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## NOTE

HOW PARALLEL MOST-FAVORED NATION CLAUSES IN  
THE TELEVISION INDUSTRY EXCLUDE COMPETITORS  
AND STIFLE INNOVATION<sup>†</sup>Bill Toth<sup>\*</sup>

*Most-Favored Nation clauses ("MFNs") are price protections common in many facets of commerce. In their simplest form, a seller guarantees that it will not offer a lower price to any competitor of its "most favored nation." Several antitrust cases, most notably in the health insurance industry, have been brought against monopolists that use MFNs with the effect of excluding "discount" competitors, some of which have been met with success. This Note posits that MFNs between television distributors and content producers may have the same exclusionary effects, even if no single distributor has monopoly power. Because many "discounters" distribute television content across the Internet, rather than via cable, this Note suggests that the exclusion of discounters in the television industry compounds the exclusionary harms to consumers by not only excluding beneficial business methods, but innovative digital video technologies. Drawing on the discussion of "Parallel Exclusion" in Professor Scott Hemphill and Professor Tim Wu's recent article in the Yale Law Journal, this Note suggests addressing these challenges by revisiting Judge Posner's "shared*

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*monopoly” approach to antitrust liability and provides support for the prohibition on MFNs in television proposed by Senator Jay Rockefeller in the Consumer Choice in Online Video Act.*

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## INTRODUCTION

Commercial entities have been granting “most-favored nation” status to business partners for centuries. The provisions granting this protection guarantee that the terms of an agreement between an offeror and its “most-favored nation” reflect the best terms that the offeror is proposing to any firm in the same market. Often, they require that the agreed-upon terms adjust to reflect any better offers.

Antitrust enforcement agencies have scrutinized these price guarantees as mechanisms of both price-fixing and competitor exclusion since the 1970s. These efforts, however, have been

limited to challenging the use of these guarantees by monopolists or firms acting in concert. A close examination of most-favored nation clauses in the television industry demonstrates that, when adopted independently by firms without monopoly power, the clauses may cause (and, indeed, may already have caused) exclusionary harms that slow innovation in business methods and technology to the detriment of consumers. This Note argues for a shift in antitrust doctrine in order to address the exclusionary harms posed by the independent adoption of this practice in the television industry.

Part I lays out the extensive background on most-favored nation clauses, discussing the strategic understanding of the clauses as well as the history of legal challenges to their use. Part II demonstrates the limitations of current antitrust doctrine to reach this kind of parallel conduct and argues that most-favored nation clauses adopted in parallel can, and, as specific examples suggest, *do*, exclude innovative firms from markets. Part III proposes a doctrinal shift that will enable closer antitrust scrutiny of parallel most-favored nation clauses and suggests some principles for limiting those adjustments so as to avoid chilling effects to pro-competitive conduct.

## I. MOST-FAVORED NATION CLAUSES UNDER CURRENT ANTITRUST DOCTRINE

In the most basic form, a “Most-Favored Nation” clause (“MFN”)<sup>1</sup> is simply a guarantee that the covered agreement reflects the most favorable terms that the offeror grants any party in the market.<sup>2</sup> Any failure to uphold that guarantee constitutes material breach of the agreement and is punishable as such. The use of MFNs in international trade treaties dates back at least six hundred years,<sup>3</sup> and they appear in American treaties at least as early as the

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1. These provisions are also known as “most-favored customer,” “most-favored buyer,” or “prudent buyer” policies.

2. For examples of early MFNs, see Stirling Adams, *Negotiating a Commercial “Most Favored Nation” Clause*, 1 INT’L L. & MGMT. REV. 79, 80 (2005) (“[I]f the Chinese were to grant any trading privileges or immunities to any subjects of non-British foreign countries ‘the same privileges and immunities will be extended to and enjoyed by British Subjects . . . .’”) and Sir Thomas Barclay, *Effect of “Most-Favoured-Nation” Clause in Commercial Treaties*, 17 YALE L.J. 26, 26-31 (1907).

3. See Adams, *supra* note 2, at 81 (“In drafting this [MFN in the mid-19th century], the British drew on a feature of treaty negotiation they had utilized for at least four centuries.”).

18th century.<sup>4</sup> MFNs remain critical components of modern multilateral international trade agreements such as the General Agreement on Tariffs and Trade, now incorporated as a component of the treaty creating the World Trade Organization via GATT 1994,<sup>5</sup> and the Trade-Related Aspects of Intellectual Property Rights agreement.<sup>6</sup>

The effect of MFNs in these agreements is to ensure non-discrimination in trade among the parties to the treaties.<sup>7</sup> MFNs in multilateral agreements ensure that the benefits of any member party's negotiations with any other member party are propagated to *all* member parties. Accordingly, an MFN in a trade treaty aims to eliminate discrimination within the community of the treaty. This non-discrimination policy is intended to benefit parties with less bargaining power, who can free-ride on rate changes and discounts negotiated by parties with more substantial bargaining power.<sup>8</sup> Ultimately, the goal of MFNs in multilateral trade treaties is to establish a level playing field that leaves markets free from protectionism and equally open to competition from any foreign producer.

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4. See Jacob Viner, *The Most-Favored-Nation Clause in American Commercial Treaties*, 32 J. POL. ECON. 101, 101 (1924) ("Article II of [the February 6, 1778 treaty between the United States and France] contained what had hitherto been the usual most-favored-nation pledge: 'The Most Christian King and the United States engage mutually not to grant any particular favor to other nations, in respect of commerce and navigation, which shall not immediately become common to the other party . . . .'").

5. General Agreement on Tariffs and Trade, art. I, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 ("Any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.").

6. Agreement on Trade-Related Aspects of Intellectual Property Rights, art. 4, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994) ("With regard to the protection of intellectual property, any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members.").

7. See George C. Fisher, *The "Most Favored Nation" Clause in GATT: A Need for Reevaluation?*, 19 STAN. L. REV. 841, 842 (1967) ("Nondiscrimination was one of the main principles upon which GATT was founded.").

8. Whether these benefits are actually realized, however, is not a certainty. See generally Henrik Horn & Petros C. Mavroidis, *Economic and Legal Aspects of the Most Favored Nation Clause*, 17 EUR. J. POL. ECON. 233, 233-37 (2001) (evaluating numerous criticisms of the theory underpinning MFNs in GATT); Fisher, *supra* note 7 (examining potential benefits of certain exceptions to MFNs in international trade).

MFNs may take on a wide range of more complex formats, however, which makes them useful tools in agreements outside the realm of international trade.<sup>9</sup> They may be limited such that the guarantee only applies to agreements within a certain geographical scope or time frame; they may be limited to purchases of comparable volume; they may be concurrent (requiring only that the instant contract terms reflect the best offer *at that time*, enforced only by actions for material breach) or retroactive (requiring that an offeror reimburse the offeree with MFN-status if it ever offers better terms to a third party). MFNs also offer various mechanisms for providing the protected party with information about the terms the offeror agrees to with third parties, such as auditing rights. An MFN may be an explicit component of a contractual agreement or it may simply be a unilateral policy offered to all contracting parties. MFNs may be triggered by the terms offered by the party offering the protection in any agreements that the offeror forms with third parties—known as a two-party MFN (“2PMFN”), or they may be triggered if *any* seller in the market offers a lower price to any party—known as a three-party MFN (“3PMFN”).<sup>10</sup>

MFNs have more recently found their way into bilateral commercial agreements in a wide range of industries.<sup>11</sup> Generally, MFNs in bilateral commercial agreements take the form of a non-reciprocal guarantee that a seller is giving a buyer its best price, and that the buyer is entitled to reimbursement should the seller subsequently offer a lower price.<sup>12</sup> Though the mechanism for an MFN is virtually the same in bilateral agreements as it is in multilateral agreements, the effect can be quite different. A

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9. See Judith A. Chevalier, Presentation at the Department of Justice and Federal Trade Commission Joint Workshop on Most-Favored-Nation Clauses and Antitrust Enforcement and Policy, *Efficiencies from MFNs: Economic Theories* (Sept. 10, 2012) (slideshow at 2-3), available at <http://www.justice.gov/atr/public/workshops/mfn/presentations/286767.pdf>.

10. *Id.* (slideshow at 3).

