prices across the participating member states. But with the observed relative lack of awareness about these changes by hotels, and narrow MFNs still being widely used in several of these 10 jurisdictions, it was agreed that the sector should continue to be monitored to ensure that narrow parity clauses do not unnecessarily restrict competition.

The breadth of MFNs and their implications for competition law assessment have been the subject of broader discussion as well. In its final report on its market study on digital comparison tools, issued on September 26, 2017, the UK Competition and Markets Authority ("CMA") expressed its concerns about narrow MFNs becoming broader than is necessary to achieve the efficiencies they can bring, and suggested continued monitoring.[8]

7 Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities in 2016, European Competition Network, April 6, 2017.

8 Digital comparison tools market study, Final Report, September 26, 2017.

III. ANTITRUST ASSESSMENT OF MFNS: A COMPLEX BALANCING EXERCISE

Across the EU, MFNs have largely been considered under the prohibition on anticompetitive agreements, but the use of wide MFNs by dominant platforms could also be found to constitute a breach of the prohibition on abuse of a dominant position because of the concerns it may raise about exclusionary effects. This was the approach taken by the European Commission in the *Amazon E-Books MFNs* case. The Commission had concerns about clauses in Amazon's e-book distribution agreements requiring e-book publishers and suppliers to inform Amazon about more favorable or alternative price and non-price related terms (such as alternative business models, including distribution models) given to competing platforms and to offer Amazon similar or better terms. The Commission determined that such clauses could strengthen Amazon's position on the relevant market by reducing the ability and incentive for e-books suppliers and competing platforms to develop new business models. On May 4, 2017, Amazon offered the Commission to terminate the use of such clauses.

The antitrust assessment of MFNs has become less clear since the *Amazon E-Books MFNs* case. As discussed above, on April 4, 2019, the European Commission published a report[9] prepared by three special advisers (the Advisers) appointed by outgoing EU Competition Commissioner Margrethe Vestager to explore how EU competition policy should evolve in the digital age. The Advisers, all academics, shared the view that MFN clauses may have both pro- and anti-competitive effects, depending very much on the specificities of the markets, making case-by-case analyses necessary. However, because in their view large platforms have an important advantage, they determined that "*strict scrutiny is appropriate.*" They added that where competition between platforms is sufficiently vigorous, it might be sufficient to prohibit wide MFN clauses while allowing narrow MFN clauses. Where competition between platforms is weak, and pressure on the dominant platforms can only come from other channels (e.g. in the online hotel booking sector, from direct sales by hotels on their own websites), they determined it would be appropriate to also prevent narrow MFNs. The Advisers, however, were of the view that given the variety of theories of harm and efficiency defenses that could apply to these practices, and the variety in rule-setting, functions, and designs of platforms, it is impossible to draw general rules about what should be allowed and what should not, and a case-by-case approach is therefore necessary.

While wide MFN clauses used by *large* incumbent online platforms have consistently been found to be problematic across the EU member states, the same might not be true for smaller platforms. The European Commission's Vertical Agreements Block Exemption Regulation ("VABER") exempts vertical agreements from the prohibition on anticompetitive agreements if the parties' market shares do not exceed 30 percent. In fact, in its May 2017 report[10] on the E-commerce sector inquiry, the European Commission suggested that in the absence of a hardcore restriction (e.g. price fixing or market partitioning), MFN clauses in vertical agreements are exempted by the VABER if the parties' market shares do not exceed 30 percent. Even where conditions for application of the VABER are not met (i.e. the parties' market shares exceed 30 percent), an MFN clause could still be subject to an individual exemption under Article 101(3) of the Treaty on the Functioning of the European Union ("TFEU") on the basis of its efficiency benefits (i.e. the clause contributes to promoting technical or economic progress; it benefits consumers; the restrictions imposed are indispensable to the objective pursued; the clause does not substantially eliminate competition in the market). In theory at least, one may argue that Article 101(3) TFEU should therefore apply to both wide and narrow MFNs, depending on the position and competitive relevance of the beneficiary concerned, and even if that beneficiary is a platform. Some EEA member states are likely to adopt a more restrictive approach however when it comes to wide MFNs. In its *Booking.com* settlement decision, the French competition authority determined that where an agreement does not meet all the conditions for exemption under Article 101(3) TFEU, the VABER could be disregarded – which, the authority determined, is likely to be the case for wide MFNs, although it did not reach a firm conclusion on the question.

While the question remains open regarding wide MFNs, a number of national competition authorities have found that narrow MFNs do meet the requirements for individual exemption under Article 101(3) TFEU. For example, the CMA found in its 2014 final report[11] on the Private Motor Insurance market investigation that narrow MFNs in that sector meet all four conditions for an individual exemption. Similarly, in the context of the online hotel booking sector, the French, Swedish, and Italian competition authorities had recognized the consumer benefits of narrow MFNs. The Düsseldorf Higher Regional Court went even one step further and determined that narrow MFNs are *necessary*[12] to the platform-to-business relationship.

9 "Competition Policy for the Digital Era," *op. cit.*

10 Report from the Commission to the Council and the European Parliament. Final Report on the E-commerce Sector Inquiry, Commission Staff Working Document, May 10, 2017, p. 179, para. 621.

11 CMA private motor insurance market investigation, Final Report, September 24, 2014.

12 Higher Regional Court in Düsseldorf, *op. cit.*

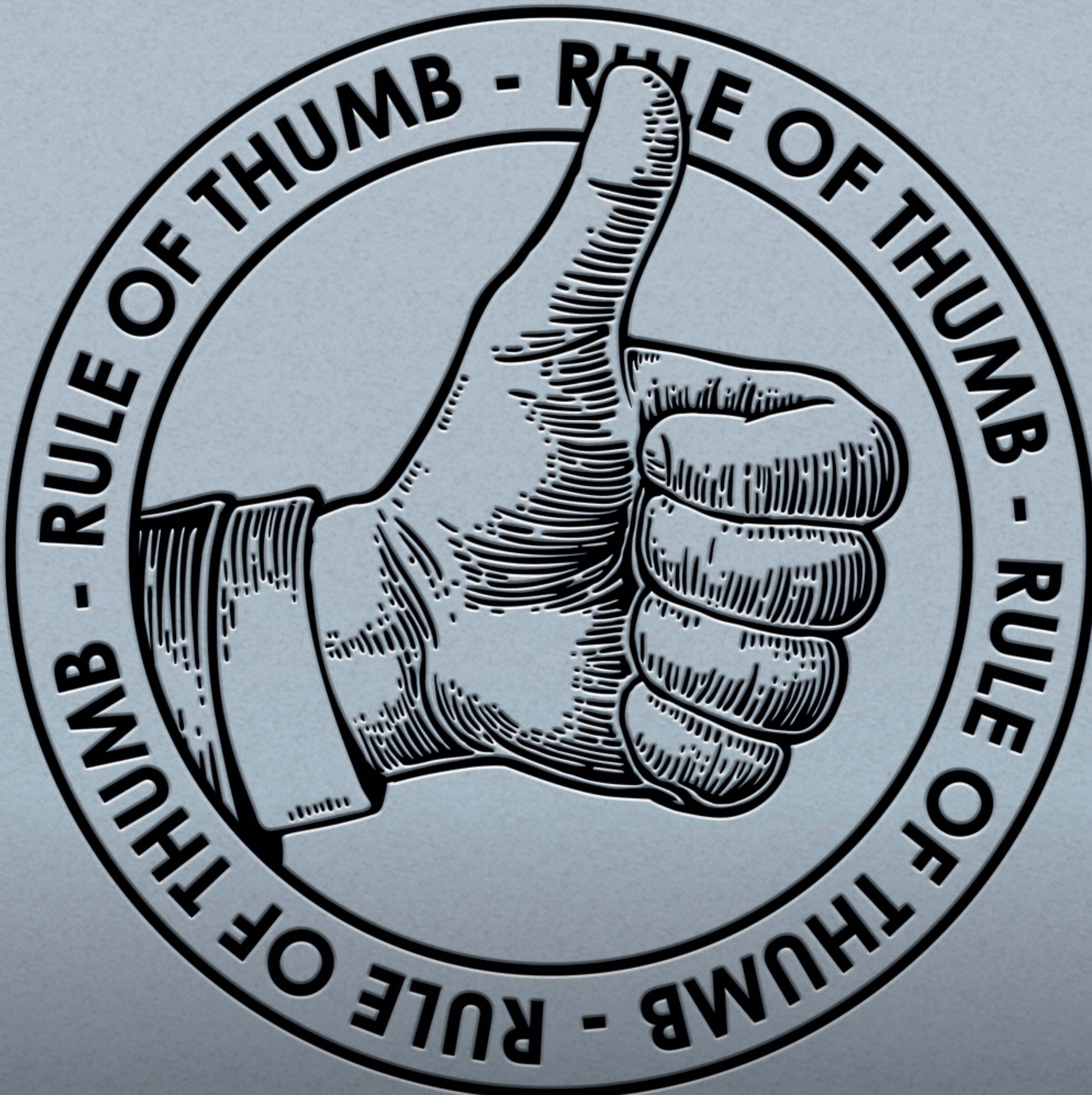
IV. PRACTICAL CONSIDERATIONS AND NEXT STEPS

The use of any form of MFNs in the online hotel booking sector has now been clearly prohibited in France, Italy, Austria, and Belgium, while narrow MFNs in the sector have become lawful in Sweden and Germany following recent court rulings. Both wide and narrow MFNs are still under close monitoring in other jurisdictions, however, including at the European Commission level, as well as in other sectors. Ongoing investigations include the CMA's examination into the use of wide MFN clauses in certain contracts restricting home insurers from quoting lower prices on rival comparison sites and other sales channels. Also, as discussed above, on June 11, 2019, the Danish hotel booking platform Nustay filed a complaint to the European Commission against Booking.com and Expedia for allegedly enforcing a new type of wide rate parity clause by imposing penalties on hotels if Nustay or other platforms are able to offer more competitive prices for accommodation. It remains to be seen whether and how the European Commission's approach will be influenced by the member states' decisions and the recent legislative initiatives and studies in relation to competitive implications of restrictions imposed by or on online platforms.

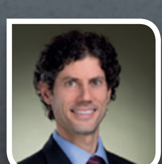
The decisions of the European Commission and member states have illustrated that MFN clauses are most likely to be problematic where used by large incumbent platforms. Divergence in approach to narrow MFN clauses remains, however, and recent enforcement and policy developments highlight the complex balancing exercise that an antitrust assessment of narrow MFN clauses require. The analysis of MFN clauses should take into account the benefits of user-friendly searches, price comparison and booking functionalities, reduced search cost, price transparency, increased consumer choice, enhanced investment and innovation, and lower entry barriers, and identify specifically circumstances in which a concern about price uniformity, reduced competition between platforms and higher barriers for market entry by smaller platforms is justified. An analysis of the permissibility of such clauses is heavily dependent on the specificities of the relevant market, the features of the platforms and the specific efficiencies they bring.

Given the growing international reach of online platforms, and their ever-growing importance to consumers, the clarity and certainty of the legislative and enforcement framework for online platforms is key. The ongoing debate regarding the application of EU competition rules to the digital sphere, the Nustay complaint, and ongoing review of the VABER, due to expire in May 2022, will provide important opportunities for clarification.

REVISITING GUIDANCE ON MFN TERMS



BY BOB MAJURE AND ANDREW SFEKAS[1]

1 Bob Majure is a vice president in Cornerstone Research's Washington, D.C. office. Andrew Sfekas is a senior economist in Cornerstone Research's Washington, D.C. office. The views expressed in this article are solely those of the authors, who are responsible for the content, and do not necessarily represent the views of Cornerstone Research.

I. INTRODUCTION

In 2012, Deputy Assistant Attorney General Fiona Scott-Morton gave a speech that cautioned against "contracts that reference rivals," including most-favored nation clauses ("MFNs") and some forms of volume discounts. While recognizing that these kinds of contracts can generate efficiencies in some cases, she advised companies to avoid using them whenever possible because of their enhanced risk of raising antitrust concerns. That risk was pointedly illustrated by a series of cases brought by the Antitrust Division at this time that featured MFNs in a particularly bad light.

Chief among these cases was *U.S. v. Blue Cross Blue Shield of Michigan* ("BCBSM"),[2] where the MFNs that BCBSM obtained from Michigan hospitals ensured not only the same price but, in some cases, a better price than any rival. Suddenly, MFNs had become a dangerous type of contract provision with no clear guidance on how to tell the good from the bad.

At about the same time, however, in *U.S. v. Comcast Corp. et al.*[3] (settling issues with the *Comcast/NBCU* merger), the Antitrust Division had not only recognized that MFNs could be part of a pro-competitive arrangement, it essentially relied on an MFN concept for a major component of the settlement agreement: under the settlement, the merged entity would have to offer MFN-type arrangements to other content purchasers.

Indeed, the Antitrust Division's use of an MFN in *Comcast* suggests that the advice to avoid these kinds of contract terms whenever possible is incomplete. Economists have established that MFNs can alternately promote or restrain competition and can alternatively enhance or detract from market efficiency. So, the question is whether economists can also offer any practical guidelines on whether an MFN in a particular case is likely to be pro- or anticompetitive — or, more to the point, how an MFN is likely to be viewed if it cannot simply be avoided altogether.

We believe that there are some appropriate rules of thumb for when MFNs are likely to be pro- or anticompetitive. Every negotiation will have its own nuances, but we suggest that a good starting point is to ask where the incentive to offer a better price is expected to come from and what source of power makes the MFN an effective constraint against following such incentives. To illustrate how the answers to those questions are likely to affect antitrust risk, we will re-examine these MFN cases after trying to generalize some of the results in the economics literature.

II. ECONOMIC THEORY AND AMBIGUITY

The academic literature on MFNs is, like the literature on most economic topics, helpful but incomplete from a practical line-drawing perspective. Each paper shows that, under its own specific assumptions about market structure, MFNs become more or less likely to result in higher or lower prices, to achieve particular outcomes, or to increase or reduce the number of competing firms. The literature does not attempt to completely map all possible situations nor to establish a definitive bright line between the positive and negative aspects of an MFN. And, to be clear, we are not going to attempt that either. But, we do hope that by illustrating what these theories have in common and where they differ, we can suggest a framework that may help distinguish the facts in specific cases.

A. A Simplified Anticompetitive Story

The simple story of an MFN's anticompetitive effect is that it makes one party hesitant to negotiate lower prices or better quality with later trading partners. In the typical case, a seller agrees with a first buyer (usually a distributor or retailer) not to offer any better terms to additional buyers. Lower prices and higher quality are generally a good thing, so presumably, an MFN must be bad. In this simple story, we can determine how bad by looking at the price or quality improvements that were rejected. Or, perhaps we layer on some more complications for that calculation. What about the price and quality terms that never happen because the second buyer knows the MFN exists and so never proposes them? Or, to continue this train of thought, what if potential competitors never even attempt to enter the retail market or to explore better ways to distribute the product because it is not worth the investment to become a competitor?

In each of these examples, the seller commits through the MFN to protect the first buyer from future competition. It is obvious why that is good for that first buyer, but presumably, the seller would be better off with more competition among buyers. So, a natural question is why the seller would sign away the prospect of a better future for itself. Typically, the explanation is that the seller needs or values a deal today enough to make this choice rational. That is, the first buyer has enough market power that it can choose to spend some of that power today on extending

2 809 F.Supp.2d 665 (2011).

3 808 F.Supp.2d 145 (D.D.C. 2011).

it into the future. Or, to generalize, one of the hallmarks of the anticompetitive story is that it depends on current market power that is at some risk of being lost.

B. A More Complicated Pro-competitive Story

The pro-competitive story of an MFN is more complicated as it focuses on what the inability to have an MFN would do to negotiations between the original parties. To see this side, it is necessary to think of the MFN less as a constraint on what future buyers might do as rivals and more as a constraint on what the seller would do once the first buyer is locked into a contract. If it is reasonable to fear that a seller will change what it is willing to do for later buyers once it has that first contract, no sane buyer would want to be the first to sign. Potentially, the seller cannot get any buyers to sign and cannot get its product to market at all. More likely, it has to give every buyer terms that assume the seller will operate in the worst possible way towards all of them. In either scenario, an MFN allows the seller to establish from the outset a commitment that defines what the terms are for all buyers — essentially defining the product it wants to offer and not letting the fact of multiple buyers over time define the product down to a lowest common denominator.

As an example, consider the licensing of video content. An important feature of this kind of product is that it is "non-rivalrous" — if a content producer sells it to one person (or one distributor), it can just as easily sell it to another person (or another distributor). So, a would-be distributor of such a product would naturally want some assurance from the producer that it will not act on that ability after the distributor's check is cashed. Perhaps an exclusive or a territorial exclusive works for both parties in this regard and they can move ahead with negotiations. But, perhaps the producer wants to be able to reach distinct but overlapping audiences of customers represented by two or more distributors.

In that case, each would-be distributor may be particularly worried that a later-contracting distributor will offer the seller a share not only of the profits from distributing to that distributor's customers, but also of the profits that could be made again within the first distributor's customers. In this scenario, the seller can potentially gain by giving a later distributor a lower price or other terms that would let that distributor offer a better product and win customers away from the first.[4] The producer may not want to have that change in its incentives kick in whenever it has signed a contract, but as long as it does, all the contracts have to reflect that a distributor will not get what it thinks the producer is offering once these later contracts happen. An MFN helps the seller commit to offer all the distributors a common set of terms and avoid this degradation of its product.

Admittedly, a defense of MFN that equates it to an exclusive may appear to just connect one set of confusing legal concepts to another. In this example, though, the exclusives essentially mirror the underlying IP rights that a producer would, presumably, have over its content. Extending that thought, the MFN is essentially maintaining the IP rights' positive incentives to create something new while allowing that new product to be used by rivals instead of through a monopoly that would have been less efficient.

C. Takeaways from the Two Stories

The positive side of an MFN, then, is its ability to assure every buyer there will be a uniform price and common terms. That assurance is only relevant, though, because of a time-inconsistency in the seller's behavior. The seller would like to assure the first buyer that it will not degrade the value of their contract in the course of negotiating with future buyers, but all parties predict that without such assurances the seller will do exactly that. Recall, however, that it was the unwillingness to engage in a price reduction for later-arriving buyers that was our simple example of a bad effect. That same mechanism is now the way an MFN becomes good. Is an insistence on uniformity of terms good or bad?

We do not usually have a problem with uniformity. Nobody challenges a grocery store for posting prices on its shelves that apply to everyone. There is not a hue and cry over the fact that this implies it will not entertain haggling. Indeed, the key part of most competition models is the idea that a seller will choose to forego some sales it could have made at a lower price because it wants to make profits on customers who will buy at a higher price — a problem that only exists because the higher or lower price is assumed to apply to everyone. Those models may generate a situation that warrants a challenge in some cases, but the culprit is not generally identified as the practice of setting uniform prices.

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4 The incentive to lower price can be a bit confusing here because price determines both the share of profit for the seller and the cost (or competitiveness) of the buyer. It works because the same profit is being "shared" multiple times. But, to make that clearer, imagine this is a market where the seller would like to charge both a franchise fee and a per-unit wholesale price. After collecting the first buyer's franchise fee, the seller would like to maximize the franchise value (and the associated franchise fee) of a second buyer. It can do so by setting a lower wholesale price so the second buyer undercuts the first and wins all the customers that they both reach. Of course, then the whole process could be repeated with a third buyer undercutting the second and so on.

So, in distinguishing MFN effects, we need to take this core mechanism as a given. The refusal to accept some future potential deals is just what makes an MFN relevant; it is not in and of itself particularly helpful in determining if the term represents a restraint on competition. To decide what MFN provisions negotiators should avoid, we need to focus on why certain deals are being discouraged and how that effect is being ensured (or who is gaining from it). If the MFN is a product of one firm's current market power and the deals it precludes are expected to become desirable primarily as a result of that market power weakening, it seems reasonably evident that the MFN likely is a restraint on competition. Conversely, if all of the buyers benefit from the term — recognizing that they may only be equal in an abstract sense of considering them before their order of negotiations is determined — it seems more likely that the enforcement power comes from that commonality of interest rather than some restraint on competition.

The key questions are whether market power led to the MFN and whether it would have come into play without that market power. That is not intended to capture every facet of economic theory in this area. In specific cases, the core mechanics of an MFN may be important or the details of which transactions became possible or were dissuaded may be relevant. And, in some cases, an MFN that originally seemed completely reasonable could become an inefficient drag on an industry's ability to adapt as the world changes in unforeseen ways. But, in the interest of abstracting enough to have a framework for general guidance, it seems that these are the key questions.

III. CONTEXT FROM CASES

Taken together, the recent cases suggest a more nuanced view of when contracts can pro-competitively reference rivals. The MFN provisions that have been most problematic are ones that are part of an overall contractual arrangement to address the potential that rivals might in their own right introduce a more attractive alternative to the contract at hand. And, the power behind enforcing these terms is the current or expected market power of the firm facing these rivals. In contrast, MFNs that address the potential for differences to arise from time-inconsistency or from general changes in an industry over time seem to be accepted as pro-competitive.

A. U.S. v. Blue Cross Blue Shield of Michigan[5]

The case filed against BCBSM in 2010 presents the most obvious example of how an MFN might be constructed to insulate a firm with substantial market power against the possibility that its rivals build their own market presence and become significant rivals. BCBSM was, and remains, the largest health insurer in the state of Michigan and the largest purchaser of healthcare services in Michigan. BCBSM had entered into contracts with Michigan hospitals that included MFN clauses, entitling BCBSM to prices equal to the lowest price agreed to with any of BCBSM's competitors, and, in some cases, MFN-plus clauses, entitling BCBSM to prices that were less than the lowest price agreed to with any of BCBSM's competitors by some agreed-upon amount. Thus, for some hospitals, BCBSM could be assured that its competitors would pay a significantly higher price for the same services. The price gap in this form of MFN is particularly difficult to construe as promoting any form of efficiency. After all, the MFN-plus arrangement specifically *prevented* uniformity of prices and other conditions. The federal and state prosecutors in the case seem to have placed it squarely on the protection-of-market-power side of the test.

B. Marshfield and Delta Dental

Other cases in health care, involving straight MFNs, have found a more mixed reception in the courts, and are more difficult to parse. For example, in *Blue Cross and Blue Shield United of Wisconsin v. Marshfield Clinic*,[6] Marshfield had an arrangement with its affiliated physicians in which Marshfield would pay physician affiliates no more than those physicians charge to any other payer. The court determined that Marshfield Clinic's MFN agreement with physicians was pro-competitive because it indicated the clinic's attempt to get the lowest prices possible. However, in *U.S. v. Delta Dental of Rhode Island*,[7] a case that settled before trial, the government argued that an MFN very similar in form to the Marshfield MFN should be considered anticompetitive. Delta Dental's MFN stated that participating dentists had to give Delta the best rate they gave any other payer. The DOJ's complaint emphasized that Delta's MFN term blocked entry by dental plans that sought to put together limited networks of dentists willing to offer lower-priced services for some part of their business in exchange for higher volume — that is, it preserved Delta's position in the dental insurance market.

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5 809 F.Supp.2d 665 (2011).

6 65 F.3d 1406 (7th Cir. 1995).

7 943 F. Supp. 172 (R.I. 1996).

What would tip the balance on these cases? Size could certainly play a role: Delta was the dominant insurer in its region, while Marshfield was a considerably smaller player. One implication of size may be that Delta had market power which Marshfield did not. But, size can also speak to the credibility of a reasonable purpose for the MFN. A need for parity with Delta is a very hypothetical exercise. It is hard to imagine that the contract was influenced by the prospect of another insurer equivalent to Delta emerging. In contrast, Marshfield could reasonably anticipate competition with other narrow network plans.

C. U.S. v. Comcast Corp. et al.[8]

The *Comcast/NBCU* merger stands in marked contrast to these cases. In 2011, after an extensive review of the video industry, the DOJ reached a settlement allowing the merger to close. While asserting some potential for abuse, the settlement explicitly recognized that some exclusive and MFN-style terms were common in the industry and represented a pro-competitive arrangement. Section V.C.3 of the *Comcast/NBCU* decree expressly allows the merged firm to obtain and enforce such MFNs as long as they are not at odds with the rest of the decree.

In the accompanying Competitive Impact Statement ("CIS"), the government explained that exclusive distribution windows can be important in this industry both to get the best value and, therefore, most incentive to create new content and also as a potentially pro-competitive boost for a new competitor. The CIS discussion assumes an exclusivity term for its exposition. But, as we pointed out above in outlining this kind of situation, the two concepts are linked in this regard. An MFN allows the producer to work with multiple distributors without losing the kind of beneficial incentives to develop content in the first place that are usually ensured by exclusivity.