11. See, e.g., *In re Vitamins Antitrust Litig.*, 398 F. Supp. 2d 209, 216 (D.D.C. 2005) (using a “most-favored plaintiff” clause in settlement of litigation); *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic (BCBSW)*, 65 F.3d 1406 (7th Cir. 1995) (Posner, J.) (health insurance); Keith J. Crocker & Thomas P. Lyon, *What Do “Facilitating Practices” Facilitate? An Empirical Investigation of Most-Favored-Nation Clauses in Natural Gas Contracts*, 37 J.L. & ECON. 297 (1994) (natural gas).

12. Though the other forms of MFNs discussed above (particularly those with geographic, temporal, and volume limitations) are fairly common, this Note will generally focus on non-reciprocal retroactive unrestricted MFNs unless otherwise designated.

multilateral reciprocal MFN with global scope has the capacity to insulate an entire community from discrimination, whereas a bilateral non-reciprocal MFN insulates only the protected party from discrimination relative to the unprotected sector of the market. The unprotected competitors remain subject to discrimination by the offering party, now subject to the disadvantage that their negotiations are burdened by the possibility of triggering the protected party's MFN.

A non-reciprocal MFN, on its own, does not confer any direct benefit on the offering party.<sup>13</sup> Accordingly, MFNs are often used as bargaining chips that a party might offer in exchange for more favorable terms from the offeree elsewhere in an agreement.<sup>14</sup> Any discussion of the harms of MFNs, then, must be considered in conjunction not only with the common business justifications for their use, but also with an understanding of the consideration an offeror might receive for an MFN.

*A. Business Justifications for Most-Favored Nation Clauses*

There are numerous pro-competitive reasons that a firm may seek the protection of an MFN. First, “[m]ost favored nations’ clauses are standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers.”<sup>15</sup> Specifically, MFNs allow a buyer to save on search costs and to free-ride on the more advantageous rates negotiated by competitors. Accordingly, a buyer that is able to gain MFN-status for itself can expect lower prices on inputs, which can translate to lower costs overall.<sup>16</sup> Observing this

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13. See David Besanko & Thomas P. Lyon, *Equilibrium Incentives for Most-Favored Customer Clauses in an Oligopolistic Industry*, 11 INT’L J. INDUS. ORG. 347, 348 (1993) (noting that the primary impetus for the clauses comes from buyers, though a seller could indirectly benefit from an MFN because it facilitates price cooperation).

14. See Joseph Kattan & Scott A. Stempel, *Antitrust Enforcement and Most Favored Nation Clauses*, 10-SUM ANTITRUST 20, 20 (1996) (“MFN clauses also facilitate the sharing of sellers’ cost savings or efficiencies associated with dealing with particular buyers by assuring such buyers that they will not pay more than competing buyers who do not provide such benefits.”).

15. *BCBSW*, 65 F.3d at 1415. See also *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of R.I. (Ocean State II)*, 883 F.2d 1101, 1110 (1st Cir. 1989) (“As a naked proposition, it would seem silly to argue that a policy to pay the same amount for the same service is anticompetitive, even on the part of one who has market power. This, it would seem, is what competition should be all about.”).

16. Jonathan B. Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of “Most-Favored-Customer Clauses” (Vertical)*, 64 ANTITRUST L.J. 517, 532 (1996) [hereinafter Baker, *Vertical*].

potential benefit, Judge Richard Posner wrote that MFNs are precisely “the sort of conduct the antitrust laws seek to encourage.”<sup>17</sup>

Beyond using an MFN as a tool to negotiate for lower prices, perhaps the most commonly asserted justification for MFNs in bilateral agreements is that they facilitate the formation of long-term contracts.<sup>18</sup> MFNs offer price flexibility, which allows the terms of a contract to adjust such that a buyer can benefit from more favorable market conditions, but they do so in a manner that limits the seller’s exposure to a buyer’s opportunism.<sup>19</sup> That is, where a seller benefits from continued business with a long-term buyer relative to dealing with a new or one-time buyer, the long-term buyer might leverage that advantage if price is left open to renegotiation over time instead of being tied to market conditions with an MFN.<sup>20</sup> Sellers, then, will offer these price guarantees to buyers in exchange for the security and efficiency savings that arise from long-term commitments, which might otherwise deter a buyer seeking freedom to benefit from future market conditions.<sup>21</sup>

MFNs can also minimize the costs of the transaction to which they relate. Though MFNs do not guarantee a buyer the best price on the market, by guaranteeing that they are receiving the best price offered by a seller in the relevant market, an MFN offers a buyer some assurance that it is receiving a fair deal, decreasing the need for comparison shopping.<sup>22</sup> Similarly, an MFN offers significant cost savings by enabling expedient clearing of

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17. *BCBSW*, 65 F.3d at 1415.

18. See Adams, *supra* note 2, at 86, 91; Joseph J. Simons, *Fixing Price with Your Victim: Efficiency and Collusion with Competitor-Based Formula Pricing Clauses*, 17 HOFSTRA L. REV. 599, 607-11 (1989).

19. Crocker & Lyon, *supra* note 11, at 311 (finding that MFNs in the natural gas industry were more likely to serve this “price index” function than to facilitate price-coordination because (1) MFNs were *more* common in markets with numerous buyers and (2) the examined MFNs were drawn to narrow coverage areas).

20. *Id.* at 304 (“The advantage of an MFN in this context is that the focused price flexibility afforded by such a guarantee permits efficient adaptation, but without opening the door to unconstrained opportunism. As long as the MFN regions are crafted to include only the set of economically relevant alternatives, prices are adjusted only to reflect documented changes in opportunity costs, which constrains the parties from engaging in surplus-eroding redistributive tactics.”).

21. Adams, *supra* note 2, at 91.

22. *Id.* at 89 (“Though this clause does not guarantee that the bidder’s price is *less* than that of any competitors, it provides the customer some assurance that the price is fair and comparable to similar sales to other buyers within the specified geographical location.”).

negotiations with smaller parties in a deal that involves numerous parties. This use can be found in negotiations to settle a multi-party dispute<sup>23</sup> as well as in talent negotiations in the entertainment industry.<sup>24</sup> Similar cost-savings can be achieved by using an MFN in a form contract.<sup>25</sup>

These savings on search and transaction costs may facilitate the entrance of weaker or uninformed newcomers, though it will be rare that a newcomer can bargain for the benefit of an MFN from its suppliers. Orbitz's entry into the Internet travel agency industry and Apple's entry into the e-book industry are two instances in which a newcomer was able to gain the protection of an MFN.

Orbitz was able to secure MFNs with the major airlines because its very inception was a joint venture of those airlines.<sup>26</sup> Orbitz utilized MFNs to guarantee that the prices it received from the airlines would be the same as—or better than—the prices offered to competing Internet travel agents. With this guarantee, Orbitz was able to overcome any price advantage its competitors might have offered and could persuade customers to switch to their platform based purely on its proffered technological advantages.<sup>27</sup>

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23. See generally, Charles E. Reynolds II, *The Most Favored Nation Clause: The Ultimate Double Edged Sword*, 74 DEF. COUNS. J. 80 (2007) (noting that a defendant may offer a plaintiff an MFN clause ensuring that it would increase its payment if any other plaintiffs receive a higher settlement).

24. See generally Lynn Elliot, *Most Favored Nations* (pts. 1 & 2), THE ACTORS' NETWORK (Aug. 15, 2010), <http://actors-network.com/blog/most-favored-nations-part-2-of-2/> (noting that a lesser-known talent may seek to have perks like dressing rooms, profit sharing, or billing tied (perhaps proportionally) to those offered to a superstar); Eric E. Johnson, *Rethinking Sharing Licenses for the Entertainment Media*, 26 CARDOZO ARTS & ENT. L.J. 391, 424-27 (2008) (discussing the use of MFNs in “credit and billing issues, such as the point-size of font to be used for an actor's name in promotional materials, and for so-called ‘back-end’ financial compensation . . .”).

25. See, e.g., *Attribution 3.0 Unported*, CREATIVE COMMONS, Section 4(b), <http://creativecommons.org/licenses/by/3.0/legalcode> (last visited Dec. 29, 2013) (requiring attribution to the creator of the licensed work “in a manner at least as prominent as the credits for [any] other contributing authors.”); Johnson, *supra* note 24, at 424-27.

26. William F. Adkinson, Jr. & Thomas M. Lenard, *Orbitz: An Antitrust Assessment*, 16-SPG ANTITRUST 76, 77 (2002) (“Orbitz's founders—American, Continental, Delta, Northwest, and United—together account for about 80 percent of U.S. domestic air travel.”).

27. See *id.* at 80 (describing Orbitz's advanced search engine).



With the barriers to entry lowered, Orbitz quickly established itself as a major player in the online travel agency industry.<sup>28</sup>

Similarly, Apple used MFNs in its contracts with publishers to facilitate its entrance into the e-book industry.<sup>29</sup> Apple sought to proliferate an alternative to Amazon's wholesale model for e-book pricing, seeking to capitalize on publishers' concerns that Amazon's discount model cannibalized sales of physical books.<sup>30</sup> Under Apple's "agency model," Apple would allow publishers to set retail prices of their products in its iBookstore in exchange for a 30% commission.<sup>31</sup> Apple used MFNs in its contracts with publishers to require the publishers to adopt the agency model with all e-book distributors.<sup>32</sup> Though Apple was ultimately found liable for violating Section 1 of the Sherman Act as a result of this conduct,<sup>33</sup> this example demonstrates another method by which an entrant might bargain for an MFN that can facilitate entry: a newcomer that offers a disruptive model that benefits suppliers more than the incumbents' model may be able to secure an MFN that facilitates its entry into a new market.

In industries that rely heavily on network effects,<sup>34</sup> MFNs support the integrity of a network-dependent platform.<sup>35</sup> For example, by requiring that intermediaries between consumers and the networked platform treat all platforms the same, an MFN guarantees consumers equal access to all platforms, which ensures

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28. See *id.* at 77 ("Orbitz has grown quickly since, claiming to be the third largest online travel agent site behind Travelocity and Expedia; according to Expedia, Orbitz is already the *largest* such site.").

29. See *United States v. Apple Inc.*, — F. Supp. 2d —, No. 12 Civ. 2826, 2013 WL 3454986 (S.D.N.Y. July 10, 2013), *appeal docketed*, No. \_\_\_\_ - \_\_\_\_ (2d Cir.).

30. See *id.* at \*7 (discussing publishers' concerns with cannibalizing hard-cover sales prior to Apple's entrance into the e-book market).

31. *Id.* at \*14.

32. *Id.* at \*42 ("Unless a Publisher Defendant followed through and transformed its relationships with Amazon and other resellers into an agency relationship, it would be in significantly worse terms financially as a result of its agency contract with Apple.").

33. The details of the antitrust violations involved are discussed in more detail *infra*, at Part II.C.

34. A "network effect" entails that a product's value increases as it gains more users.

35. Martha Samuelson, Nikita Piankov & Brian Ellman, *Assessing the Effects of Most-Favored Nation Clauses*, A.B.A. SEC. ANTITRUST L. SPRING MEETING, Mar. 28, 2012, at 1, 3, *available at* [http://www.analysisgroup.com/uploadedFiles/Publishing/Articles/Samuelson\\_MFN\\_SpringABA\\_2012.pdf](http://www.analysisgroup.com/uploadedFiles/Publishing/Articles/Samuelson_MFN_SpringABA_2012.pdf).

that consumers select a platform based on its own merits, rather than an intermediary's preference.<sup>36</sup>

The benefits listed thus far (facilitating a buyer's ability to receive lower prices from a supplier; offering protection to buyers in long-term contracts without exposing sellers to the risk of opportunism; decreasing search costs and transaction costs; and facilitating a firm's entry into a market) do not constitute a comprehensive list, though they fairly capture the most significant considerations for the purpose of the analysis that follows.<sup>37</sup>

*B. Criticisms of the Justifications for Most-Favored Nation Clauses*

The business justifications discussed above are certainly persuasive, but they are not without criticism in the academic and economic literature on MFNs. The following discussion presents criticisms that raise doubts about both the justifications for MFNs generally as well as for some of the specific justifications asserted above.

MFNs are often touted as measures for a buyer to save costs on inputs and ultimately to pass those savings on to consumers.<sup>38</sup> This benefit may be illusory, however: as MFNs become increasingly common in an industry, they are more likely to result in higher prices than lower prices.<sup>39</sup>

A simple economic analysis of a retroactive MFN will demonstrate this possibility.<sup>40</sup> Where a seller does not offer any buyer an MFN, as long as that seller has covered its fixed costs, it will be willing to expand its output for any price above marginal cost, regardless of the prices it has offered on prior sales. With those discounts, the average price of the seller's good will decrease, and consumers are able to reap the benefits.

Where a seller is bound by an MFN, however, it must evaluate whether it will gain more from expanding its output at a

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36. *Id.*

37. For a more detailed discussion of the business justifications for MFNs, see Adams, *supra* note 2, at 85-91; Baker, *Vertical*, *supra* note 16, at 530; and Samuelson, Piankov & Ellman, *supra* note 35.

38. See Samuelson, Piankov & Ellman, *supra* note 35, at 2 ("MFNs between suppliers and intermediaries may have multiple pro-competitive benefits to consumers.").

39. *C.f.* Thomas E. Cooper, *Most-Favored Customer Pricing and Tacit Collusion*, 17 RAND J. ECON. 377, 386 (explaining that a firm that offers an MFN will gain less from the higher prices it facilitates as the number of competitors not protected by an MFN increases).

40. The model discussed below is adapted from the model presented in Samuelson, Piankov & Ellman, *supra* note 35, at 7-8.

lower price than it will lose to the rebate it must provide its MFN-protected buyers that initially paid a higher price. Where the profit from expanded output exceeds the magnitude of the rebate, consumers will enjoy the benefits of discounted prices not only from the buyers that purchased the expanded output, but also from the MFN-protected buyer that received the same discounts.

As the proportion of a seller's total billing that is covered by MFNs increases, whether by increased purchasing by a single MFN-protected firm or by increased demand from MFNs from other buyers, the magnitude of the rebate the seller must pay to its MFN-protected clientele also increases. Where the magnitude of the rebate exceeds the profit from the discounted expanded output, the seller will not be willing to expand its output at a discount. The average price for the seller's good will remain at the level negotiated by the MFN-protected firms—higher than under either the no-MFN or few-MFN scenario, coupled with diminished output.

Thus, “[t]he greater the fraction of buyers who obtain most-favored-customer protection, and the larger their size, the less plausible it becomes that these contractual provisions will help buyers obtain inputs for less.”<sup>41</sup> As a result, as the DOJ argued in its complaint in *Delta Dental*, discussed below, MFNs “have ‘not generated any meaningful savings or other procompetitive benefits’ when in widespread use.”<sup>42</sup> Conversely, where an industry has many sellers that do not offer MFNs, prices will be lower.<sup>43</sup>

An experimental study of numerous common practices of participants in oligopolistic markets, primarily MFNs, further suggested one demand-side factor that may determine the effect of MFNs on price.<sup>44</sup> The study suggested that, in an economy where small buyers pay higher prices, and those small buyers make up a

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41. Baker, *Vertical*, *supra* note 16, at 531-32.

42. *Id.* at 530 (citing Complaint at ¶ 32, *United States v. Delta Dental of R.I.*, No. 96-113 (D.R.I. filed Feb. 29, 1996)).

43. See Aaron S. Edlin, *Do Guaranteed-Low-Price Policies Guarantee High Prices, and Can Antitrust Rise to the Challenge?*, 111 HARV. L. REV. 528, 552 (1997) (“Rivals of firms that have [MFNs] may be tempted to lower prices, because they have a diminished fear of being matched and so can dramatically increase market share.”); Simons, *supra* note 18, at 622-23 (“[An] MFN’s ability to raise prices to, or maintain prices at, supracompetitive levels will depend on the two interrelated factors: (1) the magnitude of the incentive not to cut prices caused by the MFN, and (2) the level of interdependence inherent in the existing market structure.”).

44. David M. Grether & Charles R. Plott, *The Effects of Market Practices in Oligopolistic Markets: An Experimental Examination of the Ethyl Case*, 22 ECON. INQUIRY 479, 498 (1984).

large portion of the market, MFNs will raise prices, whereas in a market made up of large buyers—presumably where their requests for expanded discounted output can more easily balance the magnitude of the rebates to other buyers—prices were lower.<sup>45</sup>

Apart from the benefits an offeror may receive from being able to raise prices without fear of retaliation, MFNs most directly benefit the parties who are granted the protected status. The benefits experienced by the parties who offer these provisions, then, result almost entirely from benefits offered as consideration for this protection.