Another aspect of the *Comcast/NBCU* decree also points out a different innocuous reason for MFN terms. Hypothesizing that Comcast might have different incentives *vis à vis* future online distributors than GE had as the licensor of NBCU content, the decree gives these future entrants the right to impose a form of MFN on Comcast. Specifically, if the entrant could obtain carriage agreements with specific content identified as a peer group to the NBCU content, then the merged firm has to offer its own content on no less favorable terms to the entrant. [9]

The problem that made this style of MFN desirable in the *Comcast/NBCU* decree is that renegotiation to reflect unfolding factual developments is practically impossible in the context of an agreement embodied in a judicial decree. Absent the MFN-like provision, it may not have been possible to establish an agreement before the uncertainty of the future was resolved.

IV. UNDERSTANDING MFNS AS A REGULATORY TOOL

The regulatory use of an MFN-like provision carries its own risks, one of which can be seen in another prominent example — the Medicaid Drug Rebate Program. This program was designed to rein in state and federal spending on prescription drugs. It conditions coverage of a manufacturer's drugs on an agreement to pay rebates to the states which effectively lower the price of the drug to either the best price per unit or to a fixed percentage below the average unit price. While this program did address the historic difficulties of state Medicaid programs negotiating prices with pharmaceutical manufacturers and effectively allowed them to free-ride on the negotiations of other payers, it may have inadvertently raised the prices overall. Economic studies of the Medicaid MFN have suggested that it did raise prices.

The regulatory use of MFN-like provisions illustrates our point that MFNs can resolve important difficulties with negotiation. When renegotiation is costly, but long-term contracts are desirable, MFNs may make contracts possible that would otherwise require exclusive arrangements, or would simply not occur. For example, MFNs have been common in natural gas contracts, where producers and pipeline owners typically commit to contracts with very long terms. In these markets, a typical MFN would guarantee that a pipeline operator will pay the best price in a region to a wellhead producer. The economic literature's discussion of efficiency gains from such an arrangement illustrates why private parties rely on MFN terms in this context rather than renegotiation. Pipeline operators must make costly long-term investments in capacity in order to carry gas, while wellhead producers must also make long-term investments. These investments make long-term contracts desirable lest either side be subject to a hold-up of its investments. However, neither side wants to be locked into a contract that pays less than the market rate, which will likely vary over time as market conditions fluctuate in unpredictable ways. MFNs allow pipeline operators and producers to address this uncertainty of future market conditions within the long-term contract that they both desire. In this sense, the parties are both using an MFN

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8 808 F.Supp.2d 145 (D.D.C. 2011).

9 It may be interesting to note that the settlement between the government and Comcast reverses the usual form of an MFN. It is a commitment on Comcast's part to meet any terms an entrant can obtain with certain other providers rather than a commitment to obtain the same terms from all providers or to offer all entrants the same terms. Each of these variations is a commitment contingent on the strategic choices of rivals. The set of rivals (and the firm making the commitment) may differ but, under the right circumstances, any of these variations of contracts that reference rivals could generate the same ambiguity of effects for the relevant set of rivals as we have presented for an MFN.

to regulate their trading partner (prevent hold-up of their investments) and the term is generally innocuous unless it has the kind of wider-market distorting effect seen in the Medicaid example.

The Medicaid example should stand as an important caveat to the potentially pro-competitive uses of MFNs. If the set of transactions to which an MFN links prices is not large enough and independent enough from the set being indexed, the MFN can lead to negative outcomes for all market participants. While this is generally thought of as a regulatory problem, largely because renegotiation in commercial contexts is generally assumed to be easier, there are also commercial situations that can use MFNs in this way and, potentially, present this same issue.

All of this goes to illustrate that the government's approach to MFNs in *Comcast/NBCU* represents a delicate balance between some positive and potentially negative effects of the terms. This is also reflected in the consent decree itself as a number of safeguards are built in to ensure that the usual and customary contract terms do not become a vehicle for accomplishing indirectly the restraint of new distribution rivals that the government had tried to prevent with its own form of MFN.

V. CONCLUSION

Taken together, the cases suggest that the government appreciates the pro-competitive possibility of MFNs. And, the pattern is, hopefully, somewhat understandable once you look beyond the mechanics of an MFN as a commitment not to offer somebody outside the current negotiation a better price.

For companies trying to make practical decisions, the key questions about the incentives and purposes embodied in specific MFN contracts suggest negotiators examine their own motives. If the point of seeking an MFN is to ensure parity and that what is being agreed to today will not be undermined tomorrow, that is more likely to be acceptable. If the point is to ensure an advantage relative to rivals or to firms that have not yet entered, it is more likely to pose a problem. And, if the MFN term is common in an industry because every firm has the same sort of interest in parity, it probably derives its enforcement power from a much more benign source than if it is enforced by the risk of disrupting terms to one particularly significant market participant. It is also worth keeping in mind the possibility that an MFN can create an issue unintentionally. Negotiators may want to take care to ensure that they can revisit the terms periodically, if that can be done without risking the commitment value.

THE TAX THEORY IN CONDITIONAL PRICING ANALYSIS

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I. INTRODUCTION

Loyalty and bundling arrangements have been the subject of antitrust scrutiny for decades. A comparatively recent development in this respect is the "tax theory" of rival exclusion. The idea is that, when a dominant firm offers discounts conditioned on the buyer's agreement to purchase a minimum percentage of its needs, rivals must not only meet or beat the dominant firm's discounted price to gain a sale; they must also match the discounts the customer will lose if the minimum percentage requirement is not met. This need to match the lost discounts has been described as a "tax" on rivals, and has been argued to lead to anticompetitive foreclosure.[2] The issue has received increased prominence recently, having been relied on by the court in *FTC v. Qualcomm Inc.*[3] to conclude that Qualcomm had engaged in anticompetitive exclusive dealing.[4]

This paper argues that the tax theory is misguided and should play little to no part in an appropriate analysis.

II. TAX THEORY IN THE COURTS

Exclusive dealing and its variants, including bundled and loyalty discounts, have long been understood to raise competition concerns. Dominant firms can deploy these arrangements in a manner that excludes efficient rivals and allows the defendant firm to raise price or otherwise harm consumers. If enough of rivals' customer opportunities are truly foreclosed by one of these arrangements, their costs will increase and their ability to constrain the defendant's market power will be compromised. The result can be higher prices and reduced quality for consumers. In concept, the tax theory is one way to evaluate the potential for these tactics to cause consumer harm.

Although variants of the theory had appeared earlier, the first explicit case discussion of the tax theory was in *Concord Boat v. Brunswick Corp.*[5] in 2000. There, the plaintiffs' expert "testified that Brunswick had monopoly power in the stern drive market [for boats] that enabled it to use its market share discount programs to impose a 'tax' on boat builders and dealers who chose to purchase engines from other manufacturers. He defined the 'tax' as the discount these purchasers gave up by not buying from Brunswick."[6] The Eighth Circuit rejected the argument for two main reasons: first, customers "were not unable to forego Brunswick's discounts" and therefore were not coerced into accepting Brunswick's boat engines; and, second, customers often bought more than the 80 percent required for the discount, suggesting that the "tax" was not the sole motivation for rejecting the plaintiffs' overtures and further negating any idea of coercion.[7] The court ruled, essentially, that loyalty discounts that incentivize buyers are lawful. Discounts that coerce buyers are not.

The tax theory also failed in *Church & Dwight Co. v. Mayer Labs.*[8] There, C&D had discount programs with increasingly larger rebates for 65, 70, and 75 percent of the shelf space at the affected retailer.[9] But, as in *Concord*, the theory of competitive harm was not borne out by the evidence. Of the top 25 retailers, six did not participate at all and some participated only at the lowest levels. These facts, as in *Concord*, negated any concept that the rebates were coercive.

In both cases, the concept of "coercion" was important. A purchase a customer makes based on lower prices or superior quality is the essence of competition on the merits. As *Concord* and *Church & Dwight* both recognized, in contrast, a purchase made because the buyer had little choice or against its will suggests something may well be amiss.[10] The lack of any coercion in the two cases was central to the courts' opinions.

2 See, e.g. Joseph Farrell, Janis K. Pappalardo & Howard Shelanski, *Economics at the FTC: Mergers, Dominant-Firm Conduct, and Consumer Behavior*, 37 Rev. Indus. Org. 263, 267 (2010); Roman Inderst & Greg Shaffer*, Market-share contracts as facilitating practices*, 41 Rand J. Econ. 709 (2010).

3 2019 WL 2206013 (N.D. Cal. May 21, 2019). The author's firm is one of many representing Qualcomm.

4 *Id.* at *85-87. The court referred to this effect as a "surcharge" rather than a "tax," but the terms are synonymous for these purposes. The FTC's expert used the "tax" nomenclature.

5 207 F.3d 1039 (8th Cir. 2000).

6 *Id.* at 1046.

7 *Id.* at 1056-57.

8 868 F. Supp. 2d 876 (N.D. Cal. 2012).

9 *Id.* at 905.

10 See also *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254, 285 (3d Cir. 2012).

A few years after *Church & Dwight*, the tax theory was approved on summary judgment in *Insight Equity v. Transitions Optical, Inc.*[11] The case involved agreements under which Transitions' lenses would be the "preferred" photochromic lenses for optical labs and the exclusive photochromic lenses at some retailers in return for discounts or rebates off the standard prices. The defense argued that, because the plaintiff could have met or beaten all the discounts *profitably*, the discount programs could not be unreasonably coercive. But the court said that the discounts "increase[d] rivals' costs and thus harm[ed] competition."[12] The lack of coercion and the plaintiff's ability to compete for all the affected business did not alter the result.

The most recent decision is *Qualcomm*, where the tax theory was also sustained. The court found that Qualcomm used its market power in modem chips to collect "unreasonably high" royalties for its patents rather than to collect higher prices on the chips. Because much of the technology in the chips is subject to Qualcomm patents, OEM customers are obliged to pay Qualcomm royalties on its patents even if the chips they use are from rivals, not Qualcomm. The district court concluded that customers view the bargain as implicating an "all in" price for rivals' chips that includes an excessive "surcharge" from Qualcomm's patent royalties. The court thus determined that Qualcomm's royalties operate as a tax, not by the customers that actually pay it, but by Qualcomm's competitors selling modem chips because the chip rivals' prices must take into account the royalties on their chips the customers are obligated to pay. As a result, rivals are unable to charge customers as much as they otherwise could, their margins are diminished, and they are unable to compete as effectively with Qualcomm.[13] The effect, the court ruled, was to maintain monopoly power unlawfully. Again, the concept of coercion – so central to the earlier cases – was just ignored. The decision is now on appeal to the Ninth Circuit

Of the four courts to address the tax theory head on, two sustained it and two rejected it on the facts. But how does the theory square with basic economics and competition law principles? Let us turn to those questions now.

III. TAX THEORY ECONOMICS

The concept underlying the tax theory is straightforward. If buying from a rival will lead to a loss of the discounts the customer would otherwise get from the defendant, the rival will have to make the customer whole to gain the sale. This, the argument goes, is one variety of raising rivals' costs, a recognized theory of antitrust liability.

There are at least three defects in this reasoning.

First, the tax theory is not "raising rivals' costs" at all. If effective, the dominant firm's strategy will not raise its rivals' costs; it will reduce their revenues. Nothing about a defendant's discount program strategy will raise a rival's actual unit costs; the effect instead is to force the rival to cut prices further to make up for the customer's loss of some of the defendant's rebates or discounts.

This distinction between raising rivals' costs and reducing rivals' revenues has important implications. If a dominant firm strategy raises the actual costs of rivals, rivals must recover those costs in their selling prices. That necessarily reduces the degree of constraint on the defendant's market power and may allow consumer prices to rise. Rivals cannot reduce prices further to gain share from the defendant because, as a result of the increased costs, they will lose money from doing so. If, however, the strategy is one that effectively forces rivals to reduce their prices, there is no such price-raising effect. Loyalty discounts are, after all, *discounts*; and if both the dominant firm and its rivals are *reducing* their prices, consumers stand to gain.

Second, relatedly, raising rivals' costs alone is not an antitrust problem. Competition *necessarily* tends to increase rival costs, as rivals typically must improve their product offering, add more sales support, sign more effective distributors, and the like in order to keep up. All this takes money, but the expenses in issue are aspects of competition in action, not any kind of anticompetitive effect. A rival's costs may be raised, but consumers pay an effective lower (quality-adjusted) price as a result of the product, sales, and distribution improvements. As the seminal article on the topic explains, raising rivals' costs is problematic only when it enhances the defendant's power over price.[14] A conclusion that conduct is anticompetitive just because it raises the costs of competitors is wrong. The question is the effect on consumers, and changes in the costs of rivals may or may not cause them harm. It depends on the facts.

11 2016 WL 3610155 (D. Del. July 1, 2016). The author's firm represented the defendant in this case.

12 *Id.* at *7.

13 2019 WL 2206013, *supra* note 3, at *85-89.

14 Thomas Krattenmaker & Steve Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209 (1986).

And third, the tax theory has no limiting principle. There is no data point or theorem to calculate how much rival revenues must be reduced before a problem can be identified. Since, as mentioned, all competition tends to raise rival costs or reduce rival revenues, there needs to be some objective metric to determine how much is too much for antitrust purposes. But no such limiting principle has been articulated.

IV. A SUGGESTED APPROACH

Although the tax theory, as currently articulated, is beset with very serious problems, it does provide a valid insight: discounts conditioned on a percentage of the customer's needs affect not only the seller and the customer, but the rival as well. But that should be a starting point for further analysis, not the end of the inquiry.

To determine whether the "tax" effect of a loyalty discount has the potential to be harmful, a first step should be to determine whether the complainant can *profitably* underbid the defendant taking the discounts fully into account. If it can, that should end the inquiry. Under those circumstances, there is no coercion and a complainant has not been foreclosed at all. It just has to reduce its price while still making a profit – a consequence antitrust should encourage.[15] Imposing antitrust liability in this context would have the perverse effect of rewarding a complainant's voluntary decision not to compete.

The more difficult question is what the outcome should be when the complainant cannot profitably meet the defendant's prices net of the "tax." Should that alone be sufficient to make out a case of anticompetitive foreclosure?

The answer should be "no." There can be a variety of reasons why a rival cannot match a defendant's pricing net of loyalty discounts. While some may suggest foreclosure, others do not. An obvious example is where the rival is an inefficient high-cost producer. Practices should not be deemed foreclosing unless they would exclude rivals as efficient as the defendant. As Judge Posner has said:

> The fact that a firm has monopoly power doesn't mean that the law should prevent it from competing. It would be absurd to require the firm to hold a price umbrella over less efficient entrants. . . . Only when monopoly power is used to discourage equally or more efficient firms and thus perpetuate a monopoly not supported by superior efficiency should the law step in.[16]

Both the *Qualcomm* and *Insight Equity* opinions are inconsistent with this approach. The *Insight Equity* court found no relevance in the fact that the plaintiff could profitably meet the defendant's prices. *Qualcomm* did not even address the issue notwithstanding the contrary *Church & Dwight* opinion in the same district just a few years earlier. The court there relied instead on the *margin squeeze effect* of Qualcomm's low chip prices to OEMs on one side and the rivals' need to reimburse the royalty payments on the other – a proposition in direct conflict with the Supreme Court's 2009 decision in *linkLine*.[17]

The equally-efficient rival approach is far from perfect and has a number of critics. As they point out, inefficient rivals can still exert competitive pressure on a dominant firm, resulting in consumer benefit.[18] While an equally-efficient rival framework may allow a dominant firm to exclude inefficient competitors that in fact constrain the firm's power to some extent, any alternatives would reduce the incentives for these less-efficient firms to invest in improving their competitive capacities, and would likely also chill aggressive procompetitive conduct by more successful firms fearful of legal troubles.

The equally-efficient rival paradigm tends to be more objective than the alternatives. In bundled discount cases, for example, the "discount attribution test" applies an equally-efficient rival analysis on an objective basis. Under that test, the court subtracts the total amount of the discount on all products from the price of the product in the bundle accused of excluding rivals. If the "attributed price" calculated on that basis is below the defendant's cost for that product, the bundled pricing will be deemed anticompetitive if competitive harm is shown. If, however, the price is above cost on that basis, the bundle is deemed not to be exclusionary.[19] Firms as efficient as the defendant will be able to match the

15 See Jonathan Jacobson & Daniel Weick, *Countering Exclusion: The Complainant's Obligation*, 81 Antitrust L.J. 423, 431-33 (2017).

16 Richard A. Posner, Antitrust Law 196 (2d ed. 2001); see also Eur. Comm'n, *Guidance on the Commission's Enforcement Priorities in Applying Article 82 of the EC Treaty to Abusive Exclusionary Conduct by Dominant Undertakings*, [2009] OJ C 45/7, ¶¶ 23-24.

17 *Pacific Bell Tel. v. linkLine Communc'ns*, 555 U.S. 438 (2009).

18 See, e.g. Steven C. Salop, *Exclusionary Conduct, Effect on Consumers, and the Flawed Profit-Sacrifice Standard*, 73 Antitrust L.J. 311, 328 (2006).

19 See, e.g. *Cascade Health Sols. v. PeaceHealth*, 515 F.3d 883, 904 (9th Cir. 2008) ("[A] defendant offering a bundled discount, without pricing below cost either the individual products in the bundle or the bundle as a whole, can, in some cases, exclude a rival who produces one of the products in the bundle equally or more efficiently than the defendant."); *Collins Inkjet Corp. v. Eastman Kodak Co.*, 781 F.3d 264, 274 (6th Cir. 2015).

attributed price. If the attributed price is below cost, however, equally-efficient rivals may not be able to match the price and still survive. This comparison between price and the defendant's costs provides an objective measure. Alternatives put the fact-finder largely at sea in trying to determine whether the price is exclusionary.

A similar test can be applied in some circumstances to single-product loyalty discounts. Doing so requires identification of the "contestable" and "incontestable" demand for the product in issue as the argument is that the loyalty discount ties the contestable demand to the incontestable demand (similar to bundling) to achieve a foreclosure effect. An illustration of that concept is provided in the margin.[20] If there is a basis to identify and segregate these separate demands, the discount attribution test can be applied in the same manner as in bundled discount cases: the discounts applicable to the incontestable demand are subtracted from the price of the contestable volume to determine whether the defendant's prices on this basis are below cost. The problem is that it is truly a rare case when incontestable and contestable demands can be separated in this manner. In *Eisai v. Sanofi-Aventis*,[21] for example, the effort failed as there was no *objective* way to determine whether rivals could actually compete effectively for the supposedly incontestable sales in issue. And that will frequently be the case, as determining whether a sale is contestable or not will often depend on subjective analysis of rivals' ability to compete effectively for the "incontestable" sales.[22]

V. CONCLUSION

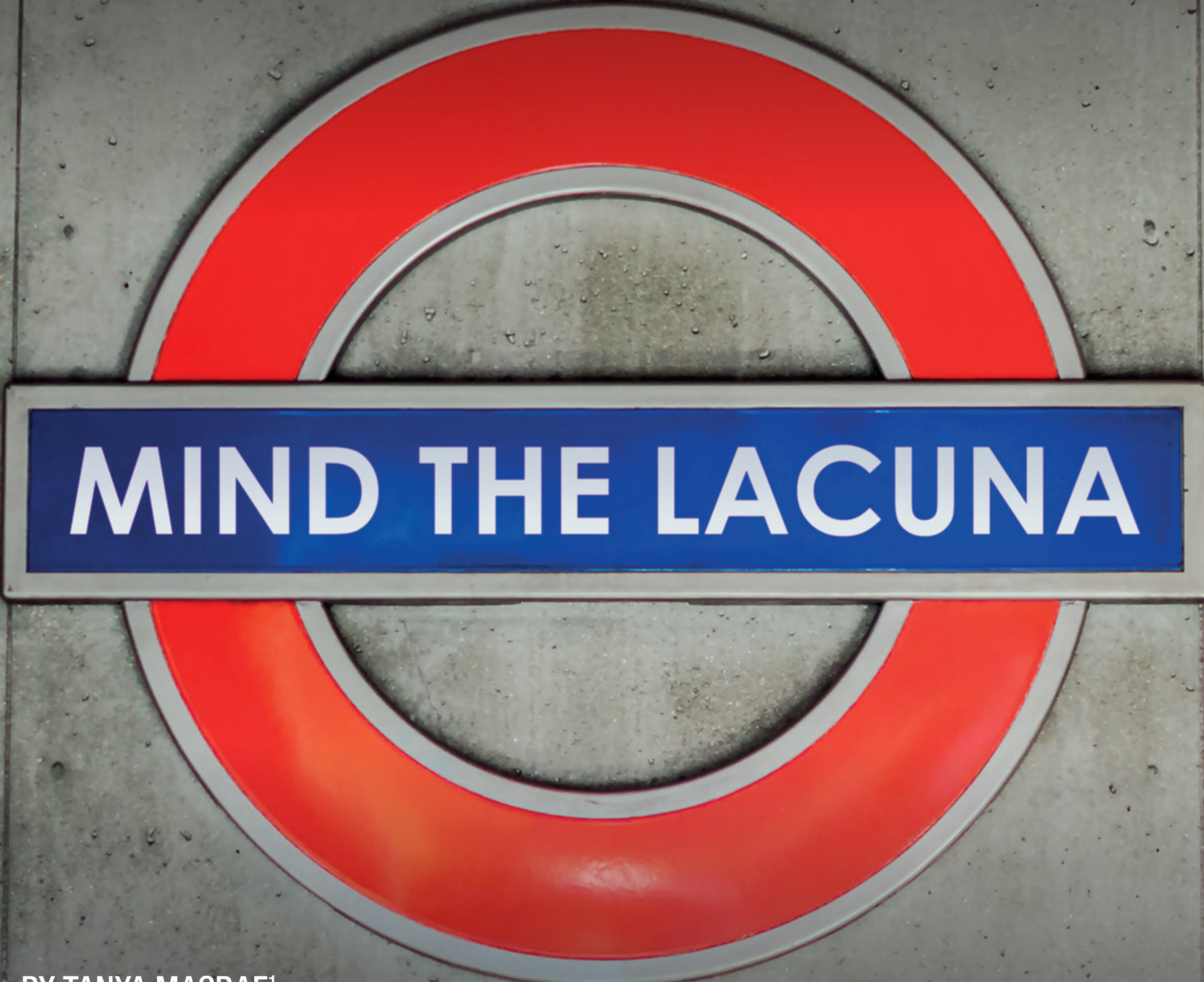
Aside from bundled discount cases and isolated loyalty discount cases where the discount attribution test can be applied, application of the equally-efficient rival test may be difficult. In concept, it requires an analysis of whether the defendant can profitably compete with itself – given the accused exclusionary tactic in question. But while application may be difficult, the equally-efficient rival test still provides the best outcomes – at least until something better comes along – because it asks the right question: are rivals being excluded on the basis of superior efficiency? Asking that question will lead to better answers in just about every case.

20 "To illustrate, suppose that the customer needs 100 units. It must take 50 from the defendant (the incontestable portion) because only the defendant sells a full line with all sizes; no rival sells a full line. The defendant's pre-entry price is $75 but, upon entry, it raises prices to $100, with a 25 percent loyalty discount for customers who agree to take 90 percent or more of their requirements from the defendant. Cost for the defendant and rivals is $60 per unit. If the customer takes 90 or more units from the defendant, and if rivals' prices are also $75, the customer pays $7500 for 100 units. But what if the customer wants to get 50 units from rivals? The 50 units will cost $5000, so rivals must charge no more than $2500 for the remaining 50 (the contestable portion) to make the customer whole. That comes to $50 per unit. Since cost is $60, however, the defendant's sales on the contestable 50 units are below cost — applying the same sort of attribution analysis used in the bundling context." Jonathan Jacobson, *A Note on Loyalty Discounts*, Antitrust Source, at 7 (June 2010).

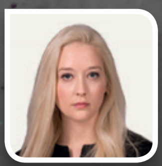
21 821 F.3d 394, 406 (3d Cir. 2016).

22 In the many instances where it is not feasible to segregate the "contestable" volume, a standard rule of reason exclusive dealing analysis should be used. See Jacobson, *supra* note 20, at 7-8.

MFN CLAUSES, FIDELITY REBATES, AND LOYALTY PROGRAMS IN THE DIGITAL ERA: CURRENT STATUS, AND A LEGAL LACUNA?



BY TANYA MACRAE[1]



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I. INTRODUCTION

MFNs and other measures which can reduce customer incentives to switch, such as fidelity rebates, have long been a complex area of European and wider antitrust laws. There is a renewed focus on these clauses, given the prevalence of MFNs in two-sided digital platform markets, and the ECJ's landmark decision in *Intel*. As regulators struggle to get to grips with the implications of the digital economy for competition law, different authorities, including within the EU, have taken seemingly contrasting approaches. This article seeks to evaluate the recent developments and shed some light on the current status. Finally, we ask whether the growing importance of big data, amassed in part by consumer-level loyalty programs, suggests a lacuna in the current EU and UK approach to dominance.

II. MFNS

A. MFN Clauses: Framework for the Analysis

So-called "most favored nation" ("MFN"),[2] "meeting competition" or "most favored customer" clauses require that if the grantor of the MFN offers any improved pricing or changed or better terms elsewhere, it should also offer those terms to the beneficiary of the MFN clause. MFNs may be "wide" or "narrow." A wide MFN is one which applies across the board to capture better pricing offered anywhere by the counterparty; a narrow MFN applies to capture only better pricing offered on the counterparty's website. More on the distinction between the two is provided below.

MFNs may have implications under both Articles 101 and 102 TFEU, when engaged in by dominant firms. As regards Article 101 TFEU, it is clear that MFN clauses do not fall within the narrow category of "by object" restrictions. "By object" restrictions are those – such as price fixing, market sharing or bid-rigging – which are viewed as sufficiently pernicious to be classed as being "by their very nature" restrictive of competition. Agreements which are not "by object" restrictions are assessed for restrictive "effects" on competition. Discussion of MFNs necessarily therefore focuses on their potential to have demonstrable negative effects on competition in a given market or markets.

An obvious consideration is that such clauses may not be entered into for anti-competitive purposes (i.e., the beneficiary may simply be anxious to ensure that it is getting the best deal). However, intent is not a necessary element in establishing a restriction of competition "by effect." The European Commission (the "Commission") has gone some way to recognize this potential for a benign motivation. In its Guidelines on the assessment of horizontal mergers, the Commission, in discussing coordinated effects, refers to:

> [p]ractices which have the effect of easing the monitoring [of deviations from a tacitly coordinated norm] … even when these practices are not necessarily entered into for such purposes. These practices, such as meeting-competition or most-favoured-customer clauses … may increase transparency or help competitors interpret the choices made.[3]

As this suggests, the Commission's guidance has typically treated MFNs as having the potential to reduce incentives to compete on price or other terms, to foreclose competitors (particularly when entered into by dominant firms), and as a potential "…'supportive' measure to make maximum or recommended resale prices work as RPM."[4] This theory of harm is elaborated on in the Commission's Guidelines on technology transfer agreements, for example, which note that:

> [d]irect or indirect price fixing can be made more effective when combined with measures that reduce the licensee's incentive to lower its licensing price, such as the licensor obliging the licensee to apply a most-favoured-customer clause … an obligation to grant a customer any more favourable terms granted to any other customer.[5]

In the digital markets context, scraping tools and pricing algorithms have amplified these concerns and made it easier to detect deviations across a wide range of products.

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2 The term MFN derives from WTO law, which (broadly) requires members to apply tariffs to all nations on the basis of the best terms they have offered to any nation.

3 Commission Guidelines on the Assessment of Horizontal Mergers, para. 51.

4 Commission Guidelines on Vertical Agreements, para. 48.

5 Commission Guidelines on Technology Transfer Agreements, para. 118.

Despite these clear indications in the Commission's guidance as to its concerns over the potential for MFN clauses to have restrictive effects, it is notable that the majority of EU and national competition authority ("NCA") investigations into MFNs have ended with settlements, or been closed with the agreed or voluntary withdrawal of the clauses (a 2017 fine of EUR 1 million imposed on Expedia by the French courts was an exception). This is likely to be because of the difficulty of demonstrating the necessary adverse effects on competition. However, the Commission clearly continues to believe that MFN clauses are capable of having restrictive effects contrary to Articles 101 and 102 TFEU, even if that belief has not yet been tested before the European courts. In a speech by Margarethe Vestager, the European Commissioner for Competition, on June 3, 2019 at the OECD/G7 conference, she described MFNs in highly negative terms, as clauses "which big platforms use to stop sellers from selling cheaper elsewhere, or offering different, more innovative products." Commissioner Vestager stated that she "fully agree[d]… that the Commission will need to watch this issue very closely in the years to come."[6]

B. Amazon E-books – An Example

These price competition softening, market transparency-increasing concerns were reflected in the approach taken by the Commission in *Amazon E-books* (2014 – 2017). *Amazon E-Books* concerned parity clauses between Amazon, a retail provider of e-books, and e-book suppliers. The clauses applied to a wide range of parameters including agency commissions, stock and functionality offered (selection), business models, promotions and pricing. The Commission found that such terms could result in a loss of innovation by suppliers, as well as restricting competition at the retail level.

At the supplier level, for example, the Commission found that selection parity clauses meant that suppliers had a reduced incentive to work with other retailers to develop novel functionality, as suppliers knew that they could also be required to develop Amazon e-reader-compliant versions of any new features/functions. Similarly, in the Commission's analysis, business model parity clauses reduced suppliers' incentives to work with other retailers to develop and support different business models (such as subscription-based pricing). Price and promotion parity clauses reduced suppliers' incentives to agree lower prices elsewhere, for example, in response to a retailer offering to charge a lower commission – as the supplier would know that, under the parity clause, they would be likely to need to replicate the lower pricing offer with the largest retailer, Amazon, without the reduced commission. By reducing the options available to Amazon's retail-level competitors to use innovative models or offer increased functionality or lower prices compared to those available via Amazon, Amazon's retail level competitors were also rendered less able to compete effectively with Amazon.

C. National Approaches

NCAs have also been active in this area, across the EU and beyond. An example is in online hotel booking platforms. Investigations began in 2012 into the use of clauses in contracts between booking platforms, such as Booking.com or HRS, and hotels, which provided that the booking platform must receive the "best price" available anywhere. The clauses were ultimately assessed by 25 national authorities within the EU. This resulted in a variety of national approaches.

In April 2015, for example, the national authorities of Italy, France and Sweden reached a settlement with Booking.com over the clauses, prohibiting wide but allowing for narrow MFNs. By contrast, in Germany, investigations closed with the prohibition of both wide and narrow MFNs. This approach has just been partly overturned on appeal, as the Higher Regional Court of Dusseldorf found on 4 June that narrow MFNs only were permissible.

Other investigations, in Austria, Denmark, France, Greece, Ireland, Italy, Norway, Poland, Sweden and the UK were settled or closed without action when the firms concerned withdrew the clauses. Subsequently, however, the Swiss, French, Italian and Austrian governments went on to ban the use of wide and narrow MFNs. Outside those jurisdictions in which MFNs have been explicitly prohibited, however, the position remains that an effects-based analysis is required. The apparent hardening of views in Switzerland, France, Italy and Austria, and the range of approaches taken by decision-makers across the EU, exemplifies the complexities of this area.

6 M. Vestager, "Competition and the Digital Economy," Paris, June 3, 2019, https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/competition-and-digital-economy_en.

D. MFNs and the Digital Economy

The rise of the digital economy has re-energized many interesting areas of antitrust law. MFNs are one of these, as can be seen from the hotel booking cases, and from Commissioner Vestager's June 3, 2019 speech.[7] Two-sided platforms have become increasingly central to the consumer experience since the digital revolution, and controversy over MFNs now most commonly arises in these markets. To date, outside the hotel booking context, investigations have taken place in online auction services, online shopping sites and in price comparison websites of various types. In the UK, these investigations have closed with commitments (*online auction services*[8]) or remain ongoing (*CompareTheMarket*[9]). MFN clauses were also among the points considered in the recent market study by the UK Financial Conduct Authority ("FCA") into investment platforms, carried out as part of the exercise of its concurrent competition powers. The FCA noted that MFNs "…could create an explicit constraint on the prices a fund manager can set for its own funds across different platforms."

As concerns the potential for restrictive effects on competition, a key fault line lies in the distinction (or lack of it) between wide and narrow MFNs. Some authorities, such as those of Sweden, Italy and Ireland, have distinguished "wide" from "narrow" MFNs. Where the distinction has been made, as in the UK (in the investigation by the Competition and Markets Authority ("CMA") into private motor insurance), Sweden, Italy and Ireland, the approach has generally been to condemn wide MFNs but allow narrow MFNs. However, the Swiss, French, Italian and Austrian prohibitions referred to above apply across the board to MFNs, whether wide or narrow. The criticism attracted by the divergent nature of these approaches, and the resultant uncertainty for business, may be one reason why Commissioner Vestager has sought to place the Commission front and center of the agenda on MFNs.

As it stands, however, this cross-EU patchwork of regulatory approaches gives multi-national companies selling across borders a difficult dilemma. One possible approach is to adopt the most stringent regulatory standpoint and to drop the use of the clauses across European (or wider) operations. This is the approach adopted by Amazon, which dropped its use of the clauses in e-books, first across the EU and then worldwide following investigations in the EU and in Japan. Amazon is now the subject of calls in the U.S. for renewed scrutiny of its wider use of such clauses.[10]

However, though this approach has the potential benefit of simplicity, it could also leave a company at a commercial disadvantage, particularly where rivals have taken a more bullish approach to the risk. A company could find itself in a position whereby it is especially difficult to negotiate preferential terms, as the counterparty knows that any better terms must instantly be offered to all rivals – and yet, the company may not itself benefit from better terms achieved by rivals. In addition, a price comparison website, for example, may rely on MFNs to allow it to state with confidence to users that it shows the best prices. However, in the CMA's investigation into private motor insurance, for example, the CMA states that though this argument had some currency as regards narrow MFNs (i.e. the price comparison website's offering should not be undermined by lower prices on the insurer's own website), it found that consumers did not expect prices shown on price comparison websites to be the lowest available, and instead shopped around on multiple sources including other price comparison websites, to get the lowest quote. It will be interesting to see how this is addressed in the CMA's ongoing investigation into comparison website, ComparetheMarket.

Another approach is to retain the clauses in those jurisdictions where they have not been prohibited outright. A company taking this approach will need to accept the attendant uncertainty as to whether its terms are enforceable – as well as the risk of wasted management time and costs in any future investigation.

In some markets, there may be a more nuanced approach to be taken here. Within the EU, in a cross-border market characterized by several strong competitors, where each party to the agreements which contain the MFN has a market share of 30 percent or less, the Block Exemption for Vertical Agreements ("VBER") will apply. The beneficiary in particular will then need to keep under review not only its own but the counterparty's market share, to assess whether the 30 percent safe harbor may be exceeded. A grace period of one year for shares exceeding 35 percent and two years between 30 and 35 percent applies to allow for adjustment. However, the Commission is entitled to disapply the VBER where networks of similar restraints cover over 50 percent of the market, so a company reliant on the perceived availability of the VBER to mitigate potential risk arising from its use of MFN clauses will also need to be mindful of what others in its market are doing.

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7 *Id.*

8 CMA investigation, *Auction services: anti-competitive practices,* https://www.gov.uk/cma-cases/auction-services-anti-competitive-practices.

9 CMA investigation, *Price comparison website: use of most favoured nation clauses,* https://www.gov.uk/cma-cases/price-comparison-website-use-of-most-favoured-nation-clauses.

10 https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1052515&siteid=190&rdir=1.

Some of these complexities should be addressed in the Commission's review of the VBER.[11] The VBER is set to expire in May 2022 and the review is currently ongoing. A much-anticipated staff working document is planned for Q2 2020 and should shed further light on the Commission's proposals.

III. LOYALTY PROGRAMS AND FIDELITY REBATES

One key focus of companies in agreeing MFNs can be how to make customers more "sticky," by making price promises more attractive and thus reducing customers' incentive to go elsewhere. A second way in which companies may seek to cement relationships with customers is through offering discounts and rebates. Generally, such practices are unproblematic and even pro-competitive when engaged in by non-dominant firms – maximizing consumer welfare through lower pricing being a key focus for European competition law.

However, conditional rebates (as opposed to unconditional discounts) can be structured to induce loyalty or fidelity. Abusive, loyalty-inducing rebates are typically viewed as those which are individualized and retroactive rather than standardized and incremental (though, as always in this area, few rules are hard and fast over time – standardized incremental rebates were at issue in *Michelin II*), and/or which are designed, e.g. by applying only over a certain individualized volume, to ensure that all or the majority of a particular customer's requirements are focused with the dominant firm. The Commission has taken the view that these are akin to exclusive dealing. In the Commission's view, loyalty-inducing rebates can have the effect of foreclosing competitors, leveraging the dominant firm's sway over the non-contestable portion of demand to charge an effective price for the contestable portion of demand that would be uneconomic for its remaining as-efficient competitors, and deterring customers from switching the small portion of contestable demand away from the dominant firm.[12]

After receiving criticism for an apparently rigid or "per se" approach to the assessment of such rebates, the Commission stated in its 2009 Guidance Paper[13] that it may also assess whether the effective price, taking into account the rebate, is such as to exclude an as-efficient competitor to the dominant firm. The question is, essentially, would a competitor need to offer goods at below cost in order to compete with the dominant firm for that customer's demand? The Commission states that effective prices below AAC[14] will be assumed to have this exclusionary effect; between LRAIC[15] and AAC, the Commission will assess the availability of effective counterstrategies by competitors and the likelihood that entry or expansion by as-efficient competitors will be affected.

The *Intel* case exemplifies the shifting sands of EU competition law and policy in this area.[16] Despite the effects-focused approach taken in the 2009 Guidance Paper, the Commission appeared to argue that exclusivity rebates were akin to a "by object" infringement when put in place by a dominant firm, as no demonstration of foreclosure effects was required. In its landmark 2017 judgment, the European Court of Justice ("ECJ") overturned this approach. The ECJ noted the presumption that loyalty-inducing rebates, which tie purchasers to obtain all or most of their requirements exclusively from one supplier, may constitute an infringement when agreed by a dominant firm. However, the ECJ found that where a dominant firm argued that there was no adverse effect on competition as a result of the provision, the Commission must assess factors including the extent of the dominant position, the share of the market covered by the rebate, the conditions for application of the rebate including the amount and the duration, and whether there was any evidence of intent to exclude an as-efficient competitor. Finally, the Commission is required to consider whether any foreclosure effects may be outweighed by efficiencies benefiting the consumer. The *Intel* case has been viewed as an exemplar of the increasing importance of economic analysis in antitrust.

A. Big Data and Loyalty Programs: A Gap in the Law?

Most consumers will be most familiar with loyalty rebates in the form of loyalty programs for supermarkets, coffee shops and other chains, big and small. Customers collect points for each purchase, redeemable against future shopping. Customers may also receive targeted mailshots with

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11 https://www.mlex.com/GlobalAntitrust/DetailView.aspx?cid=1100634&siteid=190&rdir=1.

12 Guidance on the Commission's enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings, para. 39 (the "2009 Guidance Paper").

13 *Id.* para. 41-45.

14 Average Avoidable Cost.

15 Long Run Average Incremental Cost.

16 Case C-413/14 P *Intel Corporation Inc. v. Commission* (September 6, 2017).

particular promotions, and, thanks to the data collected, it is now possible for these to be targeted with a high degree of specificity.[17] As consumer consciousness grows over the collection and storage of personal data by household name brands, the interaction of personal data with competition law becomes ever more relevant. The twists and turns of the ongoing *Facebook* case in Germany have attracted considerable interest in this regard – at the time of writing, the Higher Regional Court of Dusseldorf had just suspended the application of the German authority's landmark decision, to the effect that Facebook's data collection practices constituted an abuse of dominance. The preliminary judgment appears to call into question the newly-forged link between data privacy and Article 102 TFEU.

Antitrust concerns in this area typically focus on two main points: i) the potential for vast banks of amassed data to support dominance, deter entry and inhibit expansion; and ii) the capacity for data to be used to deter switching by customers. The latter is most often discussed in the context of social media. On such platforms, so the theory goes, users may be deterred from switching to new platforms by the difficulty of moving amassed photographs and contacts with them. Similarly, entrant platforms may find it difficult to be as attractive to users as incumbents, lacking familiarity with each customer's long-established, incrementally built up news and advertising preference profiles. The UK Government's Furman Report (the "Furman Report") added to the calls for data portability as a solution to such concerns.[18]

Sectors which currently remain primarily bricks and mortar, such as supermarkets, where loyalty programs are most often encountered, remain highly competitive in the UK. However, it is not difficult to picture a situation in which a single supermarket digitizes more effectively than rivals, and quickly gains a large, but possibly not dominant, percentage of customer spend. Could the data it amassed on those customers enable it to offer targeted, conditional promotions, with fidelity rebates on frequent purchases (say household staples such as bread or milk, often already used by supermarkets as loss leaders) sufficiently attractive to foreclose competitors? Below cost pricing of this nature, funded by a sufficiently deep-pocketed investor base, could help exclude remaining as-efficient competitors.[19]

Some new economy firms have attracted significant investment, with investors seemingly content that such firms should remain loss-making for lengthy, multi-year start up periods.[20] In our hypothetical online supermarket example, similar investor loss insensitivity could allow for the funding of such a promotional campaign. Once dominance had been achieved, the strategy could be continued as needed to maintain the position gained – leveraging the ever-increasing amounts of data gleaned from the loyalty program, in a closely targeted manner. It no longer seems far-fetched to envisage narrow targeted promotions focused, for example, on customers living close to a key bricks and mortar alternative supplier, or (as tracked by cookies) showing a propensity to search on competing providers' sites, to foreclose competitors from the residual share of demand. In addition, as noted in the Furman Report, personalized pricing could also be deployed to the detriment of consumers, particularly after dominance had been obtained – perhaps as part of a more tailored recoupment strategy.[21]

The EU guidance focuses, as stated above, on the potential for a dominant firm to exclude an as-efficient competitor. Competition law in the EU and UK already has the tools available to address predatory pricing and the abusive use of loyalty-inducing measures – but only when engaged in by firms which are dominant. By contrast to the U.S. Sherman Act, for example, under which monopolization itself can be impugned, there is arguably a gap in UK and EU law for non-merger, unilateral steps taken on the road to dominance. This has been brought sharply into relief by the rapid growth of new technology players such as Facebook and Uber.

17 C. Duhigg, *How Companies Learn Your Secrets*, New York Times, February 19, 2012, https://www.nytimes.com/2012/02/19/magazine/shopping-habits.html.

18 *Unlocking digital competition: Report of the Digital Competition Expert Panel*, March 2019, Recommended Actions 2 and 3, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.

19 Uber, for example, is understood to have raised at least USD 14 billion in venture capital funding, along with USD 6 billion in debt. *See* Heather Somerville, *Cashing out in Uber's IPO: China, Russia and the Middle East*, Reuters, May 10, 2019, https://uk.reuters.com/article/uk-uber-ipo-investors/cashing-out-in-ubers-ipo-china-russia-and-the-middle-east-idUKKCN1SG0CJ.

20 See Alexis C. Madrigal, The Atlantic, April 2019, *The Uber IPO Is a Landmark*, https://www.theatlantic.com/technology/archive/2019/04/ubers-ipo-historic-despite-its-10-billion-loss/586999/; Financial Times, *Uber: Loss Decade,* August 8, 2019, https://www.ft.com/content/8b5d1150-ba47-11e9-8a88-aa6628ac896c; Lina M. Khan, *Amazon's Antitrust Paradox*, 126 Yale L.J. (2016).

21 Furman Report, *supra*, note 18, para, 3.164 – 3.168.

IV. CONCLUSION

Antitrust authorities worldwide are still in the process of coming to terms with the transformational potential of the digital economy for competition law. Given the cross-border, cross-jurisdictional nature of digital markets, cooperation between authorities will be critical. The fast emergence of new markets and the ability for new players rapidly to gain large shares of demand, presents a serious challenge to current antitrust models. Such innovation has brought considerable benefits to consumers, in terms of increased convenience and new products and services. Antitrust authorities are anxious to safeguard the innovative potential of markets – hence the concern over Amazon's business model parity clauses, which the Commission found likely to stifle service delivery innovations such as subscription models in the e-book sector – and the related questions raised by the Furman report over possible under-enforcement in merger control in the digital sector. In addition, authorities will be increasingly alert to the possibilities of network effects and tipping towards dominance, though these can be difficult to address using current tools. In the UK, among the many other topics we can expect to see on its agenda, the possibility for consumer level loyalty programs to leverage big data to restrict competition could be a worthy initial priority for the Furman Report's mooted Digital Markets Unit.[22]

22 *Id.,* Strategic Recommendation A.

RETAIL MFNS AND ONLINE PLATFORMS UNDER EU COMPETITION LAW: A PRACTICAL PRIMER

BY SARAH LONG[1]

1 Partner at Euclid Law. The opinions expressed in this article are personal and do not constitute legal advice. I am very grateful to André Jacinto for his extensive research assistance in drafting this article. However, all errors and omissions are my own.

I. INTRODUCTION

Much has been written about most favored nation clauses or agreements ("MFNs") in the context of online platforms, and the challenges faced by competition authorities in assessing the potential anti-competitive nature of such agreements. The perceived absence of a clear legal framework, and the lack of co-ordination between competition authorities in their approach to assessing such clauses, has resulted in significant uncertainty. This uncertainty is felt most keenly by companies and businesses struggling to understand whether the MFNs they have agreed to are on the right side of the law. This article aims to build upon the existing literature and provide a practical framework for the assessment of retail MFNs in the context of online platforms under EU competition law.

The article proceeds as follows: a recap on retail MFNs in the context of online platforms; the application of the Vertical Block Exemption Regulation ("VBER") to retail MFNs (including an assessment of whether retail MFNs are equivalent to RPM); an assessment of retail MFNs under Article 101 TFEU (including whether retail MFNs should be considered as object or effect infringements, and the challenges associated with wide and narrow retail MFNs); and an assessment of retail MFNs under Article 102 TFEU. The article then concludes with a suggested policy approach for the treatment of retail MFNs.

II. A RECAP ON MFNS: WHOLESALE, RETAIL, AND THE ONLINE PLATFORM MODEL

MFNs are not a new concept. There have been agreements akin to MFNs for many years, and the European Commission (the "Commission") has been considering agreements that contain MFNs for over 50 years.[2] However, earlier consideration of MFNs generally focused on what can be described as "wholesale" MFNs, i.e. an MFN relating to the wholesale price of a good. This type of MFN may be to the advantage of a seller (a most favored supplier clause, in which the buyer agrees not to offer more favorable terms to other sellers) or to the advantage of a buyer (a most favored customer clause, in which the supplier agrees not to offer more favorable terms to other customers).

With the proliferation of online platforms, this business model has given rise to a new type of MFN – the so-called retail or platform MFN. The fundamental difference between the traditional wholesale MFN and the retail MFN is the identity of the customer. While wholesale MFNs are generally agreed in the context of B2B transactions, i.e. a supplier selling a product to a buyer not active in the retail market, a retail MFN is agreed in the context of a B2C transaction, i.e. it relates to the price charged to the end consumer. In a wholesale model, the agreement governs the price at which the supplier will sell to the retailer, but the retailer determines the final retail price to the consumer. In contrast, in a retail model (sometimes called an agency model – discussed further below) the supplier determines the final retail price that the product will be sold for on the online platform and will then pay a commission to the online platform for each sale made.

Another important distinction between wholesale and retail MFNs is the bifurcation of a retail MFN in an online setting into two types: wide and narrow. A wide MFN is an agreement between an online platform and a retailer that prevents the retailer from offering a better deal on another online platform. A narrow MFN prevents the retailer from offering a better deal on its own direct to consumer website. Usually the MFN will focus on restricting price, but it may go further and restrict non-price offerings. MFNs are often prevalent across a market (as online platforms may agree MFNs with most or all of their retailers). This results in a network of agreements that, taken together, can effectively prevent retailers from providing a more competitive offering on alternative sales channels.

2 Bostoen, F. (2017), "*Most Favoured National Clauses: Towards an Assessment Framework Under EU Competition Law",* European Competition and Regulatory Law Review 2017, Volume 1(3).