In certain circumstances, however, a buyer may be able to secure this protection without offering any consideration. In such circumstances, when a third party negotiates for a better price, a buyer with MFN-status will experience a windfall—at the seller’s expense—with no obligation to share that windfall with the seller or consumers.<sup>46</sup>

One example of this criticism is the break-up fee that Flowers Foods, Inc., negotiated in its efforts to purchase Hostess.<sup>47</sup> Flowers arranged for an MFN that guaranteed the break-up fee it would receive on a sale for over \$300 million would increase if another party were to negotiate a higher break-up fee rate on any sale \$10 million or over. The Official Committee of Unsecured Creditors in Hostess claimed that this MFN would offer Flowers a windfall with no nexus to the transaction in question.<sup>48</sup>

Where a firm is coerced into offering an MFN by a party wielding market power or leveraging some other unrelated position, the pro-competitive effects of an MFN should be

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45. *Id.*

46. Anthony J. Dennis, *Potential Anticompetitive Effects of Most Favored Nation Contract Clauses in Managed Care and Health Insurance Contracts*, 4 ANNALS HEALTH L. 71, 82 (1995) (arguing that “there is no guarantee that [a buyer] using an MFN clause will pass on to consumers the cost savings it reaps[,]” while noting that it is difficult to prove such welfare-hoarding without internal cost data).

47. Eric Schroeder, *Creditors Object to Break-Up Fee in Hostess-Flowers Deal*, BAKINGBUSINESS.COM (Jan. 24, 2013), [http://www.bakingbusiness.com/articles/news\\_home/Business/2013/01/Creditors\\_object\\_to\\_break-up\\_f.aspx?ID=%7B104E1EA0-CA2C-4D91-AECC-097D50F3BF49%7D&cck=1](http://www.bakingbusiness.com/articles/news_home/Business/2013/01/Creditors_object_to_break-up_f.aspx?ID=%7B104E1EA0-CA2C-4D91-AECC-097D50F3BF49%7D&cck=1).

48. *Id.* (“The most favored nation provision would increase the amount of compensation to Flowers based on factors that have nothing to do with its costs in preparing and submitting its bids and, in fact, are unrelated to these transactions at all[.]”).

doubted.<sup>49</sup> This scenario is especially likely where an offeree possesses disparate bargaining power relative to an offeror, in which case the offeree may be able to demand an MFN without offering any consideration to the party bound by the provision. One common situation in which this might occur is where access to a buyer's downstream market is critical to a seller's commercial success. The bargaining power will be especially unbalanced when the downstream market in question is controlled by relatively few players, such as in an oligopolistic industry or a market that relies on a nascent technology either protected by intellectual property rights or insulated by high start-up costs.<sup>50</sup>

The ability of an MFN to facilitate entry of a new competitor may be subject to similar criticism: both Orbitz and Apple gained the advantage of MFN-protection through means unrelated to the benefits of their products (Orbitz as a joint venture of its suppliers and Apple as an alleged leader of a conspiracy for the benefit of its suppliers). Without the relationships each of the firms exploited, they might not have been able to break into their respective industries. If, on the other hand, they could have entered the market in reliance only on the merits of their products, the protection of an MFN likely would have been unnecessary.<sup>51</sup>

### C. *Prior Antitrust Scrutiny of Most-Favored Nation Clauses*

Because of the questionable business justifications for MFNs, it will come as little surprise that MFNs have been the subject of antitrust scrutiny. Enforcement efforts have been met with mixed success, but MFNs have been linked to both collusive price-restraints and competitor exclusion. The cases that deal with collusion have treated the use of MFNs as a practice that facilitates

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49. Where the MFN in question affects price control or exclusion, this behavior easily satisfies the two elements of a violation of Section 2 of the Sherman Act. *See United States v. Grinnell Corp.*, 384 U.S. 563, 570 (1966) (“(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.”).

50. Adams, *supra* note 2, at 90.

51. Adkinson, Jr. & Lendard, *supra* note 26, at 81 (arguing (1) “[t]he MFN clause should not be required to attract customers if Orbitz has even a portion of its claimed benefits” and (2) “even if the new technology benefits consumers, it is questionable whether the joint venture is necessary to introduce it.”); Complaint at ¶67, *United States v. Apple, Inc.*, No. 1:12-cv-02826 (S.D.N.Y. filed Apr. 11, 2012) (“In negotiating the retail price MFN with Apple, ‘some of [the publisher Defendants]’ asserted that Apple did not need the provision ‘because they would be moving to an agency model with [the other e-book retailers,]’ regardless.”).

collusive schemes, usually aimed at price-fixing. The cases that have dealt with exclusion construed MFNs as mechanisms for both reducing competition and entrenching incumbents. The most successful of these cases were those that alleged a mix of the categories or the use of MFNs among several facilitating practices.

### Collusion Cases

The earliest cases to challenge MFNs under antitrust doctrine focused on the use of the provisions as a mechanism for facilitating price-fixing in collusive schemes.<sup>52</sup> Before detailing the litigation history on this front, it is important to explain how MFNs function to facilitate collusion without reliance on a formal agreement in restraint of trade.

“Facilitating practices” are practices that are not direct collusion in violation of Section 1 of the Sherman Act, but that nonetheless enable firms to achieve a non-competitive outcome.<sup>53</sup> That is, facilitating practices assist indirect colluders in overcoming the two challenges of an effective collusive scheme: 1) the colluders must agree on the terms of coordination; and 2) the colluders must effectively deter participants from cheating on the scheme.<sup>54</sup>

The body of literature surrounding MFNs has identified two ways in which MFNs serve as facilitating practices.<sup>55</sup> First, as discussed in Part I.B, MFNs penalize firms that seek to offer discriminatory discounts, thereby reducing a firm’s incentive to defect from a collusive scheme’s supra-competitive price level.

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52. See, e.g., *Starr v. Sony BMG Music Entm’t*, 592 F.3d 314, 322 (2d Cir. 2010) (finding that MFNs were used to enforce a price floor in a conspiracy to fix digital music prices); *E.I. du Pont de Nemours & Co. v. F.T.C. (Ethyl)*, 729 F.2d 128, 134 (2d Cir. 1984) (finding that MFNs were not used to influence price discounts, as alleged by plaintiff); *Blue Cross & Blue Shield of Mich. v. Mich. Ass’n of Psychotherapy Clinics*, No. 9-71014, 1980 WL 1848, at \*1-2 (E.D. Mich. March 14, 1980) (finding that price non-discrimination provisions were not sufficient to establish a violation of Section 1 of the Sherman Act); *Consent Decree, United States v. General Electric Co.*, 42 Fed. Reg. 17004, 17006 (March 30, 1977) (settling litigation that alleged the use of retroactive MFNs to prevent GE from offering discounts on wind turbines to Westinghouse).

53. George A. Hay, *Oligopoly, Shared Monopoly, and Antitrust Law*, 67 CORNELL L. REV. 439, 452 (1982) [hereinafter Hay, *Oligopoly*].

54. George A. Hay, *Facilitating Practices*, in 2 ISSUES IN COMPETITION LAW AND POLICY 1189, 1203-04 (Wayne D. Collins & Joseph Angland eds., 2008), available at <http://ssrn.com/abstract=811404>.

55. Joseph Kattan, *Beyond Facilitating Practices: Price Signaling and Price Protection Clauses in the New Antitrust Environment*, 63 ANTITRUST L.J. 133, 146-47 (1994).

Second, when a firm's MFN-policies are known to its competitors, those competitors may make pricing decisions in reliance on the MFN-offeror's limited incentives to discount. Thus, as an industry becomes increasingly saturated with MFNs, participants in a collusive scheme will be better able to coordinate pricing and are assured that there will be limited defection from any indirectly agreed-upon price.<sup>56</sup>

As discussed above, however, higher prices are not a necessary outcome of MFNs. Given the pro-competitive justifications for MFNs, courts have applied a balanced rule of reason analysis rather than a *per se* declaration of legality or illegality.<sup>57</sup> The challenges to MFNs under the theory that they facilitate collusion in violation of Section 1 of the Sherman Act have been met with mixed results, particularly in the face of persuasive business justifications for the policies.

In *E.I. Du Pont de Nemours & Co. v. FTC (Ethyl)*, a district court rejected the Federal Trade Commission's ("FTC") challenge to the use of MFNs, among other facilitating practices, by two manufacturers of antiknock gasoline additives (chemicals that prevent pre-ignition of gasoline which can damage an engine).<sup>58</sup> Both Du Pont and Ethyl (which controlled market shares of 38.4% and 33.5%, respectively<sup>59</sup>) had adopted MFNs independently in order to assure smaller gasoline refineries that they would not be disadvantaged by offers made to the larger refineries.<sup>60</sup> The FTC alleged that the parties' MFNs were "unfair methods of competition" in violation of Section 5 of the FTC Act<sup>61</sup> because they led to artificially high prices by discouraging discounting and

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56. For a theoretical analysis of the incentives and stability of an MFN-based priced coordination scheme, see Thomas E. Cooper, *Most-Favored-customer Pricing and Tacit Collusion*, 17(3) RAND J. ECON. 377, 378 (1986) ("Since this commitment induces the other firm to raise its price, both firms can earn greater profits if one offers the policy. Therefore, a firm has an incentive to adopt the most-favored-customer policy unilaterally.").

57. Joseph Kattan, *Beyond Facilitating Practices: Price Signaling and Price Protection Clauses in the New Antitrust Environment*, 63 ANTITRUST L.J. 133, 135 (1994) ("Indeed, given the prevalence of procompetitive explanations for these practices, the operative presumption should be that the practices are procompetitive.").

58. 729 F.2d 128, 134 (2d. Cir. 1984).

59. *Id.* at 130.

60. *Id.* at 134.

61. 15 U.S.C. § 45 (2012).

sharing pricing information among competitors, which, in turn, enabled manufacturers to avoid pricing competition.<sup>62</sup>

The FTC's findings were vacated on appeal, however. The Court of Appeals for the Second Circuit ruled that parallel conduct could not be labeled unfair within the meaning of Section 5 without "(1) evidence of anticompetitive intent or purpose on the part of the producer charged, or (2) the absence of an independent legitimate business reason for its conduct."<sup>63</sup> Nonetheless, the court left open the possibility of developing a more workable standard to reach independently adopted facilitating practices, particularly if drawn to these two "plus factors."<sup>64</sup> Without these factors or some clear causal nexus to the alleged harms, the court was unwilling to use Section 5 "to forbid legitimate, non-collusive business practices which substantially lessen competition."<sup>65</sup>

The facilitating practice approach to challenging MFNs has resurged in recent years.<sup>66</sup> Most recently, in *United States v. Apple Inc.*, the background of which is detailed in Part I.A, *supra*, Judge Denise Cote of the Southern District of New York found that Apple utilized MFNs, among other practices, in its contracts with e-book publishers to facilitate a horizontal price-fixing conspiracy.<sup>67</sup> Apple used MFNs to ensure that publishers would offer Apple the lowest retail price for their e-books even though the publishers had no control over the price offered by Amazon.<sup>68</sup> Further, because Apple's agency model meant it was entitled to 30% of the revenue from sales in its iBookstore, publishers would effectively have to pay a premium if their e-books were offered for less on other

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62. Final Order ¶194, *In re Ethyl Corp.*, 101 F.T.C. 425 (1983) (No. 9128), 1983 WL 486336, at \*103.

63. *Ethyl*, 729 F.2d at 139.

64. *Id.* at 144 ("I would therefore vacate the FTC's order, but leave open the question whether, with more clearly delineated standards and on a more compelling set of facts, the FTC could use § 5 to reach noncollusive 'facilitating practices' shown to have a substantial anticompetitive effect, without any procompetitive justification.").

65. *Id.* at 141-42.

66. See, e.g., *Starr v. Sony BMG Music Entm't*, 592 F.3d 314, 324 (2d Cir. 2010) (finding that an attempt to hide the use of MFNs in the digital music industry was a plus factor).

67. *United States v. Apple Inc.*, — F. Supp. 2d —, No. 12 Civ. 2826, 2013 WL 3454986, at \*58 (S.D.N.Y. July 10, 2013) ("What was wrongful was the use of [agency agreements, pricing tiers with caps, MFN clauses, or simultaneous negotiations with suppliers] to facilitate a conspiracy with the Publisher Defendants."), *appeal docketed*, No. \_\_\_\_ - \_\_\_\_ (2d Cir.).

68. *Id.* at \*17.



platforms.<sup>69</sup> Thus, the MFN meant that if publishers wished to gain the benefit of access to Apple's platform and pricing model, they would have to raise retail prices across the market to the detriment of competition.

Though it is difficult to deny that MFNs can function as practices that facilitate collusion, antitrust enforcement has been more successful in framing the use of these provisions as a practice that effects the exclusion of competitors from the relevant market. As this Note demonstrates, the latter is a better framework for addressing the issues that MFNs present in the current economy.

### *Exclusion Cases*

Antitrust enforcement efforts have also challenged the use of MFNs as a mechanism for competitor exclusion. That is, enforcement efforts have alleged that MFNs prevent or discourage new competitors from entering a market. Where an MFN has an exclusionary effect, consumers are deprived of the lower prices, higher volume, and innovation that free competition drives. Academic literature discussing exclusion identifies three challenges that any exclusionary scheme must overcome: (1) participants must identify a method of exclusion; (2) the exclusion must be effective; and (3) the mechanism must be profitable for all participants.<sup>70</sup>

The cases challenging MFNs as anticompetitive exclusionary practices stem largely from a common fact pattern in which all three of these challenges are easily overcome (though the legal analyses generally do not follow this framework). As discussed in Part I.B, suppliers bound by MFNs are discouraged from offering some buyers more favorable terms such as discounts because the benefit of the additional sale will be offset by the rebate that the supplier must pay to its MFN-protected customers. Because of this restraint on suppliers, any of the protected party's rivals whose models rely on cutting costs on inputs will be unable to compete, and new discount-based firms will be discouraged from entering the market.<sup>71</sup>

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69. *Id.* at \*42-43.

70. Jonathan B. Baker, *Exclusion as a Core Competition Concern*, 78 ANTITRUST L.J. 527, 540 (December 11, 2012) [hereinafter Baker, *Exclusion*].

71. Kattan & Stempel, *supra* note 14, at 21 ("By depriving rivals of advantageous prices in the input market, the dominant firm can maintain or extend its dominance in the downstream output market. The emphasis of this theory is on exclusion rather than collusion, and the theory therefore requires that a dominant buyer have some special ability to coerce suppliers to charge its competitors higher prices than they would otherwise charge.").

Thus, an MFN (1) identifies a method of exclusion: deterring the entry of discount-based firms, (2) effects that exclusion by making discounts very costly for sellers, and (3) utilizes a risk-free price protection mechanism. One can easily see that the first and third of these challenges will be met by most MFNs (MFNs will always have some effect on discounting, even if trivial, and MFNs do not entail any risk or cost apart from the consideration offered for that protection). The key, then, is to identify *effective* exclusion linked to MFNs.

Early in its campaign against exclusionary MFNs, the DOJ identified two “critical factors” of adverse competitive impact: “(1) whether the [MFN-protected firm]’s market power is sufficient to cause a very high percentage of all [suppliers] in the market to feel compelled to contract; and (2) whether that [MFN-protected firm] accounts for such a large portion of a [supplier]’s total billings that insufficient [supplier] capacity remains to support a new [competitor to the MFN-protected firm].”<sup>72</sup>

The first critical factor is important because where the bulk of the input market is bound by MFNs (such as where the downstream market is controlled by a monopolist), a new entrant will be unable to find a supplier that can offer a discount without weighing the burdens of an MFN. The DOJ’s discussion suggests that a market share of 35% warrants further analysis when considering exclusionary MFNs.<sup>73</sup>

That first condition relies, however, on the second factor, though the DOJ’s statement of the second factor insufficiently describes the condition: capacity is not the whole story.<sup>74</sup> A supplier will only be discouraged from offering a discount where the benefits of the discounted output offset the rebate that the supplier must pay to its MFN-protected customers. In the language of the DOJ’s “critical factors,” as a supplier’s “total billing” is increasingly composed of MFN-protected contracts, the rebate it must pay when offering a discount also increases.

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72. Susan E. Stenger, Note, *Most-Favored-Nation Clauses and Monopsonistic Power: An Unhealthy Mix?*, 15 AM. J.L. & MED. 111, 126 (1989) (citing C. Rule, Assistant Attorney General, Antitrust Division, U.S. Dep’t of Justice, Remarks at the Antitrust & Health Care Seminar of the Antitrust Section of the Connecticut Bar Ass’n & the Connecticut Health Lawyers Ass’n 22 (March 11, 1988)).