The distinction between wholesale and retail MFNs is important to make, as it may partially explain the renewed focus on MFNs by competition authorities. While wholesale MFNs were on the Commission's radar, they never really became an enforcement priority. However, that could potentially be explained by competition authorities tending to be less incentivized to investigate undertakings involved in pure B2B transactions than for B2C transactions. Competition law is, after all, focused largely on the concept of the consumer welfare standard, and competition authorities are consequently motivated predominantly by the benefits for consumers. With the significant increase in e-commerce and the dramatic rise in the use of online platforms by consumers,[3] it is not unexpected that competition authorities have demonstrated a new-found interest in retail MFN clauses. Wholesale MFNs are arguably not as problematic as retail MFNs because retailers retain their freedom to vary their retail prices across all channels. In contrast, in retail MFNs, suppliers determine the final retail price (rather than retailers), and the online platforms then require suppliers not to offer lower final retail prices through any other online channels.[4] Retail MFNs have therefore been shown to result in higher prices, whereas the same effect has not been seen in MFNs within a wholesale model.[5]

Assessing retail MFN clauses under competition law is challenging because it is not straightforward. Indeed, much of the literature on retail MFNs focuses on the absence of a clear legal framework for assessing such clauses, and on the lack of co-ordination between competition authorities in their approach, with the risk of inconsistent outcomes.[6] While some comment that a framework is emerging,[7] and that recent case law does demonstrate more convergence than divergence, there remains insufficient legal certainty. This results in significant challenges for companies in carrying out an assessment of the legality of these clauses and the very real prospect of both Type I and Type II errors i.e. both under and over enforcement.

This article, while acknowledging the limitations of current case law in this area, aims to provide a practical framework for the assessment of retail MFNs, and a policy proposal for guidance in this area.

III. STEP 1: ASSESSMENT UNDER THE VBER: A NEED FOR CLARITY

Strictly speaking, a retail MFN is a vertical agreement between a supplier and a retailer. As such, if the market share thresholds are met i.e. both the supplier and retailer are under 30 percent, then the MFN should benefit from the VBER.[8] However, the VBER and the Guidelines on Vertical Restraints ("VGL")[9] are both silent on the issue of MFNs.[10] The Commission's current VBER consultation has identified the lack of clarity around MFNs as being one of the major trends motivating the need for a revision of the VGL, and this is something that has been reflected in the submissions received by the Commission as part of the public consultation on the VBER. Specifically, respondents have commented on the insufficient legal certainty in the treatment of MFNs under the VBER, the incoherent application of the current rules and the fact that MFNs may not generate efficiencies.[11] However, there is unlikely to be any real clarity on whether the Commission intends to amend the VBER to provide more guidance on the treatment of retail MFNs until 2020.[12] In the meantime the VBER provides no clear guidance as to whether it offers protection for retail MFNs or not.

3 European Commission, "*Final Report on the E-commerce Sector Inquiry*," (Staff Working Document) SWD (2017) 154: e-commerce in the EU has grown from 30 percent in 2007 to 55 percent in 2016, page 10 https://ec.europa.eu/competition/antitrust/sector_inquiry_swd_en.pdf.

4 See Fletcher, A. & Hviid, M. (2014), "*Retail Price MFNs: Are they RPM 'at its worst'?*," CCP Working paper 14-5.

5 See Johnson, J. (2017), "*The agency model and MFN clauses*," The Review of Economic Studies, Volume 84(3).

6 See Akman, P. & Sokol, D. (2016), "*Online RPM and MFN under Antitrust Law and Economics*," Review of Industrial Organization.

7 See Bostoen, *supra* note 2.

8 Commission Regulation (EU) No.330/ 2010 ("VBER").

9 Commission Guidelines on Vertical Restraints OJ C 130 (2010) ("VGL").

10 See Schmidt, J.P. (2013), "*Antitrust Developments in the Food Sector in the EU*," 34 ECLR 5.

11 See European Commission, *Factual Summary of the Contributions received in the context of the open public consultation on the evaluation of the Vertical Block Exemption Regulation (EU) No 330/ 2010*, https://ec.europa.eu/competition/consultations/2018_vber/factual_summary.pdf.

12 European Commission, *EU competition rules on vertical agreements – evaluation,* https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-5068981_en.

A. Are Retail MFNs Just Another Form of RPM?

In recent years, various academics and commentators have suggested that MFNs should have the same legal treatment as resale price maintenance ("RPM") because of the similar anti-competitive effects that both produce. In fact, it has been argued that some retail MFNs are worse than RPM and therefore even more harmful to competition.[13] This is because retail MFNs have both a vertical element, where the supplier sets a final retail price, and a horizontal element where the supplier sets identical retail prices across all online platforms. While RPM agreements only affect the relationship between a supplier and a customer, retail MFNs have the aim of manipulating the minimum price across all online platforms (a wide MFN), and in some cases the direct to consumer channel as well (a narrow MFN). This feature of retail MFNs was identified as a concern in a 2013 OECD Roundtable in which the UK competition authority emphasized that retail MFNs "*have the potential to exacerbate the possible harm from RPM by explicitly introducing a horizontal element to an otherwise vertical agreement.*[14] Consequently, it is argued that retail MFNs should not be treated any less harshly than RPM.

In the EU, RPM is considered to be an object infringement and is therefore a hardcore restriction under the VBER.[15] If a vertical agreement contains a hardcore restriction, then the entire agreement is excluded from the VBER and will have to be individually assessed under Article 101. In principle, it is possible to justify the restriction under Article 101(3), and the efficiencies of RPM have been recognized by the Commission, for example where a manufacturer introduces a new product.[16] However, there remains a presumption that the conditions for an efficiency justification will not be met, and there has been no EU Court judgment or Commission decision in which it has been confirmed that RPM is objectively necessary to achieve a legitimate aim. Therefore, in practice, RPM is presumed to restrict competition and cannot benefit from the VBER.

As yet there have been no cases brought by competition authorities in which a retail MFN clause has been explicitly stated to be equivalent to RPM. However, there is a growing body of thinking which equates the harm caused by retail MFNs to that of RPM, and there remains a realistic prospect of a competition authority adopting this approach.[17] Indeed, the VGL suggest that MFNs could be considered as "*supportive*" measures enabling indirect RPM to be more effective.[18] The VGL does go on to note that the use of such supportive measures "*is not considered in itself as leading to RPM.*" However, it nonetheless seems unwise for companies to rely on the protection of the VBER for retail MFN clauses. There is currently insufficient evidence to suggest retail MFNs would benefit from the VBER's safe harbor, and a real risk that certain retail MFN clauses could be considered equivalent to RPM, a hardcore restriction, meaning the protection of the VBER falls away. It should also be recognized that, as retail MFN clauses are generally agreed with large online platforms, such platforms are likely to exceed the 30 percent market share threshold,[19] so the VBER would not apply in any event.

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13 See Fletcher & Hviid, *supra* note 4.

14 See United Kingdom, *"Policy Roundtable on Vertical Restraints for On-line Sales*," (Written Submission) DAF/COMP (2013)13 at page 149 http://www.oecd.org/competition/VerticalRestraintsForOnlineSales2013.pdf.

15 VBER, *supra* note 8, article 4(a) and VGL, *supra* note 9, at paragraphs 47-48.

16 VGL, *supra* note 9, at paragraph 225.

17 In Case B9-66, *HRS-Hotel Reservation Service*, December 20, 2013 ("HRS"), the *Bundeskartellamt* left open the question whether MFN clauses are non-exemptible hardcore restrictions at page 4 https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Entscheidungen/Kartellverbot/B9-66-10.pdf%3F__blob%3DpublicationFile%26v%3D3.

18 VGL, *supra* note 9, paragraph 48.

19 See *HRS*, *supra* note 17, at page 58.

IV. STEP 2: APPLICATION OF ARTICLE 101: OBJECT OR EFFECT?

If the VBER does not apply, the next step is to consider the application of Article 101 and whether retail MFNs should be considered as infringements by object or by effect. To date, there has been a notable reluctance by EU competition authorities to qualify retail MFNs as restrictions by object, and competition authorities have been consistent in assessing retail MFNs as restrictions of competition by effect. However, there does appear to be a consensus that certain retail MFNs are likely to be very problematic from a competition law standpoint, even if the competition authorities stop short of confirming them to be an object infringement. Nonetheless, the somewhat inconsistent approaches by competition authorities, in particular to the treatment of wide and narrow MFNs, has left considerable uncertainty as to how Article 101 should be applied.

A. Narrow v. Wide MFNs: A Competition Law Catch 22

The Commission published its Final Report on the E-commerce Sector Inquiry (the "Report") in 2017. Although the Commission did not formally draw a distinction between narrow and wide retail MFNs, the Report found that MFNs "*can provide disincentives for retailers to compete*" and concluded that this "*may ultimately lead to a reduction of intra-brand competition*," meaning competition between different retailers to sell the same branded product.[20] The Commission also found that MFNs may reduce competition between online platforms and retailers and make entry for new online platforms more difficult. However, at the same time, the Commission acknowledged the necessity for online platforms to recoup their investments and the need to avoid free-riding. The Commission concluded that MFNs should be analyzed and assessed on a case-by-case basis.

The UK *Competition and Markets Authority* ("CMA") considered both wide and narrow retail MFNs as part of the Private Motor Insurance Market Investigation ("PMI"). On March 18, 2015, the CMA issued an Order banning wide MFNs between online platforms and insurers. The CMA found that, by restricting an insurer's ability to set different prices on different sales channels, wide MFNs limited price competition and innovation, and could restrict entry into the market.[21] In its Final Report on the Digital Comparison Tools Market study ("DCT"), the CMA appears to build on this view, stating that wide MFNs are likely to be anti-competitive because they "*soften competition between [online platforms] and lead to higher prices to consumers.*"[22] In November 2018, the CMA issued a statement of objections to ComparetheMarket Ltd. ("CTM") alleging a breach of UK and EU competition law as a result of the wide retail MFNs imposed by CTM in certain contracts with home insurance providers. After reviewing the evidence, the CMA provisionally found that the MFNs "*could be causing customers to miss out on better home insurance deals.*"[23] This investigation builds on the CMA's work in the sector following the DCT market study. It should be noted that while the CTM case has been brought under Chapter I of the Competition Act 1998 ("CA98") and Article 101, the investigations into PMI and DCTs were both under the CMA's market investigation regime, which allows the CMA to investigate markets without applying either Chapter I or Chapter II of CA98.[24]

The CMA and the German *Bundeskartellamt* ("BKA") have also both investigated Amazon's use of wide retail MFNs, which imposed on sellers an obligation that their products be offered at the most favorable price via Amazon Marketplace compared to other online platforms. Only when Amazon announced that it would eliminate the MFN clause did the CMA and the BKA close their investigations.[25]

The CMA has therefore been relatively consistent in its approach to wide retail MFNs. However, the approach to narrow retail MFNs is less clear. Although narrow retail MFNs clearly raise competition concerns in at least some markets, they may also lead to efficiencies and prevent free riding. In the Final Report on the PMI investigation, the CMA stated that the restriction on competition imposed by narrow retail MFNs "*was unlikely to be significant.*"[26] Additionally, narrow retail MFN clauses "*might be necessary*" for the viability of the current online platform business

20 Final Report on E-commerce Sector Inquiry *supra* note 3, at paragraph 622.

21 Competition & Markets Authority, "*Private motor insurance market investigation*," (Final report) 2014 ("PMI") at paragraphs 8.35-8.39 https://assets.publishing.service.gov.uk/media/5421c2ade5274a1314000001/Final_report.pdf.

22 Competition & Markets Authority, "*Digital Comparison tools market study*," (Final report) 2017 ("DCT") at paragraph 4.94 https://assets.publishing.service.gov.uk/media/59c93546e5274a77468120d6/digital-comparison-tools-market-study-final-report.pdf.

23 Competition & Markets Authority, "*ComparetheMarket home insurance deals could deny people better prices*," https://www.gov.uk/government/news/comparethemarket-home-insurance-deals-could-deny-people-better-prices.

24 Market Investigation References: Guidance about the making of references under Part 4 of the Enterprise Act, OFT 511, March 2006, paragraphs 2.2 to 2.4.

25 European Competition Network Brief, "*Germany and United Kingdom: Antitrust Cases against Amazon formally closed*," https://ec.europa.eu/competition/ecn/brief/05_2013/brief_05_2013.pdf.

26 PMI Investigation, *supra* note 27, at paragraph 8.68.

model, and "*might play a role*" in reducing consumer search costs.[27] They were therefore excluded from the CMA's Order prohibiting wide retail MFNs. Following the DCT market study, the CMA did not find that narrow retail MFNs gave rise to an adverse effect on competition. However, the CMA stated that it would remain interested in these clauses because "*they could go beyond what is necessary to achieve the efficiencies they bring.*"[28] In 2017, the CMA closed[29] a parallel investigation into Online Travel Agents ("OTA") following a European Competition Network ("ECN") report on the monitoring of pricing practices in the online hotel booking sector.[30] The CMA considered it too early to reach any conclusions on whether narrow retail MFNs give rise to competition concerns, but did not rule out taking action in the future.[31]

Across the rest of the EU, the approach to wide and narrow retail MFNs remains uncertain as well. In 2015, the French, Italian, and Swedish competition authorities, in coordination with the Commission, closed their proceedings after accepting commitments from Booking.com.[32] These commitments made Booking.com abandon the wide retail MFNs but allowed them to retain the narrow retail MFN clauses. In Germany, the BKA has gone one step further and in December 2015 banned both wide and narrow retail MFNs.[33] The BKA found that narrow retail MFNs were equally as harmful as wide retail MFNs, since they disincentivize lower prices overall and prevent new online platforms from entering the market. The President of the BKA, Andreas Mundt, also stated that narrow retail MFNs offer "*no apparent benefit for the consumer.*"[34] Since the Booking.com case, various Member States seem to be moving closer to the German view that narrow retail MFNs can have the same restrictive effect as wide retail MFNs. Indeed, in spite of their settlement with Booking.com (which permitted narrow retail MFNs), both France and Italy have since introduced legislation which provide for an absolute ban on retail MFN clauses (both narrow and wide) in contracts between hotels and OTAs.[35]

B. The Pros and Cons: Anti-competitive Effects and Efficiencies of MFNs

The different approaches taken by competition authorities towards retail MFNs creates significant uncertainty as to whether this type of conduct infringes Article 101. However, there are clearly some types of retail MFNs that are problematic from a competition law perspective, particularly MFNs that have the following effects:[36]

- Creating barriers to entry and/or impeding market entry of new platforms;
- Facilitating collusion or dampening oligopoly competition;
- Price uniformity;
- Dampening of incentives to invest and innovate;

27 *Ibid*. paragraph 61.

28 DCT study, *supra* note 22, at paragraph 4.101.

29 Competition & Markets Authority, "*Hotel online booking: monitoring of pricing practices of online travel agents*," https://www.gov.uk/cma-cases/online-travel-agents-monitoring-of-pricing-practices.

30 European Commission, "*Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities*," (2017) https://ec.europa.eu/competition/ecn/hotel_monitoring_report_en.pdf.

31 Competition & Markets Authority, "*CMA closes hotel online booking investigation*," https://www.gov.uk/government/news/cma-closes-hotel-online-booking-investigation.

32 European Commission, "*Antitrust: Swedish, French and Italian competition authorities obtain commitments in online hotel booking sector*," https://europa.eu/rapid/press-release_MEX-15-4819_en.htm.

33 *Bundeskartellamt*, Case B 9-121/12, *Booking.com*, 23 December 2015 https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Entscheidungen/Kartellverbot/B9-121-13.pdf?__blob=publicationFile&v=2.

34 *Bundeskartellamt*, "Narrow 'best price' clauses of Booking also anticompetitive," https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2015/23_12_2015_Booking.com.html.

35 See France, Article 133 of *LOI no. 2015-990 du 6* août 2015 pour la croissance, l'activité et l'égalité des chances économiques (also known as Macron Law); and Italy, Article 1(166) of the Legge 4 agosto 2017, n. 124, annuale per il mercato e la concorrenza.

36 See Dias, F.G. & Bennett, M. (2015), "*The law and economics of most-favoured nation clauses*," 1 Competition Law & Policy debate 26; Akman, P. (2016), "*A competition law assessment of platform most-favoured-customer clauses",*" 12 Journal of Competition Law and Economics 781; and Ezrachi, A. (2015), "*The Competitive Effects of Parity Clauses on Online Commerce*," Oxford Legal Studies Research Paper No. 55/2015.

Nonetheless, a number of pro-competitive efficiency arguments for MFNs have also been identified, including:[37]

- Reduction of "free-riding" problems;
- Lowering of sales costs and sales prices;
- Mitigation of hold up problems;
- Increased price transparency for consumers;
- Reduction of transaction and (re)negotiation costs;
- Reduction of delays associated with contractual negotiations.

Since retail MFNs are characterized by both pro and anti-competitive effects, there is a relatively strong body of opinion that they should be assessed as "by effects" restrictions.[38] However, the focus on effects may be explained by insufficient experience on the part of competition authorities in analyzing these "newer" retail MFN clauses, and a lack of economic evidence demonstrating clearly that this conduct should be qualified as an object restriction.[39] If retail MFNs were to be considered as equivalent to RPM, then this would place them firmly in the object infringement box. Nonetheless, in the absence of any guidance or case law confirming this approach, the assessment of MFNs remains focused on restrictions of Article 101 by effect.

C. Online Platforms and the Agency Model: Exemption from Article 101?

An additional consideration in assessing retail MFNs under Article 101 is whether the online platform could, or should, be considered an agent of the suppliers for the purposes of competition law. An agent is defined as a "*legal or physical person vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal), either in the agent's own name or in the name of the principal*" for the purchase (sale) of products/services (supplied) by the principal.[40] Article 101 only applies to agency agreements where both parties to the agreement are "*independent economic operators,*" i.e. the agent assumes some level of financial or commercial risks linked to the sale of the products or services.[41] Otherwise, agency agreements fall outside Article 101 because, in effect, the agent is part of the same economic unit as the principal and therefore not an undertaking for the purposes of competition law.[42] The VGL also note that the determining factor in defining an agency agreement for the application of Article 101 is the commercial risk borne by the agent in relation to the activities for which it has been appointed as an agent.[43] The question of risk has to be analyzed on a case-by-case basis, taking into account "*the real economic situation rather than the legal classification of the contractual relationship in national law.*"[44]

There has been some suggestion that online platforms are in practice independent contractors who are agents of their suppliers.[45] Although many online platforms are unlikely to characterize themselves as agents for their various suppliers (for example Amazon's terms and conditions explicitly say that nothing in the agreement between Amazon and third party sellers on Amazon marketplace should be construed as creating an agency relationship between the parties[46]) the assessment should be conducted on the basis of the real commercial context. The

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37 See Dias & Bennet, *supra* note 36; and Bostoen, *supra* note 2.

38 See Akman, *supra* note 36 and Ezrachi, *supra* note 36.

39 See Peeperkorn, L. (2015), "*Defining restrictions 'by object'*," Concurrences Review No. 3-2015, Art. No 74812.

40 VGL, *supra* note 9, at paragraph 12.

41 See Case C-217/ 05, *Confederación Española de Empresarios de Estaciones de Servicio (CEEES) v. Compañía Española de Petróleos AS*, ECLI:EU:C: 2006:784 at paragraph 38.

42 See Joined Cases 40 to 48, 50, 54 to 56, 113, 114-73, *Cooperatieve Vereniging "Suiker Unie" UA and others v. EC Comm'n*, ECLI:EU:C 1975:174 at paragraph 480.

43 VGL, *supra* note 9, at paragraph 13.

44 See *CEEES*, *supra* note 41, at paragraph 46.

45 See Akman, P. (2019), "*Online Platforms, Agency, and Competition Law: Mind the Gap*," Fordham International Law Journal at page 57.

46 Amazon Services Europe Business Solutions Agreements, Section 14 (cited in Akman, *supra* note 45, at page 43) https://sellercentral.amazon.co.uk/gp/help/external/201190440?language=en_GB&ref=efph_201190440_cont_521.

question, therefore, is whether the criteria for an agency arrangement is met in practice,[47] and whether that arrangement should consequently be exempted from Article 101. It is argued that for many online platforms the criteria are indeed met, as:[48]

- There is no ownership of the products or services for which the online platforms facilitate transactions, and all online platforms exclude liability in relation to the performance of the contract between the supplier and the customer.
- There is no market-specific investment, nor investment in sales promotion for particular products/services of their suppliers.
- There is no assumption of significant financial or commercial risks related to the sales or performance of the contract with third parties.
- Standard terms and conditions make clear that the contract is formed between the supplier and the customer, and not the online platform.
- Remuneration is only received by the online platform when a sale is made.

These factors taken together suggest that online platforms only agree to use "reasonable" efforts to facilitate transactions for the suppliers, rather than committing to a particular outcome, and this may consequently be in line with the principles of an agency relationship. As yet, there is no case law or guidance from EU competition authorities to confirm or contest this approach. Companies and practitioners may therefore be unwilling to rely on this theory when assessing the legality of retail MFNs. However, if online platforms were to be considered as agents for their suppliers then Article 101 would not apply, and it may be that MFN clauses would need to be assessed under Article 102.

V. STEP 3: APPLICATION OF ARTICLE 102: RETAIL MFNS AS AN EXCLUSIONARY ABUSE

For Article 102 to apply, the online platform would have to be considered dominant in the relevant market, with the retail MFN clause being an instance of an exclusionary abuse. It is argued that retail MFN clauses should be assessed under Article 102 as:[49]

- Retail MFN clauses are usually imposed on trading partners against their will and the imposition of "*unfair trading conditions*" is an abuse under Article 102(a);
- Retail MFN clauses potentially lead to higher prices and this may constitute an abuse of "unfair pricing" under Article 102(a);
- The difference in treatment between trading partners that agree to retail MFN clauses and trading partners that do not agree to retail MFN clauses may put some trading partners at a competitive disadvantage which is prohibited under Article 102(c);
- Retail MFN clauses may have a foreclosure effect by hampering the entry of new online platforms, which is prohibited under Article 102(b); and
- Retail MFNs clauses may potentially exclude competition at the trading partner level if the lack of compliance with the retail MFN clause leads to the trading partner's exclusion from the market, which is prohibited under Article 102(b);

Article 102 cases are notoriously hard for competition authorities to bring. However, there are some examples of retail MFN cases which competition authorities have brought under Article 102. The Commission's investigation into Amazon's e-book distribution arrangements is perhaps the most notable. The focus of the Commission was on wide retail MFN clauses contained in the contracts between Amazon and its e-book suppliers. The retail MFN clauses allowed Amazon to protect itself from competition from other e-book distributors. The investigation ended in 2017 with a commitment decision in which Amazon agreed to no longer enforce, introduce, or change the terms of its agreements with its suppliers. According to the Commission, the retail MFN clauses may have led to "*less choice, less innovation and higher prices for consumers due to less overall competition in the EEA.*"[50] The Commission separated the European e-book market per language, defined the relevant market as

47 VGL, *supra* note 9, at paragraphs 13-17.

48 See Akman, *supra* note 45, at pages 59-68.

49 See Akman, *supra* note 36, at pages 828-829.

50 European Commission, "*Antitrust: Commission accepts commitments from Amazon on e-books*," https://europa.eu/rapid/press-release_IP-17-1223_en.htm.

the "*retail distribution of English and German language e-books to consumers*"[51], and considered Amazon to be dominant in the relevant market, although it did not provide market share figures.

In the UK, there is an interesting example of a Chapter II MFN case that was brought in the online auction sector.[52] In November 2016, the CMA opened a formal investigation into ATG Media, the leading supplier of live online bidding services in the UK. The CMA raised concerns that ATG Media may have infringed Chapter I and/or Chapter II of CA98 as a result of, amongst other things, "*clauses that required the auction house to offer 'no less favourable terms' to bidders using competing, or their own, live online bidding auction platforms.*"[53] In 2017, the CMA accepted commitments from ATG Media and closed its investigation into whether ATG had entered into anti-competitive agreements or abused a dominant position. In its decision, the CMA noted that the retail MFN clauses may be capable of "*foreclosing ATG Media's competitors given that such restrictions are likely to discourage the use by auction houses of competing [live online bidding] auction platforms.*"[54] The CMA was, ultimately, concerned that the retail MFNs made it harder for alternative online platforms to compete effectively in the market.

It is notable that the CMA's concerns regarding the retail MFN clauses in the online auction market involved the potential application of both Chapter I and Chapter II.[55] The case has since been cited as an example of an abuse dominance case.[56] However, it is clear that competition authorities, while aware of the potentially anti-competitive effects of retail MFNs, are struggling with how best to deal with them, and whether to apply Article 101 or Article 102. If competition authorities themselves are not entirely sure of the legal framework, then this leaves little hope for companies looking to understand whether they are on the right side of the law.

VI. CONCLUSION: SHOULD RETAIL MFNS BE ASSESSED UNDER AN *EX ANTE* CODE OF CONDUCT?

The biggest challenge facing competition authorities and companies alike is the absence of infringement decisions or judgments relating to retail MFNs. Aside from the HRS case in Germany, all other Commission and national competition authority cases have closed with commitments. A quick resolution through commitments can save both time and cost for the competition authority and companies concerned. However, importantly, the offering of commitments by a company under investigation does not result in an infringement decision.[57] This means that there is no clarity as to whether competition law has actually been infringed, either under Article 101 or Article 102. There does appear to be a broad consensus across the EU that wide retail MFNs are likely to be problematic from a competition law perspective. However, the approach to narrow retail MFNs remains uncertain and inconsistent.

It is unquestionable that assessing retail MFNs is complicated. A careful balancing act is required to ensure that the interests of increased competition by retailers is weighed against the need to protect and encourage investment by online platforms. But suggesting a case-by-case analysis could also be read as simply putting retail MFNs in the "too difficult" box. MFNs have now been considered in various investigations by a number of competition authorities and a large cloud of uncertainty still hangs over the legality of these business practices. This is unsettling for retailers and online platforms alike, as businesses like nothing less than uncertainty.

51 *E-book MFNs and related matters* (Case COMP/ AT.40153) Communication from the Commission [2017] OJ C26/ 2 at page 13 http://ec.europa.eu/competition/antitrust/cases/dec_docs/40153/40153_4392_3.pdf.

52 See Chisholm, S & Long, S & Parker H. (2019), "*Interim Measures in the UK: Lessons from the Online Auction Services Case,*" International In- house Counsel Journal 2019, Volume 12(46).

53 Case number 50408: CMA Notice of intention to accept binding commitments offered by ATG Media in relation to live online platform services, decision of 30 May 2017 at paragraph 2.3 https://assets.publishing.service.gov.uk/media/5954be5c40f0b60a44000092/auction-services-commitments-decision.pdf.

54 *Ibid.* at paragraph 3.15.

55 From the period 2014-2018, the CMA only opened 5 cases involving both Chapter I and Chapter II CA98, "CMA annual report and accounts," (years 2014 – 2018).

56 UK Furman Report, *Unlocking digital competition,* Report of the Digital Competition Expert Panel (2019), paragraph 3.116 (footnote 21). https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.

57 The Commission is able to adopt decisions whereby, without a finding of infringement, commitments given by undertakings as to their future behaviour are made binding upon them (Article 9 of Council Regulation (EC) No 1/2003).

One potential solution could be the introduction of an *ex ante* code of conduct for retail MFN clauses, similar to that proposed in the Furman Report.[58] The aim of the Furman code of conduct is to provide clarity to digital platform businesses (deemed to have strategic market status) about the "*boundaries of acceptable competitive conduct.*" [59] Although retail MFNs are not referred to specifically, one illustrative example of the type of behavior that could be considered unfair or unreasonable is "*an online platform penalising a business user for providing a more attractive offering on another site.*"[60] The proposals put forward in the Furman Report have been widely discussed, with practitioners, academics, and competition authorities all alive to the fact that the digital economy and the rise of e-commerce presents relatively unique challenges for the existing legal framework. Indeed, following the Furman Report, the CMA has acknowledged that "*enforcement action is no longer enough to address the wider concerns in online markets, and that ex- ante regulation in some form is likely to be required.*"[61]

Taking the Furman Report code of conduct proposal and applying it to retail MFNs could provide a stepping stone to legal clarity, while we await a fully reasoned infringement decision or judgement in this area. There is arguably sufficient consensus around the anti-competitive effects of wide MFNs to set out certain types of clauses that should be presumed problematic within a code of conduct. The presumption would be rebuttable, thus avoiding the categorization of these clauses as object infringements – something that competition authorities appear reticent to do. But more explicit *ex ante* guidance would provide much needed clarity as to how retail MFNs should be treated under EU competition law.

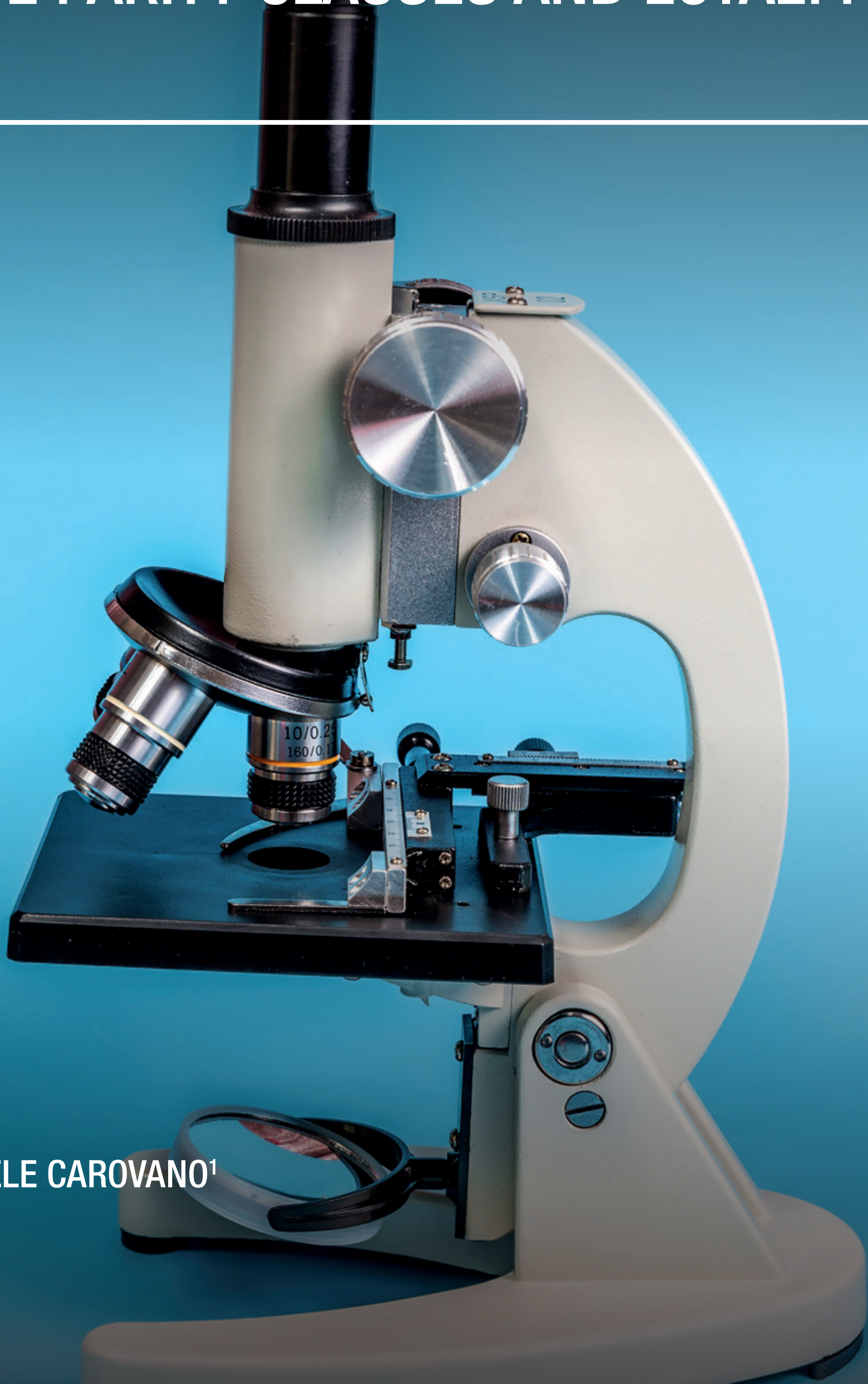
58 UK Furman Report *supra* note 56.

59 *Ibid.* at page 55 at paragraph 2.8.

60 *Ibid.* at page 61 at paragraph 2.36.

61 Competition & Markets Authority, "*CMA Letter to BEIS*," (2019) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/788480/CMA_letter_to_BEIS_-_DCEP_report_and_recommendations__Redacted.pdf.

COMPETITION LAW UNDER FIRE: RESPONDING TO COMPETING DEMANDS FOR CHANGE IN THE CASE OF PRICE PARITY CLAUSES AND LOYALTY REBATES



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I. INTRODUCTION

Competition law is under attack. On the one hand, globalization and the digital revolution have greatly benefited the owners of firms, and particularly the wealthiest 1 percent, while delivering fewer benefits to consumers and workers. This has led to calls for a fundamental rethinking of the principles and purpose of competition law and policy. One area where competition law is particularly under the microscope concerns its ability to ensure that consumers obtain a larger share of the benefits generated by the rise of so-called tech giants and the digital economy. Some commentators have made the case that in order to better protect the interests of consumers and workers a fundamental rethink is not required, but that competition enforcement does need to re-examine the balance of risks that it is prepared to take.[2] Specifically, enforcers should consider accepting a greater risk of inefficiencies and "false positives" (over-enforcement) in order to prioritize the protection of competition and the delivery of fewer "false negatives" (under-enforcement) (**n.1**).

On the other hand, economists have focused on reducing the total number of false results, improving the accuracy of enforcement. In doing so they have criticized the inaccuracy of a *per se* or formalistic approach to practices with ambiguous effects, and have called for the adoption of a more economic effects-based approach, which requires competition authorities to conduct sometimes complex and time-consuming economics analyses in order to reduce the risk of inaccurate enforcement (**n.2**). In practice this approach has no doubt significantly reduced the number of false positives, since the facts of each case are scrutinized and the case-specific inapplicability of certain assumptions is identified. However, in order for this reduction in false positives to translate into fewer false results, it is crucial that the number of false negatives does not significantly increase as well. For example, if the more economic approach creates a deterrence effect that discourages agencies from taking risky cases then the overall accuracy of enforcement may not improve and, more importantly, the nature of enforcement will be skewed towards prioritizing the protection of efficiencies at the expense of competition.

This paper argues that the calls for fewer false negatives and those for the reduction of false positives are less incompatible than they might at first appear. This is because, fortunately, this is not a zero-sum game. The paper uses the lens of recent (mainly EU) decisions and case law related to platform parity clauses and Loyalty Rebates to suggest that they can be reconciled. It argues that call **n.1** can be applied at the level of "legal presumption." In particular, it argues that it is vital, where a more economic approach is adopted, for agencies to actively prioritize the delivery of fewer false negatives and hence take a purposefully brave approach to the mix of battles that they fight. Part of creating such courageous agencies certainly requires governments to get the right staff. The way in which governments assess the performance of their agencies is also important, for instance, whether it recognizes that the optimal loss record in court is non-zero. Arguably, however, the only guaranteed way to incentivize agencies to prioritize the delivery of fewer false negatives is either to explicitly provide that objective for the agency, or to establish those presumptions within the legal framework. Meanwhile, we argue that call **n.2** can be simultaneously applied by ensuring there is scope for the rebuttal of those presumptions. Such a rebuttal must be possible, both in the understanding of whether the presumption of an anti-competitive effect is fitting, absent countervailing efficiencies, and if so, in ascertaining whether that effect is in fact outweighed by any such pro-competitive efficiencies.

II. PRICE PARITY CLAUSES

Price parity clauses (also known as Across Platform Parity Agreements and retail Most Favored Nation clauses) prevent producers from setting lower retail prices (or better terms and conditions) on rival platforms that offer more competitive commissions. These have given rise to a range of competitive concerns, generated what some consider to be conflicting decisions among enforcers, been treated as both agreements and unilateral abuses,[3] and have led to government interventions to overrule some agencies' approaches.[4]

The primary competitive concern is that the use of these clauses means that rival platforms cannot turn to price differentiation to increase their volume of sales or bookings. Rival platforms therefore have no incentives to bring down the commission that producers are charged by a platform with a parity clause. Equally, platforms with a parity clause can increase their commission without fear that it will create a price disparity and lead to them losing volume. This means that, in addition to eliminating intra-brand price competition, the parity clause can inflate prices across all producers on the platform even if there exists healthy inter-brand competition.

2 For example, among others, see Herbert Hovenkamp & Carl Shapiro, "Horizontal Mergers, Market Structure, and Burdens of Proof," Faculty Scholarship, (2018); Stigler Center, "Committee for the Study of Digital Platforms," (2019); Tommaso Valletti, "A view from the Chief Economist," CRA Conference (2018); and Andrew Tyrie, "Is competition enough? Competition for consumers, on behalf of consumers," (2019).

3 Pinar Akman, "A Competition Law Assessment of Platform Most-Favoured-Customer Clauses," 2015. Notably the EU Commission opened an 'abuse of dominance' investigation when it probed Amazon's e-books distribution agreements.

4 Among others, "narrow parity clauses" were banned by France in August 2015 and Italy in 2017.

A second concern is that parity clauses serve to prevent entry by new low-cost platforms, while encouraging entry by high-cost platforms that compete on quality rather than price. The lack of price differentiation prevents consumers from identifying their preferred balance of price and quality. A third worry is that in the presence of parity clauses, platforms are less likely to compete to offer producers a better-quality service because these agreements prevent the producer from steering consumers towards platforms that offer better services (e.g. anti-fraud protection).

There is also a concern that parity clauses might help facilitate collusion: either on retail prices amongst producers by improving their ability to monitor adherence to collusive agreements; or amongst platforms on their commissions by creating an automatic punishment mechanism for platforms that deviate from the collusive commission. Finally, there may also be a concern that parity clauses might incentivize a shift towards an agency relationship which would allow prices to be set by producers who face less competitive pressure. For example, if platforms face less competitive pressure than producers, then platforms would set higher retail prices than those set by the producers (see for example eBooks). Therefore, if the ability to agree on a parity clause makes it profitable for a platform to allow producers to set retail prices, then permitting said parity clause might result in higher prices for consumers.

In addition, where wide parity clauses are removed, but narrow clauses that only impose parity on sellers' own direct sales channel remain, there is a risk that these may have the same effect as wide clauses in eliminating competitive pressure from rival platforms. This is because although sellers are free to differentiate prices across platforms, their incentives to do so might remain limited as this would require them to undercut the price on their own sales channels in order to comply with the narrow best price clause. As the CMA suggested in its motor insurance market study, small producers without strong brands are unlikely to credibly threaten to undercut the price on their own website, particularly since visitors to that website are likely to be more price sensitive. While this was not the case in motor insurance, it might, as the *Bundeskartellamt* argues in *Booking*.com and *HRS*, be a better fit for hotel markets.

Leaving aside the competitive concerns, the question of whether these clauses create efficiency-enhancing effects has been particularly controversial. It has, for instance, been argued that parity clauses protect platforms from free-riding behavior, and hence protect the viability of the platform in addition to facilitating investments to improve its quality. Moreover, it has been argued that no less anticompetitive alternative solutions to the free-riding issue exist.

Some authorities have accepted these arguments and agreed on commitments that allow narrow parity clauses that only impose parity on the sellers' own direct sales channel (and not on other platforms, as is the case for a wide parity clause). These have achieved a quick resolution of these cases. However, they arguably embody the concerns expressed in call **n.1** that agencies are not sufficiently prioritizing the delivery of fewer false negatives. In contrast, when the ACCC found parity agreements in airline bookings it fined Flightcentre 12.5million AUD for price fixing. Similarly, the *Bundeskartellamt* concluded in both hotel-booking cases that the claimed efficiency gains were not sufficiently substantiated. In particular, the parties did not sufficiently demonstrate: (i) that there were no less anticompetitive options available for achieving the claimed efficiencies; and (ii) that the risk of free-riding was sufficient to result in platforms exiting the market, thereby denying buyers the efficiency of having access to such a platform.

With the benefit of hindsight, while there may be a degree of free-riding, an *ex post* assessment exercise conducted by the European Commission and a group of ten national agencies in 2016 (the "monitoring report") found no significant difference in conversion ratios in those jurisdictions where narrow parity clauses were removed. Moreover it has demonstrably not resulted in all, or indeed any, platforms exiting markets that have removed narrow parity clauses as a tool for addressing the problem.[5] Indeed, entry has continued with meta-search engines becoming increasingly popular. Consumers in these markets continue to enjoy the benefit of the existence of matching platforms. In addition, the nature of the allegedly forgone investments has not become any clearer. For instance, it is not clear that information on sellers has deteriorated (unsurprisingly, since this content is seller-generated). It is also not clear that potential improvements in the quality of matching by the algorithm have been passed over. The impact on investment in platform advertising has not, to our knowledge, been examined.

The outcome of the Monitoring exercise was ultimately inconclusive, and diplomatically suggests only that both types of enforcement "*which are based on a converging theory of harm (…) go in the right direction.*"[6] However, what can be seen is that the narrow clauses that were removed in 2015 have not led to exit, suggesting that these clauses were not in fact essential to ensuring the viability of the platform business model. This perhaps explains why following the publication of the monitoring report, Italy, Belgium, Australia, Sweden, and New Zealand have all prohibited narrow parity clauses.

5 Report on the monitoring exercise carried out in the online hotel booking sector by EU competition authorities, para 39.

6 Notably, many hotels reported that they did not offer cheaper prices on competing platforms because they did not want to undercut their own website.

The results of empirical studies appear to support a ban on narrow parity clauses.[7] Hunold et al. (2018) report that hotels used the removal of narrow parity clauses to charge the lowest price on their direct sales channel while increasing the use of *Booking.com* (suggesting any reduction in investment did not reduce the choice of hotel on the platform). Meanwhile Mantovani et al. (2018) collected data on listed prices on *Booking.com* for the period 2014-16 with regard to France, Italy, and Spain. In all three countries, the study reports a significant price drop between 2014 and 2015, followed by a price increase between 2015 and 2016. Significantly, countries that intervened (France and Italy) when compared to Spain (which adopted a "wait-and-see" approach) achieved a more marked price decrease in the period 2014-15, and a less powerful price surge in 2015-16. In addition, data shows that among France and Italy, only France – which in 2015 banned narrow parity clauses – managed to keep 2016 prices at a lower level than 2014. While price trends undoubtedly reflect several factors, such as changes in demand, it seems that the ban on narrow parity clauses benefitted consumers without resulting in *Booking.com* exiting the market.

In this light, it is perhaps surprising that in recent months, the *Bundeskartellamt* lost an appeal by *Booking.com* against its infringement finding.[8] While it remains to be seen if it will appeal, the unresolved nature of this case demonstrates the need to be careful in interpreting the implications of a lack of exit in Germany. However, it is notable that the legislation in Italy, France, Austria and other countries is not subject to the same uncertainties.

In the context of concerns that consumers are losing out because agencies are more worried about protecting claimed efficiencies than reducing false negatives, the experience on price parity clause cases is a useful case study. It shows that the existing enforcement framework does not prevent agencies that are willing to do so from taking a strong enforcement stance, and that legislators will not hesitate to take matters into their own hands where agencies appear unable or unwilling to take a strong enforcement stance. However, it also illustrates the risk of court loses that will need to be faced if agencies are to reduce the risk that consumers are left behind in digital markets (call **n.1**) while taking an economic approach to enforcement (call **n.2**). Finally, it demonstrates that in taking a more economic approach it is important to rigorously test the likely effects of claimed efficiencies.

III. LOYALTY REBATES

The call for a "more economic effect-based approach" has featured heavily in the practice and recent case law on loyalty rebates. These cases offer a useful lens through which to consider the extent to which this call has been heeded, and whether it has been, or can be, reconciled with the call to "prioritize the delivery of fewer false positives." In particular, we argue that the ECJ judgement in *Intel* seems to set out a framework through which the two calls can be simultaneously answered (false positives can be reduced while a more economic approach is adopted) without the need for trading off or balancing the two concerns.

First, the ECJ approach in *Intel* should be recognized as a substantially new approach. Paragraph 137 recalls paragraph 89 of *Hoff-Mann-La Roche*, and the presumption of the unlawfulness of exclusivity rebates when carried out by a dominant firm without objective justification. In contrast, the ECJ sets out that the Commission is required to conduct an 'effect analysis' every time that "*the undertaking concerned submits, <u>during the administrative procedure</u>, on the basis of <u>supporting evidence</u>, that its conduct was not capable of restricting competition and, in particular, of producing the alleged foreclosure effects.*" Since dominant undertakings are always expected to argue that their conduct is not capable of producing foreclosure effects, the Commission will in practice be required to address those arguments in almost all cases.

Shifting from allowing "*prima facie* anticompetitive conduct" to continue only where objective justification is demonstrated, to allowing rebuttal on the grounds that the conduct was not capable of restricting competition, delivers on the call for a more effects-based approach. It completes the move away from a formalistic approach that, while not a *per se* prohibition, since it allowed an objective justification defense,[9] was nevertheless a *per se* presumption on the capability of the practice to restrict competition. As such it addresses the problem that there was no opportunity for the defendant to rebut the presumed restrictive effect of a conduct which economic analysis suggests has ambiguous competitive effects. At the same time, placing the burden on a dominant firm to provide evidence to support a rebuttal of the presumed effect allows the Commission, and in turn the ECJ, to simultaneously satisfy the call to "prioritize the delivery of fewer false positives."[10]

7 Andrea Mantovani, Claudio Piga & Carlo Reggiani, (2018), "On the economic effects of price parity clauses – what do we know three years later?" note that quality did not fall. Instead, between 2015 and 2016, *Booking.com* enhanced the quality of the services it provides to both hotels and consumers, it enabled users to browse activities in the destination and book tickets in advance, and introduced tools to help hotels to build their websites (Section 3).

8 The Higher Regional Court quashed the *Bundeskartellamt Booking.com* decision. Similarly, the ruling of the Swedish Patent and Market Court requiring *Booking.com* to remove "narrow parity clauses" from its contract terms with hotels was overturned.

9 Richard Whish, "Intel v Commission: Keep Calm and Carry on!," *Journal of European Competition Law & Practice*, January 2015.

10 Wouter Wils, "The judgement of the EU General Court in Intel and the so-called 'more economic approach' to abuse of dominance," *World Competition*, December 2014.

The judgement can be seen as requiring the Commission to conduct an "effects analysis" in cases where a dominant firm produces supporting evidence that its conduct was not capable of foreclosing competition. However, it does not suggest that the Commission should in every case (i) conduct an efficient competitor (AEC) test; or (ii) prove that prices were negative, each of which would increase the scope for false positives. This is welcome, as exclusivity rebates do not exclude only through predatory pricing but may also do so through other mechanisms. In this sense, although the AEC test should not be ruled out in principle, as it may still be used in cases where the dominant firm implements the rebates by sacrificing profits, it is only "*one tool amongst others*" for the purposes of assessing whether a rebate scheme amounts to an abuse of dominance (see *Post Danmark*).

The AEC test, indeed, has several limitations, the first being that "*it only makes possible to verify the hypothesis that access to the market has been made impossible and not to rule out the possibility that it has been made more difficult.*"[11] For instance, conduct that raises rivals' costs may reduce the competitive constraint imposed by rivals. This is supported by the ECJ holding in *Tomra* and *Post Danmark II* that "*the invoicing of 'negative prices', that is to say, below cost prices, to customers* ***is not a prerequisite*** *of a finding that a retroactive rebate scheme operated by a dominant undertaking is abusive.*" This is consistent with recent court decisions in the US where both *Eisai/Sanofi* and *ZF Meritor/Eaton* rulings set out that price-cost tests need not apply, it therefore appears that where plaintiffs make the case, loyalty rebates in the U.S. need to be analyzed as *de facto* exclusive dealing arrangements rather than predatory pricing practices.

More generally, foreclosure of less efficient competitors can harm consumers if it weakens the competitive constraints upon the dominant firm. For instance, future consumers may benefit if firms with market power are prevented from foreclosing less efficient rivals that - if they had survived - might become equally or more efficient. Moreover, concerns that dominant firms should not be asked to hold a 'price umbrella' over less efficient firms (to keep them viable) do not apply to loyalty rebates as they would in predatory pricing. This is because the option to undercut through a simple unit price reduction, rather than a loyalty rebate, is always available.[12] The pro-competitive effects of less efficient rivals were explicitly recognized by the ECJ when it held that "*(…the presence of a less efficient competitor might contribute to intensifying the competitive pressure on that market and, therefore, to exerting a constraint on the conduct of the dominant undertaking.*"[13] It is also unclear what basis should be used to identify the so-called 'non-contestable share' of the market that is required to run the "discount attribution" variation of the AEC test. This makes it difficult for firms to self-assess the lawfulness of their actions.[14]

In line with the economic analysis, the ECJ recognizes that there is no single test for determining liability in regard to loyalty rebate schemes. Instead, the analysis will depend on "all the circumstances of the case." In particular, the theory of harm and the relevant test for determining the unlawfulness of the rebate schemes will vary according to the kind of asymmetry within the market in question. The presence of some asymmetry is indeed crucial since in its absence, a loyalty rebate that moves the market from competition for units, to competition for customers, will not protect the dominant firm's market power. As such, identifying that a loyalty rebate scheme has "loyalty-inducing" effects is, on its own, not sufficient to show an abuse of dominance. Whenever competition agencies take action against a loyalty rebate scheme, they should therefore be able to demonstrate not only that the scheme has "loyalty-inducing" effects which create exclusive relationships, but also explain, with evidence, why it is more difficult for rivals to effectively compete for that exclusivity.