73. Stenger, *supra* note 72, at 127 (citing Rule).

74. See Stenger, *supra* note 72, at 126 (“This second consideration is simplistic and misses the point. A potential market entrant, battling the additional costs of the market entry phenomenon, may be excluded via an MFN clause despite sufficient provider capacity.”).

The bulk of antitrust litigation targeting MFNs has focused on their use in the health care industry. In the 1980s and 90s, the paradigm for purchasing health care shifted towards the more-efficient Health Maintenance Organization (“HMO”) and Preferred Provider Organization (“PPO”) model. HMOs and PPOs saved on costs by selecting only a subset of providers and better integrating the care provision and payment functions in comparison to the incumbent third-party payors. In response to their challenge, the incumbents, which covered care from all providers, began imposing and enforcing MFNs to ensure they would not experience price discrimination as the new models emerged.<sup>75</sup> The MFNs deterred health care providers from granting, and alternate insurance models from receiving, discounts relative to the traditional-model payors’ prices, effectively nullifying the benefits of the alternate-model companies and preventing them from gaining a foothold in the market.<sup>76</sup>

The campaign against exclusionary MFNs began in 1989 with *Ocean State*.<sup>77</sup> In that case, Ocean State challenged Blue Cross’s “Prudent Buyer policy” (effectively equivalent to an MFN) as a mechanism for maintaining its monopoly power in violation of Section 2 of the Sherman Act. Ocean State was a burgeoning HMO that operated as a non-profit and arranged for 20% discounts on care provision in exchange for a promise to return the profits if the organization was profitable. In 1985 and 1986, Ocean State was not profitable, and so did not reimburse providers for the discounts it received; as a result, it effectively received a permanent 20% discount.<sup>78</sup>

Blue Cross was an incumbent traditional third-party payor with a market share of at least 57%.<sup>79</sup> Blue Cross then bargained for an MFN in its contracts with care providers with the goal of receiving the lower fees offered to Ocean State.<sup>80</sup> Ocean State alleged that Blue Cross’s MFN discouraged doctors from offering the discounts and instead led to their resignation from dealing with

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75. Arnold Celnicker, *A Competitive Analysis of Most Favored Nations Clauses in Contracts Between Health Care Providers and Insurers*, 69 N.C. L. REV. 863, 869 (1991).

76. *Id.* at 870.

77. *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of R.I. (Ocean State I)*, 692 F. Supp. 52 (D.R.I. 1988), *aff’d*, 883 F.2d 1101 (1st Cir. 1989).

78. *Ocean State II*, 883 F.2d 1101, 1104 (1st Cir. 1989).

79. *Ocean State I*, 692 F. Supp. at 58.

80. *Ocean State II*, 883 F.2d at 1104.

Ocean State, which threatened the success of Ocean State's new cost-cutting business model.<sup>81</sup>

The First Circuit rejected Ocean State's argument, however, and reinstated the district court's view, quite similar to Judge Posner's opinion expressed in *Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic*,<sup>82</sup> stating, "it would seem silly to argue that a policy to pay the same amount for the same service is anticompetitive, even on the part of one who has market power. This, it would seem, is what competition should be all about."<sup>83</sup> Similar to the decision in *Ethyl*, the court was simply unwilling to condemn a practice with observed pro-competitive benefits.

In the wake of *Ocean State*, the FTC and the DOJ brought several cases seeking to prevent similar exclusionary harms under Section 1 of the Sherman Act. Armed with evidence of agreements among the defendants to exclude, these efforts were more successful. In the first of these, *Primestar*, the DOJ successfully secured a consent decree enjoining the enforcement of MFNs in contracts between stakeholder-television-programming providers and Primestar.<sup>84</sup>

Primestar was a Direct Broadcast Satellite ("DBS") system created as the result of a partnership of the largest Multiple Cable System Operators ("MSOs") and several major programming providers in order to delay or prevent the emergence of any more DBS services, which would cut at the MSOs' business.<sup>85</sup> The DOJ alleged that Primestar's MFNs, particularly when combined with other restraints, discouraged Primestar's partners from offering lower prices (or exclusive deals) to competing DBS services, thereby preventing the entry of those competitors.<sup>86</sup> The DOJ was especially concerned about these restraints "[b]ecause the

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81. *Ocean State I*, 692 F. Supp. at 73 ("Some physicians, not willing to give Blue Cross & Blue Shield a discount, resigned from Ocean State as permitted by their contract with Ocean State.").

82. See *supra* text accompanying notes 15-17.

83. *Ocean State II*, 883 F.2d at 1110 (quoting *Ocean State I*, 692 F. Supp. at 71).

84. *United States v. Primestar Partners, L.P.*, No. 93 Civ. 3913, 1994 WL 196800, at \*1 (S.D.N.Y. Apr. 4, 1994) ("Each Defendant is enjoined and restrained from adhering to, carrying out or enforcing any provision of the Partnership Agreement that affects the availability, price, terms or conditions of provision, sale or licensure of programming to any provider of multichannel subscription television[.]").

85. *Primestar*, 58 Fed. Reg. 33944-03, 33945 (Dep't of Justice June 22, 1993) (competitive impact statement).

86. *Id.* at 33949.

Primestar partners own or control a significant amount of popular cable programming,” so little desirable content would be available to new DBS services.<sup>87</sup>

A series of enforcement efforts followed *Primestar* in which the DOJ brought Section 1 claims against health care insurance plans.<sup>88</sup> In each of these cases, most of which were resolved in consent decrees, the defendants controlled a substantial portion of their respective markets and were found to effect the exclusion of small discount and managed care plans. Most recently, in *United States v. Blue Cross Blue Shield of Michigan*, the DOJ alleged that defendant Blue Cross Blue Shield’s MFN and “MFN-plus” (requiring that hospitals must charge competitors *more* for services)<sup>89</sup> raised prices for rivals and discouraged discounts effecting the exclusion of competitors.<sup>90</sup>

The history of litigation over MFNs demonstrates that enforcement agencies, courts, and lawmakers recognize that MFNs may cause substantial exclusionary harms, though they are not willing to label them *per se* illegal. It also demonstrates a reluctance to punish MFNs supported by assertions of pro-competitive benefits without at least circumstantial evidence of

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87. *Id.*

88. See, e.g., *United States v. Delta Dental of R.I.*, No. Civ.A. 96-113P, 1997 WL 527669, at \*6 (D.R.I. July 2, 1997) (“Delta currently provides so much more of most Rhode Island dentists’ income than would any entering managed care plan that if these dentists were to reduce their fees to such plans, the resulting reduction in their income from Delta would be much greater than their added income from the entrant plan. Because few dentists in Rhode Island are not under contract with Delta and because Delta’s MFN clause gives its participating dentists strong disincentives to contract with dental managed care plans at fees below Delta’s, other plans have been unable to form a competitively viable panel.”); *Blue Cross and Blue Shield of Ohio v. Bingaman*, No. 1:94 CV 2297, 1996 WL 677094, at \*1 (N.D. Ohio June 24, 1996); *Delta Dental of Ariz.*, 59 Fed. Reg. 47349, 47349 (Dep’t of Justice Sept. 15, 1994) (competitive impact statement); *Oregon Dental*, 60 Fed. Reg. 21218, 21218 (Dep’t of Justice May 1, 1995) (competitive impact statement).

89. It should be noted that an MFN-plus could function in much the same way that Apple’s MFN did. See *supra* text accompanying notes 69-70.

90. See *United States v. Blue Cross Blue Shield of Mich.*, 809 F. Supp. 2d 665, 670 (E.D. Mich. 2011). This case was dismissed in light of the Michigan legislature’s ban on MFNs in contracts between insurers and providers, which takes effect on January 1, 2014. See Order of Dismissal Without Prejudice re Joint Mot. to Dismiss Without Prejudice, *United States v. Blue Cross Blue Shield of Mich.*, No. 2:10-CV-14155 (E.D. Mich. Mar. 28, 2013). See also Brent Kendall, *U.S. Moves to Dismiss Suit Against Michigan Blue Cross*, WALL ST. J. (Mar. 25, 2013), <http://online.wsj.com/news/articles/SB10001424127887323605404578382890428658594>.

collusion among the parties or some other “plus factor” as discussed in the *Ethyl* case.