There are perhaps four different sources of asymmetry. One is that the dominant firm might be able to sacrifice profits, either in the short term, or on "non-contestable" sales, where a rival cannot afford to do so. Second, where there are economies of scale, the asymmetry might come from the dominant firm's ability to prevent rivals from making enough sales to obtain those economies of scale.[15] Alternatively, instead of denying rivals access to consumers, the dominant firm might deny rivals access to key inputs and hence increase their costs. A further possibility is that the dominant firm might be willing and able to coordinate with downstream firms to increase the retail price of its product, while its rivals are not. This coordination would need to split the increase in profits with the downstream firms so that they do not react to the increase in the wholesale price by switching to selling a rival product. It will not always be possible to reach such an agreement; however, in certain circumstances, as in horizontal collusion, a sustainable agreement seems likely to be possible.

11 See *Intel* paras. 146-153.

12 Steven C. Salop, "Wright is Right and Price-Cost Safe Harbors are Wrong: The Raising Rivals' Cost Paradigm, Loyalty Discounts and Exclusive Dealing," 2013. *Truth on the Market*. http://truthonthemarket.com/2013/06/07/wright-is-right-and-price-cost-safe-harbors-are-wrong-theraising-rivals-cost-paradigm-loyalty-discounts-and-exclusive-dealing/; OECD Executive summary on Fidelity Rebates, 2016.

13 See *Post Danmark A/S* para. 60.

14 Nicholas Banasevic, King's College London Lecture, March 2017.

15 It might do so by offering individualized rebates, at different times, and without making information available (a "divide and conquer" strategy) to induce buyers fear amongst buyers that a lack of coordination will leave them purchasing from a seller without efficient scale.

One application of this is to consider the argument that ride-sharing services operate driver pay policies that include a low base rate and a bonus for achieving a certain acceptance rate.[16] Such bonus payments may well be loyalty-inducing, and hence incentivize exclusivity. However, where this simply constitutes a move towards competition for drivers, rather than competition for rides, it may not necessarily have an anticompetitive effect.[17] For there to be an adverse effect on competition, there would need to be an asymmetry in the ability to compete for drivers (rather than rides), that non-dominant rivals cannot match. One might, for example, therefore need to consider whether such contracts might limit a rival's ability to expand and obtain economies of scale, thereby raising their costs and reducing competition. Alternatively, and without the need for economies of scale, one might consider whether denying a bonus to drivers that accept rides from rival platforms, in effect places a tax on the price of working for rival platforms, thereby raising rivals' costs when recruiting drivers. In either case, the impact might then be less effective competitive constraints, and hence prices, that are higher than they otherwise would be.

Returning to *Intel* it appears that the ECJ, successfully reconciles the two calls for change. On the one hand it endorses the move towards a "more economic effect-based approach." On the other, it limits the risk of false positives by affirming a presumption that exclusivity rebates will restrict competition absent supporting evidence from the firm that shows the conduct was not capable of restricting competition.

In this context, the EU Guidance on enforcement priorities in applying Article 102 TFEU to exclusionary abusive conduct (Guidance paper), appears somewhat incongruous. In particular, relying exclusively on a price-cost test as a screening device seems likely to misdirect resources towards predatory cases and away from cases in which high prices are set and protected through loyalty rebates. These high price exclusionary strategies are likely to be less risky (since there is no loss-making period), and hence more attractive to dominant firms, as well as more immediately harmful to consumers. A more effective screen would therefore be one that prioritized the investigation of cases in which high prices are insulated.

Moreover, if a narrow "prioritization test" gives a safe harbor to cases that may harm competition and consumers, this guarantees false positive results and is therefore difficult to reconcile with call **n.1**.

Finally, while *Intel* has confronted and corrected past mistakes, it did not address the lack of a *de minimis* doctrine under Article 102 TFEU (as established by the ECJ in *HoffMann-La Roche* and later reaffirmed in *Post Danmark II*). In the context of this paper, we would argue that the introduction of a *de minimis* under Article 102 TFEU would be consistent with a more economic approach, since it operates on the scale of the economic effects of the conduct in question (while also introducing helpful uniformity with enforcement of Article 101, Merger control, and State aid).

In summary, the ECJ in *Intel*, and decisions taken by some countries on platform parity agreements have, we argue, shown a way to deliver an approach that is both more economic, and more forceful in ensuring that consumers obtain a share of the benefits of globalization and the digital transformation. In combination with the radical proposals for pro-competitive regulatory action offered by the Furman, Cremer, and Scott-Morton led reviews, they therefore offer the best defense against demands for a more fundamental rethink of the principles and purposes of competition law and policy.

16 See Marshall Steinbaum, "Antitrust, the Gig Economy, and Labor Market Power," *Law and Contemporary Problems*, 2019.

17 If it creates an exclusive employment relationship, it may also suggest that drivers are employers of these platforms.

TRADITIONAL AND PLATFORM MFN CLAUSES UNDER ANTITRUST LAW: INSIGHTS FROM RECENT PRACTICE

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I. INTRODUCTION

Most Favored Nation ("MFN") clauses have long been a controversial issue in antitrust. Within economics and legal literature attention has in the past been devoted to traditional or wholesale MFN clauses (also known as most favored customer "MFC" clauses), according to which one party (the supplier) undertakes to treat the other party (the buyer) as well as it treats its best customer, i.e. guaranteeing the best terms and price conditions to that buyer as compared with any other dealer. MFNs can be considered as belonging to the more general categories of "price relationship agreements" ("PRAs"), i.e. agreements where the price that the seller charges the buyer is related to another price,[2] and of "contracts that reference rivals" ("CRRs"), meaning contracts between a buyer and a seller where the terms depend on information outside the buyer-seller relationship and derive from other transactions to which those same firms are party.[3]

Recently the use of some particular forms of MFN clauses by platforms has come under antitrust scrutiny. The main difference between traditional and platform MFNs is that the former are a means for the parties to regulate the price and conditions of their own transaction, whereas the latter place restrictions on the parameters of a transaction that one of the parties concerned (the intermediary) will conclude with a party outside the agreement (the final consumer). Different terminologies can be traced in the literature, such as Across-Platforms Parity Agreements ("APPAs"),[4] Retail Price MFNs,[5] platform MFN agreements,[6] and price parity clauses.[7] In digital settings, the typical situation consists of an upstream supplier that sells its products through an online intermediary platform and guarantees that the price and terms it sets for a particular product or service on that platform is no higher than the price and terms it sets for the same product on other platforms and/or distribution channels. In this case, the platform imposes restrictions on the behavior of the producer.

In a different way, there are cases in which the behavior of the retailer may be restricted. In the credit card industry, the so-called no surcharge rule (according to which retailers cannot charge more for purchases made with one credit card than for purchases made with other cards and ultimately other payment methods) and no-steering or non-discrimination provisions ("NDPs," prohibiting the merchant from using any means of encouraging consumers to adopt another card or transaction method) have been considered as vertical MFN ("vMFN") restraints, meaning contractual clauses preventing a multiproduct retailer from charging more for one supplier's product than for the products of rival suppliers.[8]

II. OVERVIEW ON TRADITIONAL MFNS

Literature on traditional MFNs has identified both efficiency reasons and potential anticompetitive effects related to their use.

On the one hand, with regard to the main competitive harms deriving from MFNs, these can amount to both collusive and exclusionary effects. First of all, such clauses may negatively affect price competition. An MFN provision typically does not limit the seller's commercial freedom to have more customers. However, the MFN undermines the seller's incentives to offer low prices by raising the cost to the seller of cutting prices to buyers other than the beneficiary of the MFN. As any price discounts must be offered to all buyers covered by the MFN itself, such clause in practice reduces selective discounts and leads to higher prices.[9] In addition, MFNs are considered as facilitating coordination and helping firms operating in the markets concerned to deter cheating (as it would be more easily detected). MFNs may also dampen competition when they lead those firms to compete less aggressively.[10]

2 LEAR, *Can 'Fair' Prices Be Unfair? A Review of Price Relationship Agreements*, OFT1438 (September 2012) (report prepared for the Office of Fair Trading).

3 Scott Morton, U.S. Dept. of Justice, *Contracts that Reference Rivals, paper presented at Georgetown University Law Center Antitrust Seminar (April 5, 2012),* https://www.justice.gov/atr/file/518971/download.

4 See LEAR, *supra note 2; OECD, Hearing on Across-Platforms Parity Agreements* (2015).

5 Fletcher & Hviid, *Broad Retail Price MFN Clauses: Are they RPM 'at its worst'?*, 81 Antitrust L.J. 65 (2017).

6 Boik & Corts, *The Effects of Platform MFNs on Competition and Entry*, 59 J.L. & Econ. 105 (2016).

7 E.g. Ezrachi, *The Competitive Effects of Parity Clauses on Online Commerce*, 11 European Competition J. 488 (2015); Vergé, *Are Price Parity Clauses Necessarily Anticompetitive?*, CPI Antitrust Chron. (January 2018), https://www.competitionpolicyinternational.com/wp-content/uploads/2018/01/CPI-Verge.pdf.

8 Carlton & Winter, *Vertical most-favored-nation restraints and credit card no-surcharge rules*, 61(2) J.L. & Econ. 215 (2018).

9 Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of 'Most-Favored-Customer' Clauses*, 64 Antitrust L.J. 517, 519 (1996).

10 Baker & Chevalier, *The Competitive Consequences of Most-Favored-Nation Clauses*, 27 Antitrust 20, 24 (2013).

With regard to the exclusionary harms, MFNs may help an incumbent in foreclosing rivals' entry or expansion by making it impossible for them to bargain for a low price with input suppliers or distributors bound by that clause with the incumbent: this, in turn, would mean that rivals would be discouraged from lowering their own costs and, again, from competing aggressively with the incumbent. Such anticompetitive effects are more likely to arise when parties hold a certain degree of market power or when there is a widespread use of such clauses in an industry to the extent that cumulative effects arise. When MFNs are in place across all buyers for the adopting seller, this amounts to a commitment to uniform pricing.[11]

On the other hand, with regard to the efficiency justifications for the adoption of MFNs, such clauses can be considered as being designed to solve the hold-up problem typical of vertical settings, minimizing externalities, and facilitating investments. According to this argument, they can be used when a party makes relationship-specific investments in order to mitigate the risks of opportunistic conduct of the other party to the contract and to allow the protection of distributors from free-riders. This is particularly true in the case of long-term contracts, where both the buyer and supplier are legitimately concerned about being locked into a deal with potentially disadvantageous terms.[12] Another typical efficiency argument concerns the prevention of delays in transacting and the reduction of transaction and negotiation costs that MFNs may grant (even if it must be considered that they also involve the costs of monitoring and potentially litigating compliance with the agreement).[13]

III. OVERVIEW OF PLATFORM MFNS

Similar antitrust concerns and efficiency justifications also relate to platform MFNs. However, they are characterized by some distinctive features.

Important insights derive from cases which have arisen in digital markets, including, e.g.: the U.S. and European *E-books* cases concerning Apple;[14] the European Commission's investigation of Amazon *E-books MFN*;[15] and the investigations in the European context at national level, such as price comparison websites ("PCWs") in the field of motor insurance and in the field of electricity and gas prices,[16] online travel agents ("OTAs"),[17] online bidding auction services,[18] and Amazon Marketplace.[19]

In digital markets, the use of MFNs has been observed in conjunction with the adoption of the agency model by online platforms, which, as opposed to the wholesale model, provides for suppliers to set final prices.[20] Platform MFNs ensure that the price and terms quoted through the platform will not be higher than those available to a third party (the buyer) on the supplier's website ("narrow MFN") or on other platforms and/or any other channel ("wide MFN").

Although they relate to vertical relationships, the main anticompetitive effects of platform MFNs are realized on a horizontal level and include the foreclosure of market entry for new resellers, the reduction of competition, and the facilitation of collusion between platforms. Moreover, these clauses may serve to acquire or strengthen monopoly pricing by preventing other retailers from competing in the market by offering lower prices, thereby limiting entry.

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11 Boik & Corts, *supra* note 6, at 108.

12 Salop & Scott Morton, *Developing an Administrable MFN Enforcement Policy*, 27 Antitrust 15, 17 (2012).

13 Baker & Chevalier, *supra* note 10, at 21 et seq.

14 *United States v. Apple Inc., et al., 952 F. Supp. 2d 638 (S.D.N.Y. 2013); EU Commission, Case No. COMP/39.847 – E-books.*

15 EU Commission, Case No. AT.40153, *E-book MFNs and related matters (Amazon), final commitments published on July 28, 2017.*

16 CMA, *Private motor insurance market investigation*, Final report (September 24, 2014); *Bundeskartellamt*, Press Release, *Verivox vows to stop using 'best price' clauses* (June 3, 2015), http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2015/03_06_2015_Verivox.html.

17 For details, see next paragraph.

18 CMA, *Decision to accept binding commitments offered by ATG Media in relation to live online bidding auction platform services*, Case No. 50408 (June 29, 2017).

19 See *Bundeskartellamt, Press Release, Amazon abandons price parity clauses for good (November 11, 2013),* http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2013/26_11_2013_Amazon-Verfahrenseinstellung.html%3Fnn%3D3599398; OFT, Press Release 60/13, *OFT welcomes Amazon's decision to end price parity policy (August 29, 2013),* https://webarchive.nationalarchives.gov.uk/20140402160400/http://oft.gov.uk/news-and-updates/press/2013/60-13. It is worth mentioning that Amazon dropped MFN clauses in the U.S. too. See *Amazon eases price restrictions on third-party vendors,* Financial Times (March 12, 2019), https://www.ft.com/content/3beea4a6-445b-11e9-b168-96a37d002cd3.

20 Johnson, *The Agency Model and MFN Clauses, 84 Rev. of Econ. Stud.* 1151 (2017).

In detail, platform MFNs limit the possibility of passing on fees imposed on the seller in the form of higher retail prices. If the supplier is bound by the MFN to set on a platform a price not higher than that set on other intermediaries, the platform concerned will not be afraid (or rather will be incentivized) to increase the fee, and other platforms will also have fewer incentives to reduce their fees as well. Moreover, if platforms coordinate and agree on the fee level, free-riders will have less incentive to reduce fees deviating from the collusion due to parity agreements, as such a reduction will be transferred to users of other platforms. In other words, higher fees, in turn, lead to higher retail prices and potentially to higher profits for platforms.

Even without coordination among platforms, platform MFNs may still have a negative impact on entry. Consider the case of a new entrant platform which may wish to gain customers by charging a lower fee to the supplier, thus a lower final price to consumers: the supplier, bound by an MFN clause with an incumbent platform, will be forced to charge the entrant the same price as the incumbent. As a consequence, if the supplier has concluded this kind of agreement with several platforms, the combined effect will be the application of the same price on the various platforms.

Importantly, successful platforms have often proved to hold a strong contractual power over suppliers, allowing platforms themselves to impose fee levels and parity clauses as an unavoidable condition of service.

According to some scholars, since in the case of the agency model the final price is fixed by the upstream supplier and not by the reseller, even though the agreements in question do not fix a certain price, wide platform MFNs combine two elements: a vertical one, whereby an upstream firm sets final downstream retail prices, and a horizontal one, whereby the upstream firm sets identical retail prices across all intermediaries. The latter is of major concern and would make the clauses at issue equivalent to the "worst" of RPM.[21]

Such concerns relate mainly to wide MFNs, whereas narrow parity clauses, which affect only the relationship between a single supplier and a single platform, would result in less intrusive restrictive effects.[22]

However, it is worth noting that there are relevant cases in which a combination of platform MFNs with "best price guarantees" ("BPGs," also known as low-price guarantees) occurs. As a matter of fact, antitrust concerns related to the use of best or low price guarantees have been the subject of inquiry by literature in the past.[23] In the case at issue, platforms may have an MFN clause with the supplier and also advertise a BPG clause to consumers, meaning those unilateral promises made by a retailer to consumers that it will offer them the lowest price, typically combined with a commitment to match (price matching) or beat (price beating) competitors' prices. In both platform MFNs and BPGs the price of the goods sold by the retailer is linked to the prices charged by rivals. The difference lies in the fact that, whereas platform MFNs seem not to have a direct effect on consumers' search behavior (since consumers generally are not aware of the agreement), BPGs typically do, as they link the platform and the consumers. BPGs of the matching type, which are used in practice by some online intermediaries, are likely to reinforce the anticompetitive effects of platform MFNs even in their narrow version. Indeed, consider the case of an incumbent platform A, having a narrow platform MFN with a supplier X. Even if other platforms are not covered by such MFN, if platform A offers a price matching guarantee to its consumers, competing platforms will not be incentivized to quote lower final prices to the same product as any reduction will be matched by platform A to any consumer activating the guarantee to obtain the lower price. Moreover, collusive risks derive from the adoption of such BPGs as, in order to avoid the erosion of their market share, other platforms may decide to imitate the strategy offering themselves a price matching guarantee: in this case, they could set the higher price offered by platform A and in turn guarantee a price matching clause. Thus, there would be no difference in prices set by the firms concerned, and so the price matching guarantee would grant customers a reimbursement equal to zero (or rather they would have no reason to use the guarantee) and ensure platforms' higher profits. This outcome is similar to the horizontal effect claimed to result from wide platform MFNs, so that the combination between narrow MFNs and price matching guarantees requires appropriate consideration.

With regard to the efficiency justifications for platform MFNs, the main one can be identified in the protection of investments maintained by the intermediary in order to build a reliable platform and to reduce the risk of "showrooming," which is a form of free-riding.[24] Economic theory teaches that multi-homing has a crucial relevance in the management of indirect network effects between customer groups by multi-sided

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21 Fletcher & Hviid, *supra note 5, at 79 et seq.*

22 Ezrachi, *supra* note 7, at 506 et seq. (affirming that with "narrow MFN" clauses each platform may be incentivized to compete by lowering its commission to obtain a lower price).

23 For an overview, see Hviid, *Summary of the literature on price guarantees* (2010), http://competitionpolicy.ac.uk/documents/107435/107582/Summary+of+LPG+literature+Final.pdf.

24 Wang & Wright, *Search platforms: showrooming and price parity clauses*, Mimeo (2017).

platforms, which tend to design strategies in order to ensure themselves users' preference.[25] MFN clauses may constitute protective measures aimed at preventing customers from using the platform in order to get information about the products and then subsequently finalize the transaction on the supplier's website or through other channels at a lower price. An appropriate consideration of the multi-sided nature of platforms, which typically implies the platform charging different prices that reflect the demand elasticity of the users on each side, is essential.

Thus, online platforms usually offer their services for a fee on one side of the platform (typically, suppliers/businesses) and for free on the other side (consumers), on which others can free-ride. The same may occur with payment cards, where the merchant has an incentive to advertise acceptance of a card to generate increased custom only to steer customers away from using that card once they have started the process of a purchase and transact on a cheaper platform. As noted in literature, the fact that a consumer and a merchant may transact off the platform that brought the two users together in the first place is the key element of free-riding on platforms.[26]

IV. INSIGHTS FROM THE EUROPEAN EXPERIENCE

In the EU, existing practice reveals different approaches by competition agencies and courts. The most prominent example concerns the online travel agency sector. Notably, the first investigation in this sector was conducted in the UK by the Office of Fair Trading (OFT), but its decision was quashed by the Competition Appeal Tribunal (CAT) and the Competition and Markets Authority (CMA) did not continue the inquiry.[27] Later, Italian, French, and Swedish national competition authorities (NCAs) collaborated under the coordination of the European Commission in their investigations into Booking.com and Expedia addressing parity clauses providing the obligation for hotels to offer the OTAs conditions (i.e. prices and other conditions, such as room availability) that were at least as favorable as those offered on other platforms and on the hotels' own websites (wide MFN). Such clauses were considered as vertical restrictions capable of significantly reducing competition on prices and supply conditions, both between platforms and different sale channels, and discouraging entry by newcomers. Booking, in settling with the NCAs, committed to remove the wide MFN and maintain the narrow one (according to which the OTA has undertaken to only apply MFN clauses to prices and conditions publicly offered by hotels through their own direct online sales channels).[28]

The *Bundeskartellamt*, on the other hand, in similar cases, firstly against the portal HRS and later against Booking, did not accept even the narrow MFN.[29] In particular, the *Bundeskartellamt* rejected the free-riding argument and considered that the parties were failing to demonstrate that: the investments made by OTAs in the quality of the service were contract-specific, thus lost as a result of free-riding; MFNs were indispensable to the attainment of efficiencies; and less restrictive remuneration models other than the commission model in use were possible. One main concern of the German NCA was that the narrow MFN would not prevent the "cannibalization" effect, i.e. the erosion of direct sales by hotels.

It is worth mentioning that narrow MFNs have also been accepted by the CMA in its investigation into the private motor insurance ("PMI") market, finding them essential and vital for a PCW in order to protect its credibility, as no alternative mechanisms which can serve to this end were identified. With regard to free-riding, the CMA analyzed some possible alternatives but not in depth due to the lack of harm by narrow MFNs found by the agency in this case. On the other hand, no justifications were considered for wide MFNs, as they would not grant any more protection from free-riding than that already provided by narrow MFNs: free-riding by PMI providers was possible because the PCW made clear which PMI provider had offered the quote, enabling the consumer to go directly to the provider itself, whereas there was not the same possibility for another PCW to free-ride on the first PCW's investment as other PCWs would still need to invest in advertising to attract customers.[30]

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25 Armstrong, *Competition in two-sided markets*, 37 Rand J. Econ. 669 (2006).

26 Johnson, *Suggestions for competition authorities when assessing vertical restraints in multi-sided platforms*, in OECD, *Rethinking Antitrust Tools for Multi-Sided Platforms* 2018, at 201, 207 (April 6, 2018), www.oecd.org/competition/rethinking-antitrust-tools-for-multi-sided-platforms.htm.

27 OFT Decision, *Hotel Online Booking: Decision to Accept Commitments to Remove Certain Discounting Restrictions for Online Travel Agents*, OFT 1514dec (January 31, 2014). The commitment decision, regarding agreements between Booking and Expedia and the hotel chain IHG, was quashed by the CAT [*Skyscanner Ltd v. CMA*, [2014] CAT 16]. See also CMA, Press Release, *CMA closes hotel online booking investigation* (September 16, 2015), https://www.gov.uk/government/news/cma-closes-hotel-online-booking-investigation.

28 See Autorità Garante della Concorrenza e del Mercato, Case I779 B, decision of April 21, 2015; Autorité de la Concurrence, Décision n° 15-D-06 of April 21, 2015; Konkurrensverket, Case Ref. No. 596/2013, decision of April 15, 2015.

29 *Bundeskartellamt*, *Hotel Reservation Service* (*HRS*), Case B 9-66/10. This decision was later confirmed by the Düsseldorf Higher Regional Court [Düsseldorf Higher Regional Court (OLG), VI - Kart. 1/14 (V)]. See also *Bundeskartellamt*, *Booking*, Case B 9-121/13.

30 CMA, *supra* note 16, para. 8.106; see also CMA, *Digital comparison tools market study*, *Paper E: Competitive landscape and effectiveness of competition*, para. 3.16 (Sept. 26, 2017).

Following the closure of the OTAs' investigations, some Member States have intervened, introducing *ad hoc* provisions for online platforms banning any restrictions on hoteliers' pricing freedom (including those that were allowed under the commitments accepted by the NCAs involved, such as in Italy and France), which appear to safeguard the particular interests of hotels.[31] Then, in June 2019, a plot twist has come from the Düsseldorf Court of Appeal, which quashed the decision of the *Bundeskartellamt* prohibiting Booking from operating the narrow MFN clause, finding such clause as compatible with antitrust law and considering it as a means to creating a fair and balanced contractual exchange of services between the portal and the hotels.[32]

OTAs' investigations have been the subject of huge debate. Recent empirical studies provide initial insights into the effects of the removal of platform MFNs.[33] Among these, some have analyzed the combination of narrow platform MFNs and price matching guarantees – frequently used by OTAs such as Booking – supporting the idea that such BPGs may have in practice substituted the wide MFN's anticompetitive role.[34]

As a matter of fact, inconsistencies among Member States resulting from the investigations have been condemned by scholars as a missed opportunity for the Commission to provide unitary guidance.[35] Only later, in the 2017 E-Commerce Sector Inquiry, [36] did the Commission explicitly state that, in the absence of a hardcore restriction, price parity clauses are covered by the VBER if the parties' market share does not exceed 30 percent and that an individual assessment is required if that threshold is exceeded.[37] Criticisms have also been raised against the legal approach adopted by NCAs, including the adoption of a theory of harm based on Article 101 TFEU rather than on an assessment of the existence and exercise of market power which would have been a more appropriate basis for an infringement of Article 102 TFEU.[38]

In the Amazon *E-Books* MFN investigation, the Commission analyzed MFNs under Article 102: in this case the Commission considered that such clauses could strengthen Amazon's position by reducing the ability and incentive of e-book suppliers and competing platforms to develop new business models and accepted commitments offered by Amazon, according to which it undertook to no longer enforce or introduce MFNs in agreements with publishers.

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31 See the French 'Loi pour la croissance, l'activité et l'égalité des chances économiques' (Loi Macron), adopted on August 5, 2015; the Austrian law amending the Austrian Federal Act against Unfair Competition and the Austrian Price Marking Act, which entered into force on January 1, 2017; and the Italian law (Legge annuale per il mercato e la concorrenza), adopted on August 2, 2017 and entered into force on August 29, 2017. Ban of price parity clauses has been then established in Belgium, and in July 2018 the Swedish Patent and Market Court issued a judgement forbidding Booking.com to impose parity clauses in its contracts with hotels.

32 See Oberlandesgericht Düsseldorf, Press Release, *Hotelbuchungen im Internet: "Enge" Bestpreisklauseln sind zulässig* (April 6, 2019), http://www.olg-duesseldorf.nrw.de/behoerde/presse/Presse_aktuell/20190604_PM_booking/index.php. Full judgment is not available at the time of writing. Some commentators have advanced the idea that the court may have considered the narrow MFNs as a type of ancillary restraints to the overall agreement between portal and hotels.

33 See, e.g. Mantovani, Piga & Reggiani, *Much Ado About Nothing? Online Platform Price Parity Clauses and the EU Booking.com Case* (May 1, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3381299; Calzada, Manna & Mantovani, *Platform Price Parity Clauses and Segmentation*, UB Economics Working Papers, 2019/387; Caccinelli & Toledano, *Assessing Anticompetitive Practices in Two-sided Markets: The Booking.com cases*, 14(2) J. Competition L. & Econ. 193 (2018); Hunold, Kesler & Laitenberger, *Evaluation of best price clauses in online hotel booking*, 61 Int. J. Ind. Organ. 542 (2018).

34 Wals & Schinkel, *Platform Monopolization by Narrow-PPC-BPG Combination: Booking et al.*, 61 Int. J. Ind. Organ. 572 (2018). See also Akman, *A Competition Law Assessment of Platform Most-Favoured-Customer Clauses*, 12 J. Competition L. & Econ 781, 786-87 (2016).

35 Akman & Sokol, *Online RPM and MFN under Antitrust Law and Economics, 50 Review of Industrial Organization 133 (2017);* Colangelo, *Parity Clauses and Competition Law in Digital Marketplaces: The Case of Online Hotel Booking*, 8(1) JECLAP 3 (2017).

36 See European Commission, *Commission Staff Working Document, Accompanying the Final report on the E-commerce Sector Inquiry, SWD(2017) 154 final, at 177 et seq.*

37 Commission Regulation (EU) No 330/2010 on the application of Article 101(3) of the TFEU to categories of vertical agreements and concerted practices, [2010] OJ L 102/1 (hereinafter "VBER").

38 Akman, *supra* note 34; Colangelo, *supra* note 35. Another issue concerns the legal nature of Internet intermediaries, i.e. whether they should be considered as genuine agents or independent resellers to be covered by Article 101 TFEU. Widely, on this topic, Akman, *Online Platforms, Agency, and Competition Law: Mind the Gap*, Fordham Int'l L.J (2019, forthcoming).

V. INSIGHTS FROM RECENT U.S. EXPERIENCE

Leaving aside the *E-Books* case mentioned above, where MFNs were considered in the context of the conspiracy between Apple and publishers to raise certain e-book prices, there has been almost no government enforcement against platform MFNs in the U.S. The approach adopted in the U.S. may be emblematically explained through the analysis of two cases.

The first case once again concerns the OTA sector, where a class action by consumers was brought against hotel chains and OTAs on the basis of an alleged industry-wide conspiracy to impose rate parity across room booking websites in order to eliminate intra-brand competition (i.e. among each hotel's online distribution channels, including its own website and OTA-run websites).[39] The Court dismissed the action due to the plaintiffs' failure to allege facts supporting their claim, but recalled that MFNs, such as RPM, are subject to the rule of reason, mentioning precedent cases where the courts deemed them not illegal.

The second relevant case is *AmEx*, which has given some guidance on the antitrust evaluation on anti-steering provisions in the credit card industry.[40] It is worth noting that in the EU the very same clauses are prohibited by Regulation.[41] The U.S. case stems from the particular business model adopted by American Express ("AmEx") which earns most of its revenue from merchant fees that are higher than those applied by Visa and MasterCard (holding higher market share than AmEx), which earn half of their revenue by collecting interest from their cardholders. Amex's business model thus focuses on cardholder spending rather than cardholder lending. To encourage cardholder spending AmEx provides better rewards than other networks, and thereby attracts wealthier (marquee) cardholders, who are also very valuable to merchants. The anti-steering provision at issue prohibits merchants from discouraging customers from using their AmEx card, thereby avoiding AmEx's fee.

After describing credit-card networks as "transaction" platforms,[42] which require that both sides of the platform should be taken into account for the relevant market definition and for the netting of competitive effects, the Supreme Court has declined to consider AmEx's anti-steering provisions as anticompetitive. Indeed, according to the majority of the Court, these provisions stem from negative externalities in the credit-card market, preventing free-riding on AmEx's investments in rewards for cardholders, and promote inter-brand competition, being essential to AmEx's business model which has fostered innovation, improved the quality of the services offered to consumers, and increased the volume of output (i.e. transactions).

VI. CONCLUDING REMARKS

The absence of substantial intervention on platform MFNs in the U.S. has led some scholars to call for antitrust enforcement targeting these clauses in the wake of the approach taken by the EU in digital markets. According to this view, the ability of platform MFNs to make online commerce more concentrated, would require a change in U.S. policy.[43]

In truth, in the EU the antitrust treatment of platform MFN clauses is still a thorny issue. Indeed, on the one side, at national level, some Member States - despite the decisions taken by NCAs mentioned above - have adopted national legislation banning all types of platform MFNs in the online hotel booking sector. On the other side, at EU level, in the 2017 Sector Inquiry on E-Commerce, the European Commission has in the first instance acknowledged both anticompetitive effects and efficiencies linked to parity clauses used by marketplaces and PCWs, arguing that they should be assessed on a case-by-case basis.[44]

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39 *In re Online Travel Company (OTC) Hotel Booking Antitrust Litigation*, 997 F. Supp.2d 526 (N.D. Tex. 2014).

40 *Ohio et al. v. American Express Co. et al.*, 585 U. S. ____ (2018). Previously, the District Court for the Eastern District of New York in 2015 found that AmEx violated the Section 1 of the Sherman Act. Then the Court of Appeals annulled such ruling, holding that the District Court failed to properly define the relevant market by not taking into account the multi-sided nature of the credit card market. This case is particularly relevant - and controversial - for the issue of the market definition in two-sided markets.

41 Regulation (EU) 2015/751 of the European Parliament and of the Council on interchange fees for card-based payment transactions, (2015) OJ L123/1. Article 11 provides for a general prohibition of NDRs, stating that any rules imposed by a payment card scheme preventing merchants from steering shoppers to use different payment instruments or informing them about interbank fees charged is forbidden. As noted by Borgogno & Colangelo, *Antitrust Analysis of Two-sided Platforms after AmEx: A Transatlantic View*, 15 Eur. Competition J. 107 (2019), this could raise some doubts in the consideration of the alleged indispensability of NDPs in the case at issue, as one would expect that, for a clause to be considered as essential for the viability of the business, it would have to be as necessary for the platform in the U.S. as it would be in the EU.

42 Filistrucchi, Geradin, Van Damme & Affeldt, *Market Definition in Two-Sided Markets: Theory and Practice*, 10(2) J. Competition L. & Econ 293 (2014).

43 Baker & Scott Morton, *Antitrust Enforcement Against Platform MFNs*, 127 Yale L. J. 2176, 2194 (2018).

44 European Commission, *supra* note 36.

More recently, Crémer, de Montjoye & Schweitzer in the Report released for the European Commission on competition policy in digital markets have taken a stance on the issue, arguing that general rules cannot yet be developed and that a case-by-case approach is necessary. However, they claim that any practice aimed at protecting the investment of a dominant platform should be minimal and well-targeted: this would imply that banning only the wide MFN would be sufficient in cases where competition between platforms is vigorous; on the other hand, when competition between platforms is weak, then pressure on the dominant platforms can only come from other sales channels and it would also be appropriate to prevent narrow MFNs.[45]

Finally, the new Regulation on platform-to-business relationships imposing transparency measures requires online intermediaries to disclose the economic, commercial, or legal grounds for MFNs in their terms and conditions, thus implicitly accepting the use of such clauses.[46]

A clear indication on the approach guiding the enforcement on the clauses at issue should come from the Commission in the revision process of VBER and related Guidelines. This would also constitute an opportunity to address the critics on the current enforcement record on vertical restraints and on the lack of a proper consideration of the efficiency justifications for such contractual restrictions in multi-sided environments.[47]

45 Crémer, de Montjoye & Schweitzer, *Competition Policy for the Digital Era,* at 56-57 (2019), http://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf. As an example of weak competition between platforms, experts argue that in the case of hotel booking platforms direct sales by hotels on their own websites may exercise pressure on dominant platforms. *Id.* at 5-6.

46 *Regulation (EU) 2019/1150 of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services*, OJ L 186/57, 11.7.2019, Art 10.

47 Caffarra & Kühn, *The competition analysis of vertical restraints in multi-sided markets*, in OECD, *supra* note 26, at 213, 219.

CHINA'S *EASTMAN* CASE: A NON-EXCLUSIVE VIEW ON EXCLUSIVE DEALING?

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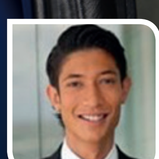

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I. INTRODUCTION

In April 2019, almost a year after the merger of the three former antitrust agencies, China's State Administration for Market Regulation (the "SAMR") published an administrative sanction decision (the "Sanction Decision") against Eastman Chemical (China) Co., Ltd ("Eastman China"), a multinational chemical company (the "*Eastman* Case"). SAMR's local branch in Shanghai (the "SHAMR") imposed a fine of approximately USD 3.5 million (RMB 24.38 million) for abuse of dominance through exclusive dealing measures and other trade restrictions in violation of Article 17.1(4) of PRC's Anti-Monopoly Law (the "AML").

The antitrust agency determined that Eastman China held a dominant position in the relevant market for the supply of CS-12 coalescent (a type of additive used in latex paints) in China from 2013 to 2015. Eastman China implemented two sets of exclusivity arrangements, which effectively forced customers to purchase most or all CS-12 coalescent from Eastman China and therefore restricted these customers from trading with other competitors. Specifically:

- Eastman China entered into long-term contracts with six direct sales customers (collectively referred to as Company A), which included a minimum purchase obligation for two to three years (the "Minimum Quantity Clause"). In order to enforce the Minimum Quantity Clause, Eastman China also included an obligation in the contract requiring Company A to either take the minimum quantities or make payment for such minimum quantities (the "Take-or-Pay Clause").

- Separately, Eastman China entered into a long-term agreement with Company B, pursuant to which Company B would be entitled most favored nation ("MFN") terms in the global sales territories of Eastman if the total amount of coalescent purchased by Company B from Eastman China accounted for more than a certain percentage of its total demand (the "MFN Clause"). In addition, Eastman China reached an ancillary sales incentive agreement with Company B and offered additional sales discounts.

II. MFN CLAUSES AS A MEANS OF ACHIEVING EXCLUSIVITY

Even though the adoption of MFN terms in the *Eastman* Case was heavily scrutinized, the competition assessment clarified that MFN clauses would only attract such scrutiny under specific circumstances. MFNs are often ambivalent and not systematically anticompetitive. In particular, MFN clauses may only raise concerns where there is market power and where such clauses are adopted as part of a wider set of multiple measures to achieve exclusivity. In the *Eastman* Case, MFN clauses were implemented alongside a number of other measures to achieve exclusivity. A clear focus on market power and competitive harm, as articulated in the *Eastman* Case, is a sensible approach to the assessment of MFN clauses.

A. MFN Clauses will Generally not Attract Scrutiny in China Unless there is Market Power

An MFN clause typically represents an arrangement in vertical agreements between buyers and sellers whereby the seller guarantees that the buyer will receive the best price or terms for a product or service compared to its competitors. In particular circumstances, such clauses may raise antitrust concerns where sellers are prevented from lowering their prices, and where beneficiaries of MFN clauses have little incentive to compete with each other.

In China, MFN clauses are unlikely to raise such concerns where there is a lack of market power by the parties or where markets are not concentrated. So far, other than this case where MFN is viewed as a means for a dominant firm to implement an exclusivity arrangement, there have been no regulations or precedents addressing MFN clauses. The recently promulgated Interim Provisions for Monopolistic Agreements introduced a catch-all provision that could allow China's antitrust agency to look at exclusivity arrangements, including MFN clauses, outside dominance and in the context of anticompetitive agreements. In light of these recent changes, there may be greater scope for enforcement actions against MFN clauses, including on the basis of possible collusion or vertical restraints on pricing in markets adopting MFN clauses as a common practice (i.e. for two-sided or multi-sided markets or oligopoly markets).

In jurisdictions outside China, MFN clauses can still attract horizontal and vertical issues in the absence of dominance:

- MFN clauses may facilitate collusion amongst competitors, as displayed by Apple's *e-book* case in the United States where MFN clauses were found to have been utilized by Apple to facilitate "hub-and-spoke" collusion amongst publishers to raise the price of e-books;

- MFN clauses may also decrease a seller's motivation to reduce prices and damage other undertakings' freedom to determine their own prices, which may generate anticompetitive effects similar to resale price maintenance. Germany's Federal Cartel Office, for instance, found that MFNs could reduce intrabrand price competition. In its online hotel bookings investigation, the Federal Cartel Office considered that hotels would be reluctant to offer lower prices in light of an MFN scheme being in place.[2]

B. MFN Clauses Alone are Unlikely to be Presumed Anticompetitive and Abusive

The adoption of MFN clauses by dominant undertakings is not presumed to be abusive and will be judged under a rule of reason analysis.[3] The Sanction Decision acknowledges that "a global MFN Agreement may not give rise to the effect of restricting transactions." In the *Eastman* Case, the antitrust agency classified the arrangements entered into between Eastman China and its customers as the "MFN Agreement", even though it might be better described as exclusivity arrangements which involved a most-favored nation regime, minimum quantity obligations, and loyalty discounts. Notably, the MFN Clause itself was insufficient to generate the anticompetitive effects of foreclosure and restricting competition. Instead, the Sanction Decision clarifies that it is the combination and aggregation of all the above arrangements in the *Eastman* Case that render the conduct as a whole incompatible with the AML.

Eastman China achieved exclusivity through minimum purchase obligations, take-or-pay arrangements, and incremental purchase discounts above and beyond the MFN regime:

- Minimum quantity forcing and Take-or-Pay. The Take-or-Pay Clause and the Minimum Quantity Clause were considered forms of exclusivity measures in the *Eastman* Case. The antitrust agency pointed out that "the anticompetitive effects in this case are enhanced by the Take-or-Pay Agreement and the MFN Agreement. Considering Eastman China imposed exorbitant minimum quantity requirements in both of the abovementioned exclusivity agreements, which created onerous compulsory obligations in respect of purchase quantity in the long term, and rendered it obviously difficult for transaction counterparties [customers] to change suppliers."

- Incremental purchase discounts. Another exclusivity measure were sales discounts implemented by Eastman China. A supplementary incentive agreement provided that "a sales discount, in addition to the most-favored price, would be offered to Company B, on the condition that certain product purchase quantity had to be reached in a particular regional market." Eastman China offered an incremental purchase discount on the basis of the lowest price level. Under such conditions, no other competitors in China were able to match the price level offered by Eastman China. Company B would only purchase CS-12 coalescent from Eastman China during the term of the agreement alongside a minimum purchase quantity obligation that locked-in 75 percent of the product demand of Company B in China.

III. INCREASED RISK AS A RESULT OF ADDITIONAL LOYALTY DISCOUNTS

The "MFN Agreement" by Eastman China also offered additional sales discounts, which in a broad sense were a type of loyalty rebate program, which raised exclusive dealing concerns in combination with a range of other measures. In terms of the analysis, the *Eastman* Case applied the well-established "as-efficient competitor" test adopted in the *Tetra Pak* Case to determine the possible anticompetitive effects arising from the MFN Agreement. In particular, the Sanction Decision noted that "under such conditions, no other competitors in China were able to match the discount and other favorable conditions under the most-favored-nation treatment." Such "other" favorable conditions were contemplated in a separate incentive agreement which detailed the sales discounts at agreed levels/percentages to be paid to customers on the condition that certain product purchase quantities were met.

A. Narrowly Defined Loyalty Discounts under the Tetra Pak *Case*

In 2016, one of the former antitrust agencies, the State Administration for Industry and Commerce (the "SAIC") imposed a fine of RMB 668 million (USD 96.3 million) on Tetra Pak for conduct involving tying, exclusive dealing, and loyalty discounts that were found to eliminate and restrict competition (the "*Tetra Pak* Case"). This was the first time China's antitrust authorities elaborated on their position on loyalty discounts, finding

2 Similar MFN clauses have been condemned by other antitrust agencies. In the literature, Fletcher & Hviid suggest that retail price MFC clauses can be seen as equivalent to the worst of RPM and should not be treated any less harshly than RPM. See Amelia Fletcher & Morten Hviid, Retail Price MFNs: Are They RPM "At Its Worst"? 2 (ESRC Ctr. for Competition Pol'y, Working Paper No. 14-5, 2014) at 32.

3 See Taking Eastman Monopoly Case as an example: the investigation and handling of abuse of dominant market position case, China Market Supervision News, July 9, 2019. Senior officials responsible for the *Eastman* Case investigation explained that "… for the same business conduct, when it is implemented by different undertakings, under different market conditions, or in different geographic markets, it may produce completely distinct results. Therefore, the antitrust agencies, when pursuing this type of cases, should conduct their analysis by taking into account various factors and should follow the principles of case-by-case analysis and rule of reason."

that Tetra Pak had implemented tens of different types of discounts including retroactive cumulative volume discounts and customized targeted discounts (also known as retroactive discounts with single thresholds).

Tetra Pak's retroactive discount scheme offered customers discounts in accordance with preset thresholds based on the total volume of packaging material purchased from Tetra Pak in a given year. SAIC noted that the anticompetitive effects of the retroactive discounts stem from their ability to lock-in the purchases of a specific customer and convert this previously contestable demand into non-contestable demand. A critical feature of the retroactive discount is the lack of incentive to switch to alternative suppliers before qualifying for the rebate. Therefore, "the setting of intervals between different thresholds and ranges of discounts are of critical importance to the inducing effect." In other jurisdictions such as EU and US, loyalty discounts imposed by dominant undertakings are not presumed illegal. This includes the recent *Intel* decision[4] in 2017 where the European Court of Justice applied the rule of reason to set aside the General Court's quasi-per-se test for loyalty rebates. The US antitrust regime treats loyalty discounts in a more lenient manner based on rules that govern predatory pricing.

In China, there is no doubt that the retroactive and customized targeted discounts carry higher risks than basic incremental discounts. However, not all rebate/discount schemes that meet the basic characteristics of these retroactive cumulative discounts are automatically prohibited by the AML. To determine their competitive harm, the effects of the discounts need to be assessed in light of factors including the size of the non-contestable demand, the design of the discount, the market conditions, etc.

B. A Broader Take on Loyalty Discounts in the Eastman *Case*

The Sanction Decision does not characterize the sales discounts included in the arrangements of Eastman China. They could be similar to the retroactive cumulative volume discounts in the *Tetra Pak* Case or simply incremental discounts. Regardless, SHAMR may at least consider them to be "loyalty discounts in a wide sense" by inducing customers to purchase more products through discounts or preferential trading conditions, the outcome of which is to lock-in purchase quantities and demand.

IV. ANALYZING MFN CLAUSES AND LOYALTY DISCOUNTS IN THE CONTEXT OF EXCLUSIVE DEALING

China's antitrust agency found that Eastman China sought to implement exclusive dealing arrangements by way of a range of measures including the MFN Clause, Take-or-Pay Clause, and the loyalty discounts. Their purpose was to lock in customers' demand which had the effect of foreclosing its competitors. Regardless of the apparent competitive harm that could arise from these arrangements, it is still necessary to analyze their substance and potential effects, in isolation and in aggregation.

Notably, the Sanction Decision precedes the recent promulgation of the Interim Provisions on the Prohibition of Abuse of Dominant Market Position (the "Provisions on Abusive Conduct"). Article 17 not only refers to exclusive dealing in terms of the "direct restrictions" explicitly noted in the Provisions, but also refers to restrictions "in disguised form by imposing [unreasonable] trading conditions." There is a possibility that the antitrust agency may further expand the scope of law enforcement of exclusive dealing and challenge atypical forms (such as the MFN Clause plus minimum quantity purchase obligations in the current case against Eastman China).

In addition, the Provisions on Abusive Conduct detail a number of potential reasons that may justify exclusive dealing, such as "ensuring product quality and safety or protecting intellectual property and specific investments." Although the list of reasons is primarily geared towards establishing a proper purpose for the conduct in question, the broader effects of the conduct need to be taken into account as well. This includes the benefits to counterparties and consumers as well as the broader impact on economic efficiencies. Accordingly, the list of justifiable reasons set out in the Provisions on Abusive Conduct does not operate in isolation and cannot be applied in a formalistic manner. Undertakings may also need to consider the competitive effects of the conduct in question in addition to their purpose based on the list of justifiable reasons.

The Sanction Decision fails to elaborate on any justifications or efficiencies that could have motivated the exclusivity arrangements Eastman China entered into with customers in this case. The Sanction Decision does note that the long-term contracts and exclusivity agreements "can reduce the negotiation costs of the seller and the purchaser to a certain extent" and "make it easier for both parties to transactions to plan purchases and production." However, the antitrust agency held that "they have also brought about the obvious result of restricting transactions and anti-competitive effects, and their negative effects are greater than economic efficiency." Therefore, from the perspective of antitrust compliance, when formulating specific business policies the undertaking should not only refer to the "justifiable reasons" listed in the Provisions on Abusive Conduct, but also engage in a balancing exercise to determine whether any benefits outweigh any possible anticompetitive harms.

4 T-286/09, *Intel v. Commission.*

V. KEY TAKEAWAYS FROM THE *EASTMAN* CASE

The *Eastman* Case demonstrates that certain trading restrictions will not fall foul of the AML in isolation but may raise concerns in aggregation and on a case-by-case basis, where they can be classified together as measures intended to achieve exclusivity.

A. Capturing Substantial Proportion of Demand will Suffice to be Classified "Exclusive"

Article 17 of the AML describes exclusive dealing as "an undertaking with a dominant market position restricting trade of the counterparties with it or its designated undertakings only." It has so far not been immediately apparent whether an arrangement by a dominant firm to lock-in less than the total market demand could be classified as "exclusive dealing" in violation of the AML. The application of exclusive dealing prohibition by China's antitrust agencies over the last decade prior to the *Eastman* case arose only in the context of obligations that required counterparties to deal with the dominant firm *solely* rather than predominantly or partially. The *Eastman* Case now confirms (although not surprisingly) that the exclusive dealing prohibition under the AML does not require customers to deal entirely with the dominant firm – a substantial proportion of demand can suffice.