In September 2012, the DOJ hosted a conference to discuss MFNs in an economic, legal, and political context.<sup>91</sup> The theories of liability underlying the presentations therein were largely limited by the bounds of the prior enforcement efforts discussed above: for an MFN to violate antitrust law, it must protect a single party with monopoly power, be pursuant to an agreement among competitors, be coupled with some explicit exclusionary intent, or be tied to some other plus factor such as the absence of a pro-competitive justification.<sup>92</sup>

The harms that result from MFNs, however, are not so limited. Rather, the same exclusionary harms previously discussed may be present in industries without a single monopolist or an agreement among firms.

## II. THE INABILITY OF CURRENT ANTITRUST DOCTRINE TO REACH THE EXCLUSIONARY EFFECTS OF MFNs ADOPTED IN PARALLEL

MFNs can cause substantial exclusionary harms whether adopted by a single monopolist, a cartel, or independently by multiple firms. Because antitrust enforcement is limited to those circumstances where an MFN has no legitimate business justification or where there is an explicit expression of exclusionary intent, ongoing exclusionary harms may sit just out of reach. This limitation, however, is hardly unique to MFNs.

This Part will proceed by briefly outlining the recent legal and economic discussions of the current difficulties in reaching parallel conduct. Part II.B will provide greater detail on the current understanding of exclusion as a concern for antitrust enforcement, particularly in technology-based industries. Part II.C will demonstrate that MFNs can exclude competitors whether they are enforced by a single monopolist or by an uncoordinated set of firms. Lastly, Part II.D will present evidence that parallel MFNs are currently causing exclusionary harms in the television industry to the detriment of consumers.

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91. See *Most-Favored-Nation Clauses and Antitrust Enforcement and Policy: Workshop Information*, U.S. DEP'T JUST. (Sept. 10, 2012), <http://www.justice.gov/atr/public/workshops/mfn/index.html> (providing the workshop agenda and the presentations from the conference).

92. See John H. Lyons & Steven C. Sunshine, *DOJ/FTC Ask If MFNs Are Anti-Competitive, and Get an Earful*, SKADDEN.COM (Sept. 14, 2012), <http://www.skadden.com/insights/dojftc-ask-if-mfns-are-anti-competitive-and-get-earful> (providing a more detailed description of the conference).

A. *Limitations of Antitrust Doctrine Regarding Parallel Conduct*

The difficulty of reaching apparently uncoordinated but harmful conduct is a frequently discussed limitation of current antitrust doctrine. Though Section 1 of the Sherman Act generally requires some “concerted activity,” courts have been willing to find a Section 1 violation in the absence of evidence of an express agreement, based on circumstantial evidence.<sup>93</sup> This inference can be drawn from conduct that is probative of nefarious intent (such as hiding an MFN as in *Starr*),<sup>94</sup> or from some other “plus factor,” such as the absence of a business justification for the conduct.

Nonetheless, significant bodies of academic literature from both the legal and the economic perspectives have advocated for a better approach to oligopolistic behaviors. Most notably, Richard Posner has advocated for a doctrinal shift that would enjoin anticompetitive price elevation undertaken in reliance on competitors’ mutual interests, which has been called “conscious parallelism” or “tacit collusion.”<sup>95</sup>

The classic understanding of conscious parallelism relies on finding that the firms in question effected oligopolistic control of a market based on recognizing their interdependence. In a perfectly competitive market, a price above the marginal cost will not be sustainable. Competitors would simply increase output in order to capture the market share of any firm instituting a price increase. By contrast, in an oligopolistic market, firms can rely on the small number of competitors, and the monopoly profits available to them, to conclude that raising prices above the competitive level and maintaining consistent output is the optimal pricing strategy.<sup>96</sup> Such interdependent conduct, so the argument goes, should be

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93. *Interstate Circuit v. United States*, 306 U.S. 208, 226-227 (1939) (“Acceptance by competitors, without previous agreement, of an invitation to participate in a plan, the necessary consequence of which, if carried out, is restraint of interstate commerce, is sufficient to establish an unlawful conspiracy under the Sherman Act.”); see, e.g., *C-O-Two Fire Equip. Co. v. United States*, 197 F.2d 489, 497 (9th Cir. 1952), cert. denied, 344 U.S. 892 (1952) (inferring an agreement in violation of Section 1 from parallel pricing coupled with illegal licensing agreements, artificial standardization, and published price lists, among others).

94. See *Starr v. Sony BMG Music Entm’t*, 592 F.3d 314, 319 (2d Cir. 2010) (“Defendants attempted to hide the MFNs because they knew they would attract antitrust scrutiny.”).

95. Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562, 1562 (1969).

96. Louis Kaplow, *An Economic Approach to Price Fixing*, 77 ANTITRUST L.J. 343, 349-54 (2011).

sufficient to find an agreement under Section 1 of the Sherman Act.<sup>97</sup>

In his 1982 paper on oligopoly, George Hay recommends a different framework for antitrust enforcement with a focus on economic harm, rather than the formalistic search for an agreement.<sup>98</sup> Instead of seeking to expand the definition of agreement to include interdependence, Hay writes, enforcement agencies should search for behavior that accomplishes the tasks necessary for maintenance of an oligopoly, which essentially match the challenges of a collusive scheme discussed above: (1) establishing a mutual understanding or consensus regarding price and division of output, and (2) promoting mutual confidence that there will be adherence to these decisions.<sup>99</sup> This approach would tie the legal understanding of “culpability” more closely to the economic harms that antitrust doctrine is meant to protect from.<sup>100</sup>

This debate as to whether parallel conduct should constitute an antitrust violation rages on.<sup>101</sup> Nonetheless, antitrust jurisprudence remains stuck with the notion that “‘conscious parallelism’ has not yet read conspiracy out of the Sherman Act entirely.”<sup>102</sup>

Similar analysis of parallel *exclusion* is severely lacking.<sup>103</sup> Part II.B will demonstrate that exclusionary practices, both parallel and coordinated, deserve more significant attention, as they may present more substantial harms that could tip the balance more clearly towards finding an antitrust violation in a rule of reason analysis.

### B. Academic Literature Concerning Exclusion

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97. Posner, *supra* note 95, at 1605.

98. Hay, *Oligopoly*, *supra* note 53, at 481 (“To distinguish among these various categories of behavior based on whether an agreement exists seems largely an exercise in semantics.”).

99. *Id.* at 445.

100. *Id.* at 480.

101. Louis Kaplow, *On the Meaning of Horizontal Agreements in Competition Law*, 99 CALIF. L. REV. 683, 689 (2011) (“[I]t is observed that what economics teaches about why we should be concerned about price fixing not only fails to support reasoning offered in favor of a heightened agreement requirement but also cuts against it because the cases exonerated on the ground that they involve mere interdependence are those that involve the greatest rather than the least social harm.”).

102. *Theatre Enters., Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954).

103. See C. Scott Hemphill & Tim Wu, *Parallel Exclusion*, 122 YALE L.J. 1182, 1185 (2013).



Perhaps a cause of the dearth of economic analysis of parallel exclusion, and exclusion generally, is the fact that exclusionary conduct is largely a secondary concern for antitrust enforcement, relative to collusion. In his recent comprehensive discussion of exclusion, Jonathan Baker suggests that this priority may be mistaken. “Indeed,” he writes, “anticompetitive exclusion may be the more important problem because of the particular threat exclusion poses to economic growth.”<sup>104</sup> Beyond the harms of dampened price competition, Baker argues, exclusionary practices can suppress competition along multiple dimensions, most notably, along the dimensions of innovation in technology and business methods.<sup>105</sup>

This is precisely the harm the courts and enforcement agencies addressed in the exclusionary cases discussed in Part I.C.<sup>106</sup> In *Primestar*, the DOJ alleged that Primestar’s MFNs with certain content-providers, among other restraints, prevented competing DBS systems from entering the market and challenging the MSOs’ hegemony. By limiting the competing DBS systems’ access to programming content, the MSOs were able to maintain their dominance over television content distribution, even while consumers were deprived of the proliferation of the innovative satellite technology and alternative subscription terms offered by the new DBS systems.

Similarly, in the health insurance cases,<sup>107</sup> the dominant third-party payors’ MFNs with care providers prevented HMOs and PPOs from gaining the discounts their models relied on, thus depriving consumers of a cheaper health care plan more tailored to their needs.