Separately, exclusive dealing is condemned where dominant firms lock-in demand of customers in order to maintain or increase their market share and consolidate or strengthen their market power. Eastman China's market share was above 50 percent while the demand of customers locked-in through its exclusivity arrangements accounted for about 20 percent of the total sales volume in the market. In other words, the market demand locked-in by Eastman China's "exclusive dealing" (i.e. 20 percent) was significantly lower than its own market share (i.e. more than 50 percent), which arguably could not have enabled Eastman China to maintain or increase its market share or market power.

B. Relative Market Power of Other Competitors to Determine Extent of Exclusivity

The structure and specific characteristics of the market are of vital importance. In this case, the specific structure of the relevant market can be divided into two parts: large direct clients with stable demand, and small and medium-sized clients with unstable and scattered demand (mainly supplied through distributors and agents). The antitrust agency determined that Eastman China had locked-in "most demand" (between 60-80 percent) from large direct clients through "exclusive dealing." For small and medium-sized clients, who account for nearly 80 percent of total market demand, Eastman China did not engage in any restrictive dealing arrangements. In that regard, with the characteristics of scattered demand and low orders from individual customers, the other two major competitors active in the relevant market should in principle be able to effectively compete, given the remaining 80 percent of market demand. The Sanction Decision fails to address this point sufficiently. Together, the three undertakings including Eastman China account for about 95 percent of the total market size, demonstrating that Eastman China's competitors had at least relative market power and could have possibly competed for the demand of small and medium-sized customers irrespective of the exclusive dealing arrangements entered into by Eastman China in respect of large direct clients.

C. Risks of Quantity Forcing

As for the type of the minimum quantity clause, it will generally be riskier to agree on the purchase proportion (such as requiring the customer to source 90 percent of its estimated annual demand from the dominant firm) than to agree on the specific purchase volume or purchase value. A minimum quantity clause linked to the customer's overall demand is a more direct restriction on the customers who cannot purchase from dominant firm's competitors (may be similar to the non-contestable demand, the antitrust agency held that "the entry barrier for the locked-in portion of demand is extremely high" in the *Eastman* Case). Further, in case the customer has new and additional demand on top of the original estimate, it may not be able to switch to a new supplier competing with the dominant firm for such new demand when the proportion of total demand (rather than specific volume) is locked. The proportion requirement therefore may further exclude competitors and reduce competition in the relevant market.

D. A Note on the Economic Analysis

The authority in the *Eastman* Case applied econometric tools to help define relevant markets and assess possible anticompetitive effects. This included Critical Loss Analysis to determine the amount of substitution necessary to expand a provisional market definition and the Lerner Index to measure market power by relating price to marginal cost. To a degree, this has increased the predictability, transparency, and sophistication of the authority's enforcement practice, providing an invaluable self-assessment tool in responding to antitrust investigations. Still, the agency took a potentially narrow approach in its economic analysis. For instance, in analyzing the exclusivity arrangements, the agency found it apparent that the absence of the Take-or-Pay Clause would have effectively diminished the level of market power of Eastman China as determined by the Lerner Index, therefore suggesting that the Take-or-Pay Clause itself (rather than the combination of all exclusive arrangements including the MFN Clause) had the effect of eliminating and restricting competition. However, the agency seemed to fail to consider other factors that could have also been relevant here when construing the counterfactual situation. For instance, the systematic impact of the fluctuations of international prices of crude oil on the raw material prices of the relevant products in this case also has a significant influence on the level of competition in the whole market. Further, as marginal costs form the basis of calculating market power under the Lerner Index, it would have also been necessary to compile and compare marginal costs data of comparable homogenous goods of major suppliers in the market. In that regard, the use of econometric models, and their results, will continue to depend on the nature, credibility, and comprehensiveness of the underlying data.

LOYALTY REBATES – A CORPORATE COUNSEL GUIDE

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I. INTRODUCTION

Corporate counsel is most often asked to provide reliable and business-oriented guidance on business practices, assess whether those practices may result in foreseeable and avoidable contingencies, and structure those practices in such a way that the company is able to maximize its profits. Companies doing business on a global basis further need to make sure those business practices may be pursued in a consistent manner across the various jurisdictions, or otherwise be adapted according to the prevailing legal environment. In circumstances where companies have dominant or otherwise strong market positions, such position imposes higher standards towards competitors.

In his dissent in *ZF Meritor v. Eaton Corp.*, a 2012 case involving loyalty rebates, Judge Morton Greenberg stated that "I do not know how corporate counsel presented with a firm's business plan at least if it is a dominant supplier that seeks to expand sales through a discount program that might be challenged by competitors as providing for a *de facto* exclusive dealing program and asked if the plan is lawful under the Sherman and Clayton Acts will be able to advise the management. The sad truth is that the counsel only will be able to tell management that it will have to take a chance in the courtroom casino at some then uncertain future date to find out."[2]

II. THE NOTION OF LOYALTY

Management — including corporate counsel — is asked to maximize a firm's results, and business performance targets are normally measured *vis-à-vis* certain indicators achieved by the firm in prior periods, including volumes, EBITDA, market shares, or other thresholds that need to be maintained or maximized. Management thus implements business programs geared towards achieving those targets, including conditional pricing practices or contracts that reference rivals.[3] Loyalty incentives are envisioned as minimizing agency costs and aligning performance targets between suppliers and buyers, where buyers undertake to provide sales-shifting services towards increasing their demand for the seller's product, normally at the expense of its rivals.

Loyalty is not only praised, but has unambiguously positive connotations when analyzed from an ethical, political, and legal perspective. But when it comes to the antitrust arena, such unambiguously positive connotation is often put into doubt, particularly when the firm may enjoy a strong market share.[4] The antitrust concerns that the notion of loyalty may bring are normally associated with the ability of dominant firms to foreclose rivals.

Loyalty discounts are "a particular form of non-linear pricing in which the unit price of a good declines when the buyer's purchases meet a buyer-specific minimum threshold requirement."[5] Non-linear pricing occurs when the buyer's total expenditure on an item does not rise linearly with the amount purchased. In a loyalty discount setting, the buyer gets a better price per unit if it purchases specified percentages of its requirements from the vendor, once the stipulated non-linear threshold is met.

Loyalty discounts may take many forms and vary in at least three important dimensions.[6] The first dimension is the nature of the threshold purchased for the discount to be triggered, which may include a market share discount, a volume discount, a shelf facing or space share discount, and a growth discount *vis-à-vis* prior periods in any or a combination of these thresholds. The second dimension involves the units the discounts will be applied to upon meeting the threshold, and may include an all-units discount — resulting in a rebate that shall apply retroactively to all units purchased, both above and below the stipulated threshold — or a traditional incremental discount, being one that shall only apply to those incremental purchases exceeding the agreed upon threshold. Finally, the third dimension is the number of products upon which the thresholds are applied, and may include a single product loyalty discount or a bundled rebate that may involve more than one product.

2 *ZF Meritor, LLC v. Eaton Corp.*, 696 F.3d 254.

3 Fiona M. Scott Morton, *Contracts that Reference Rivals, American Bar Association*, Antitrust, Vol. 27 No. 3, Summer 2013.

4 Daniel A. Crane, *Bargaining Over Loyalty*, 92 TEXAS L. REV. 253, 274–75 (2014).

5 Bruce H. Kobayashi, *The Economics of Loyalty Discounts and Antitrust Law in the United States*, COMPETITION POL'Y INT'L, Autumn 2005, at 115, 116.

6 Joshua D. Wright, "Simple but Wrong or Complex but More Accurate? The Case for an Exclusive Dealing-Based Approach to Evaluating Loyalty Discounts," Bates White 10th Annual Antitrust Conference Washington, DC June 3, 2013.

III. THE LEGAL STANDARDS

The legal framework under which these conditional pricing practices are analyzed remains polarized between two main views.

A first group endorses the analysis of loyalty rebates from an exclusionary perspective and would argue that any competitive concerns that may arise are similar to those that may arise from exclusive dealing. Thus, discounts may be used as a strategy to exclude rivals, raise rivals' costs to ultimately reduce output, increase prices, and harm consumer welfare. Loyalty discounts that require a substantial threshold, but less than one hundred percent, would qualify as a *de facto* exclusive dealing, and conversely, exclusive dealing may be portrayed as loyalty discounts that are triggered at a one hundred percent threshold.[7]

A second group advocates in favor of analyzing loyalty rebates from a predation perspective. As per this approach, antitrust law should not penalize unilaterally established prices unless they are predatory, because preventing above-cost conditional discounts could otherwise chill beneficial price competition and have adverse effects for consumer welfare.

Preventing discounts that are above an appropriate measure of cost would otherwise reduce price competition, which is a goal that antitrust ultimately pursues in order to promote consumer welfare. This safe harbor for conditional discounts that are above cost echoes Brooke Group,[8] would provide predictability — as claimed by Judge Greenberg in the opening statement — and would ensure that less efficient firms should not be able to turn their defeat in the market into an antitrust claim.

The *ZF Meritor* decision highlights the tension between analyzing conditional pricing practices following the exclusive-dealing approach and the predation approach. The court analyzed the claim as exclusive dealing and concluded that "[t]he legality of an exclusive dealing arrangement depends on whether it will foreclose competition in such a substantial share of the relevant market so as to adversely affect competition." In turn, eighteen highly reputed scholars submitted an *amici curiae* brief in support of the Petitioner (Eaton) to argue that "a plaintiff challenging market share or other loyalty discounts as exclusionary must prove below-cost pricing" and favoring a price-cost analysis rather than asking whether rebates were coercive.[9]

Supplementing these two main theories of harm, additional perspectives have been suggested to analyze loyalty rebates. Some make a distinction on whether the rebate may be characterized as a penalty rather than as a reward. Whenever a supplier is able to threaten its customers with financial penalties and deploy a coercive strategy, the retailer is likely to be unable to afford not carrying the supplier's products to attend its customers' needs, because of their preference for the dominant supplier's products.

A variation of this "discounts as penalties" argument consists in defining the discounts as disguised taxes on disloyalty. This argument proposes that discounts are used by a supplier to impose a "tax" on retailers who purchase products from rival manufacturers, equal to the units discounts these purchasers give up by not buying from the supplier, and may ultimately result in barriers to entry or in foreclosure effects.

Another view states that if the price set by the dominant vendor is above marginal cost, an equally efficient competitor can still compete and make sales. The 'as efficient competitor' test, known as the "AEC test," plays an important role in the EU legal framework to assess the possible existence of a strategy aiming to exclude from the market competitors that are at least as efficient as the dominant firm.

An interesting notion is the one that refers to the contestable units or volume, which would mean the portion of the demand for which customers may consider switching between different suppliers. Some inframarginal customers may buy the leading firm's products even if a competing firm would offer a lower price and thus, the leading firm may structure the discount to induce purchases beyond that uncontestable threshold in the hope of foreclosing rivals.[10] However, others advocate against trying to isolate the contestable and incontestable volume as it would constitute "a fruitless exercise" which is "modeled beautifully in economic papers but in the real world is just not practical."[11]

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7 Derek W. Moore & Joshua D. Wright, *Conditional Discounts and the Law of Exclusive Dealing*, 22 GEO. MASON L. REV. 1205 (2015).

8 *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209.

9 Brief for Eighteen Scholars as *Amici Curiae* in Support of Petitioner, *Eaton Corp. v. ZF Meritor, LLC*, No. 12-1045 (U.S. Mar. 28, 2013), 2013 WL 1309073. Interestingly, they took "no position on how the cost-price test should be applied to market share discounts".

10 Cf. *Eisai, Inc. v. Sanofi Aventis U.S., LLC*, 821 F.3d 394 (3d Cir. 2016), in which Eisai argued that Sanofi bundled the contestable and incontestable portion of the demand as an exclusionary tool. Cf. Article 39 of EU Guidance on Article 102 Enforcement Priorities.

11 Jonathan Jacobson, Partner, Wilson Sonsini Goodrich & Rosati, Presentation at the DOJ/FTC Workshop on Conditional Pricing Practices (June 23, 2014). Leah Brannon, Partner, Cleary Gottlieb Steen & Hamilton, LLP, also raised similar objections at the same Workshop.

The analysis of the legal standards that would apply to loyalty rebates would not disregard the three categories of rebates drawn by the EU General Court in *Intel*.[12] First, quantity rebates, which are those linked solely to the volume of purchases made and which are *prima facie* lawful, as they are deemed to reflect gains in efficiency and economies of scale. Second, exclusivity rebates, which are conditional on the customer's obtaining all or most of its requirements from the undertaking in a dominant position and that, as per the EU General Court, are *prima facie* prohibited. And finally, rebates falling within the "third category," which depend on the attainment of individual sales objectives and do not constitute exclusivity rebates. These "third category" rebates require an assessment of all circumstances, particularly the criteria and the rules governing the granting of the rebate, to determine whether there is an economic service that justifies it.

The EU General Court in *Intel* had concluded that the Intel rebates fell within the second category as "fidelity rebates within the meaning of Hoffmann-La Roche," the first major judgment of the European Court of Justice dealing with rebates in 1979, and which imposed a strict standard finding it abusive for an undertaking in a dominant position to offer rebates conditional on the customer's obtaining all or most of its requirements — whether the quantity of its purchases be large or small, even in circumstances where they were entered at the request of the purchasers. Rebates by dominant firms would constitute an abuse "by object" without inquiring whether they resulted in harmful effects on consumer welfare or whether they foreclosed competition. This €1.06 billion fine imposed by the EU Commission on Intel in 2009 and upheld by the General Court in 2014 was heavily criticized because the approach to the application of Article 102 TFEU was formalistic and because it had declared that there was no need to prove whether AMD, the competing microprocessor supplier, was an equally efficient competitor.

In 2017, the EU Court of Justice set aside the judgement of the General Court[13] concluding that the presumption of abuse arising from the dominant undertaking could be reversed in the event supporting evidence could be produced. The Court of Justice further argued that the AEC test played an important role in the assessment of whether the rebate scheme was capable of having foreclosure effects and should include (i) the extent of the undertaking's dominant position on the relevant market; (ii) the share of the market covered by the challenged practice; (iii) the conditions and arrangements for granting the rebates, their duration, and their amount; (iv) the possible existence of a strategy aiming to exclude competitors that are at least as efficient as the dominant undertaking from the market (i.e. the AEC test); and (v) whether the exclusionary effect arising from such a system, which is disadvantageous for competition, may be counterbalanced, or outweighed, by advantages in terms of efficiency which also benefit the consumer.

The *Intel* decision of the EU Court of Justice is said to have made two fundamental contributions to understand the notion of abuse.[14] First, that Article 102 TFEU is only concerned with the exclusion of rivals that are as efficient as the dominant firm. This implies that the departure from the market of rivals that are less attractive in terms of, inter alia, price, quality or innovation is deemed to be a natural outcome of the competitive process and as such unproblematic. And second, that practices are only caught by Article 102 TFEU insofar as they are capable of having anticompetitive effects, which translates into the ability of dominant firms to provide evidence showing that the practice was incapable of having anticompetitive effects.

The EU Court of Justice decision in *Intel* is consistent with the Commission's approach to conditional rebates in its Guidance on Article 102 Enforcement Priorities,[15] which was adopted in 2009 after the investigation on Intel had started. The Guidance Paper provides certain benchmarks and criteria[16] to conduct a price/cost analysis that shall be integrated into a more general assessment of anti-competitive foreclosure, in its aim to add rigor to the assessment of exclusionary practices.

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12 Case T286/09, *Intel Corp v. Commission*, EU:T:214:547.

13 *Intel v. Commission*, Case C-413/14P.

14 Pablo Ibañez Colomo, *The Future of Article 102 TFEU after Intel*, Journal of Competition Law & Practice, 2018, Vol. 9, No. 5.

15 2009/C 45/02.

16 "The Commission considers that: where a dominant firm is charging an effective price below AAC [average avoidable cost], the rebate is generally capable of foreclosing competitors as efficient as the dominant firm; where a dominant firm is charging an effective price that is between AAC and LRAIC [long-run average incremental cost], other relevant factors, such as competitors' counterstrategies, should be taken into account to determine the possibility of anti-competitive foreclosure; where a dominant firm is selling at an effective price above LRAIC, the rebate is normally not capable of anti-competitive foreclosure." Richard Whish & David Bailey, Competition Law, Seventh Edition, Oxford University Press 2012, page 735. As per footnote 18 of the Guidance Paper, AAC may be assimilated to the Average Variable Cost, while LRAIC may be assimilated to the Average Total Cost.

IV. GUIDELINES FOR CORPORATE COUNSEL

Consistent with the conclusions of the EU Court of Justice in *Intel*, Judge Richard A. Posner has stated that "[t]he fact that a firm has monopoly power doesn't mean that the law should prevent it from competing. It would be absurd to require the firm to hold a price umbrella over less efficient entrants. [...] Only when monopoly power is used to discourage equally or more efficient firms and thus perpetuate a monopoly not supported by superior efficiency should the law step in."[17] And similarly, the U.S. Supreme Court concluded in Matsushita that "cutting prices in order to increase business is often the very essence of competition."[18] In short, even when a firm enjoys a significant market share, it should not be prevented from competing.

A first approach would suggest corporate counsel to confirm that the discount program does qualify as competition on the merits and has a business justification different than simply pursuing exclusionary effects on as efficient rivals and ultimately, adversely affecting consumers. The efficiency gains or objective justification of the program may be explained by the sales-shifting services provided by the buyer, the stimulation of retailer services and dealer focus, the protection of manufacturer investments in relationship-specific assets, brand positioning, or otherwise. "If it appears that the conduct can only raise obstacles to competition and that it creates no efficiencies, its anti-competitive effect may be inferred."[19]

A price-cost analysis of conditional pricing practices, particularly in industries with low average variable costs, high profit margins and/or high R&D investments, like the pharma industry, would not constitute a fruitful endeavor. It may be, however, a starting point for analyzing whether the discounts lead to above-cost prices, which would in principle be easier for counsel than analyzing the (exclusionary) effects in the industry or the market or assessing whether the program violates the rule of reason. However, by no means would an above-cost price measured against all units represent a safe harbor, as such discount may still produce anticompetitive effects. The pricing orientations contained in the EU Guidance on Article 102 Enforcement Priorities "to determine whether even a hypothetical competitor as efficient as the dominant undertaking would be likely to be foreclosed by the conduct in question" or otherwise to conduct the AEC test would indeed be very helpful for counsel, but not necessarily would those automatically fit every industry.[20]

As regards the analysis of the potential exclusionary and foreclosing effects, and further to the standards developed in the preceding chapter, the exercise would be identical to the one to be conducted in connection with exclusive dealing agreements and the principles laid down in *Tampa*[21] would apply, to wit: "[e]xclusive dealing arrangements are unlawful when they foreclose a substantial share of the relevant market to rivals." The notions of "substantial share" and of "minimum efficient scale" would not be consistent notions across industries, and a variety of economic and business facets would need to be analyzed, including the structure of the market, the fixed and variable costs in the industry, whether the industry deals with differentiated or homogeneous products, barriers to entry, capacity and distribution constraints, the ability of expansion of existing competitors, and the ability of rivals to compete for exclusives.[22]

The retroactive or incremental nature of the rebates (all-units discount) is an element to consider carefully, as it may, in general terms, favor market foreclosure and make it less attractive for customers to switch even small amounts of demand to competitors.[23] While retroactive or all-units discounts "can benefit consumers by reducing prices and increasing output beyond what the monopolist would otherwise have charged or produced, leading to more efficient resource allocation," [24] they "may be anticompetitive in certain circumstances."[25]

17 Richard A. Posner, Antitrust Law, quoted by Jacobson, Jonathan & Weick, Daniel, *Countering Exclusion: The Complainant's Obligation*, Antitrust Law Journal, Chicago, Volume 81, No. 2 (2017); 423-446.

18 *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

19 EU Guidance on Article 102 Enforcement Priorities, article 22.

20 *Supra* note 16.

21 *Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961).

22 For an analysis of the notion of foreclosure, cf. Joshua D. Wright, *Moving beyond naïve foreclosure analysis*, George Mason Law Review, Vol. 19, No. 5, Summer 2012, pp. 1163-1198.

23 EU Guidance on Article 102 Enforcement Priorities, article 40.

24 U.S. Dep't of Justice, Competition and Monopoly: Single-Firm Conduct under Section 2 of the Sherman Act 106 (2008).

25 *Idem* at 107.

In the event the product were to qualify as a must-have or a must-stock item, this would be an important element for analyzing the coercion to be exerted on customers if they fail to comply with the loyalty or exclusivity conditions, and the potential effect of locking-in customers and excluding rivals. After *Intel* and *ZF Meritor*, coercion and the structure of the market would not qualify as stand-alone arguments to question the legality of rebates.

The duration of the agreement or agreements and their ease of termination would be important elements for analyzing the potential exclusionary nature of the rebates, along with the other facets of the pricing program. In *Concord Boat* the court reiterated that "contracts terminable in less than a year [are] presumptively lawful."[26] In *Tampa*,[27] a twenty-year exclusive arrangement foreclosing only a very small percentage (one percent) of the market was upheld, and the long-term agreements at issue in *ZF Meritor*, with rebates triggered on minimum purchases between 70 and 97.5 percent, were of at least five years.

Another aspect to pay attention to would be the reference period upon which to calculate discounts *vis-à-vis* the turnover, particularly in retroactive or all-units discounts settings: "[t]he longer the reference period, the more loyalty-inducing the quantity rebate system."[28]

Market thresholds would be another issue to be considered. May a company with a 40 percent market share seek to increment its market share to 45 percent? And what about one with a 70 percent market share? And one with a 90 percent market share? And would they play safe if their exclusives do not exceed their existing market shares or could those exclusives constitute barriers to entry or expansion to competitors? An increase in the market share shall entail a reduction of its competitors' shares — but not necessarily their volumes or income may be adversely affected.

In 2013, the FTC voted to issue a Complaint and Order against Graco, Inc.[29] to remedy the allegedly anticompetitive effects of Graco's acquisition of Gusmer Corp. and GlasCraft, Inc. Graco's market share of between 90 and 95 percent in the fast-set equipment industry had remained intact since its 2008 acquisition of GlasCraft.

FTC confirmed it tended to "believe that exclusive dealing relationships can have procompetitive benefits and that such relationships should not be condemned in the absence of a thorough factual and economic assessment of the circumstances surrounding such conduct." However, the FTC also indicated that "when employed by a competitor that has acquired significant market power or monopoly power, exclusive dealing arrangements have the potential to cement such power and prevent or deter entry that would lead to lower prices, higher quality, and better service for consumers." As a consequence thereof, behavioral remedies were imposed to restrict the scope of loyalty discounts that Graco was able to grant its distributors — requiring distributors to meet annual purchase and inventory thresholds to qualify for discounted prices — by prescribing the maximum threshold levels Graco may set in 2013 and by only allowing those maximums to increase by 5 percent year to year.

The FTC said nothing as to whether those thresholds would ultimately foreclose rivals from achieving minimum efficient scale, but rather authorized a (compounded and unlimited) 5 percent increase year after year. The *ex ante* review and further sign-off by corporate counsel of loyalty rebates to be granted by a company that enjoys such a significant amount of market share, and that may increase year after year, in a compounded and unlimited manner, would not be free from doubt. While such a sign-off was indeed given by the FTC itself, we would be careful of simply relying on the fact that that the FTC arguably blessed a compounded and unlimited *per se* legality that may be satisfied within those formal settings.

Corporate counsel shall be asked to provide orientation and structure conditional pricing practices or contracts that reference rivals in a variety of market and industry conditions. In between casino-gambling and full certainty, numerous legal and economic elements are available to give a reliable and thoughtful guidance for the firm to be able to promote efficiencies, maximize results and ultimately benefit consumers. We trust these thoughts may contribute to such analysis.

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26 *Concord Boat Corp. v. Brunswick Corp.* 207 F.3d 1039 (8th Cir. 2000), which in turn quoted *Rowland Mach. Co. v. Dresser Indus., Inc.*, 749 F.2d 380, 395 (7th Cir. 1984).

27 *Supra* note 21.

28 Case T-2 03/01 *Michelin v. Commission* [2003] ECR II-4 071.

29 Statement of the Federal Trade Commission *In the Matter of Graco, Inc.* FTC File No. 101-0215 April 17, 2013. Commissioner Wright issued a separate statement supporting the decision but disagreeing on two aspects, namely the provisions prohibiting Graco from entering into exclusive dealing contracts with distributors and establishing purchase and inventory thresholds that must be satisfied in order for distributors to obtain discounts. Cf. Statement of Commissioner Joshua D. Wright *In the Matter of Graco, Inc.* FTC File No. 101-0215, April 17, 2013.

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