The Apple e-books case presents yet another example of how exclusion could stifle technology. Under its wholesale model, Amazon sold e-books at a retail price often below the price for which they were purchased, a model which has been termed the “\$9.99 problem” by its critics. By utilizing this model, Amazon was able to persuade consumers to adopt Amazon’s content-distribution platform: the Kindle.<sup>108</sup> Apple’s MFNs, then, deprived

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104. Baker, *Exclusion*, *supra* note 70, at 559.

105. *Id.* (“When antitrust cases address the suppression of new technologies, products, or business models, the disputes are almost always framed as exclusionary conduct allegations.”).

106. *See supra* text accompanying notes 85-86.

107. *See supra* note 88.

108. Peter Cohan, *\$9.99 Ebook Price to Cost Apple \$252 Million*, FORBES, at 2 (Apr. 12, 2012), <http://www.forbes.com/sites/petercohan/2012/04/12/9-99-e-book-price-to-cost-apple-252-million/>.

consumers of Amazon's \$9.99 model, and further, could have slowed the proliferation of the Kindle's technology and subsequent related innovation once Amazon no longer offered a price advantage for using their platform.<sup>109</sup>

These examples demonstrate that competitor exclusion, including the exclusion effected by MFNs, may entail substantial harms not only to price competition, but to the emergence of new technologies and new ways of doing business. Part III.D will demonstrate that these harms are especially sharp in the television industry.

### C. *Parallel Most-Favored Nation Clauses in Theory*

Where a set of firms adopts MFNs in parallel, the same exclusionary effects may occur as where a single monopolist imposes an MFN. Where a single dominant monopolist binds a seller to an MFN, sellers are discouraged from offering discounts because of the magnitude of the rebate it must provide to the MFN-protected buyer, which raises the barrier to entry for any firm that relies on that discount. From a seller's perspective, the penalty for discounting—the rebate—is identical whether the seller's MFN-protected sales follow from contracts with a single monopolist or numerous small buyers. Thus, the same exclusionary effect may be accomplished by parallel MFNs.

Two challenges exist, however, in examining parallel MFNs adopted independently. First, the MFNs in contracts involving a buyer with less market share may be more likely to be supported by legitimate business justifications, at least on an individual level.<sup>110</sup> This challenge may be overcome by targeting investigations of MFN usage narrowly and by carefully balancing the benefits against the harms. Part III.B provides guidelines for proceeding accordingly.

Second, in a market without a monopolist, the “critical factors” that indicate harmful MFNs will be less likely to occur.<sup>111</sup>

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109. This is essentially the converse of the network-integrity justification for MFNs, discussed *supra* text accompanying notes 34-35.

110. Though any of the justifications discussed in Part I.A may apply, perhaps the most persuasive argument is that a small buyer will be less likely to gain an MFN as a result of disparate bargaining power. Accordingly, it is more likely to have given the seller some consideration for the protection, which it would not have offered without the expectation of some savings.

111. With the adjustments discussed *supra* text accompanying note 74, the DOJ's “critical factors” can be restated as: (1) whether the MFN-protected firm's market power is sufficient to cause a very high percentage of all [suppliers] in the

Considering the first factor: where at least one supplier may remain viable without contracting with a downstream purchaser that demands an MFN, entrants into that downstream market will be able to purchase inputs at a discount from such a supplier without triggering the penalty for discounting inherent in an MFN. Considering the second factor: even where the downstream market is compelled to deal with at least one firm that demands an MFN (which may occur as a result of forces like industry custom), if there remains sufficient demand unencumbered by MFNs, the rebate that a seller owes to the MFN-protected firm will be less likely to be so large as to discourage discounting. Thus, *a priori*, a more competitive market may be a less likely home for exclusionary MFNs.<sup>112</sup>

Nonetheless, the judiciary and academics alike have counseled against expanding antitrust doctrine to better reach parallel practices, primarily out of a fear of false positives.<sup>113</sup> That is, courts fear that a looser standard for finding an antitrust violation will ultimately punish pro-competitive and reasonable conduct. Jonathan Baker argues, however, that the concerns regarding the frequency and cost of false positives in challenging exclusionary conduct are overstated.<sup>114</sup> Baker's argument notwithstanding, Part III.B details several guideposts to enable enforcement agencies to expand the reach of antitrust doctrine to the exclusionary harms of parallel MFNs with caution.

#### *D. Parallel Most-Favored Nation Clauses in Television Industry*

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market to feel compelled to contract; and (2) whether that MFN-protected firm accounts for such a large portion of a supplier's total billings that the rebate the supplier must pay as a result of the proposed discount exceeds the benefits of expanding output for a discounted price.

112. See Crocker & Lyon, *supra* note 11, at 320.

113. Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414 (2004); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 575 (1986) ("Mistaken inferences in cases such as this one are especially costly, because they chill the very conduct that the antitrust laws are designed to protect.").

114. See Baker, *Exclusion*, *supra* note 70, at 55-69 (arguing that the frequency of error in exclusion simply because there are fewer exclusion cases, which can be explained several practical considerations including greater success in deterring exclusion, and that the concerns of the cost of false positives are grounded in weak assumptions: (1) the relevant empirical data does not differentiate between exclusion and collusion, and (2) the doubts in institutional competence to fairly evaluate exclusionary cases are misstated).

The modern television industry presents a particularly timely window into the exclusionary effects of MFNs. Even as the incumbents in television distribution recognize an impending sea change in the form of digital distribution,<sup>115</sup> they have utilized numerous strategies to exclude disruptive competitors and preserve their dominance of the industry, perhaps most notably, MFNs.<sup>116</sup> The discussion that follows will show that the anticompetitive harm done by MFNs in the television industry may extend beyond inflating prices to stifle technological innovation. The reality and immediacy of these harms in television distribution demonstrate that it may be time for a deeper analysis of the limitations of antitrust liability for parallel conduct discussed in Part II.A—and perhaps a concordant doctrinal shift.

In 2012, the DOJ opened an investigation into the exclusionary effects of MFNs in the television industry.<sup>117</sup> Specifically, the DOJ is evaluating whether MFNs in the agreements between Multichannel Video Programming Distributors (“MVPDs”)<sup>118</sup> and content providers or

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115. See David Carr, *TV Foresees Its Future. Netflix Is There.*, N.Y. TIMES (July 21, 2013), [http://www.nytimes.com/2013/07/22/business/media/tv-foresees-its-future-netflix-is-there.html?pagewanted=all&\\_r=1&](http://www.nytimes.com/2013/07/22/business/media/tv-foresees-its-future-netflix-is-there.html?pagewanted=all&_r=1&) (“Consumer cord-cutting is a looming threat, not a current reality, but without prospects for growth, cable companies and programmers will continue to robotically raise rates, blaming one another as they go and deepening consumer antipathy that will eventually come home to roost.”).

116. See Brian Stelter, *Gatekeepers of Cable TV Try to Stop Intel*, N.Y. TIMES (June 12, 2013), [http://www.nytimes.com/2013/06/13/business/media/gatekeepers-of-cable-tv-try-to-stop-intel.html?pagewanted=1&\\_r=2&ref=business&](http://www.nytimes.com/2013/06/13/business/media/gatekeepers-of-cable-tv-try-to-stop-intel.html?pagewanted=1&_r=2&ref=business&) (“So-called most favored nation clauses, which are common, exist to ensure that if another distributor receives a cheaper rate for a channel later, that rate applies across the board.”).

117. Shalini Ramachandran, *Favored Nations’ Fight for Online Digital Rights*, WALL ST. J. (June 14, 2012), <http://online.wsj.com/article/SB10001424052702303410404577466940749077080.html> (raising the possibility that the MFNs used by MVPDs constrain content providers beyond non-discrimination, similar to the “MFN-plus” seen in *BCBS Michigan* or the combination of Apple’s MFN and the agency model). This investigation is also evaluating the use of data caps by Internet service providers to induce customers to prefer MVPD services over independent Internet video services.

118. MVPD is a broader term now in use by the Federal Communications Commission (“FCC”) that includes both the cable distributors (“MSOs”) discussed in *Primestar*, *supra* at Part I.C, as well as satellite distributors. See 47 U.S.C. § 522(13) (2012). Importantly, the FCC has not read the term MVPD to include Internet video distributors. See *In re Sky Angel U.S., LLC*, 25 FCC Rcd. 3879, 3882 (2010) (“[Sky Angel, an online video distributor] has failed to analyze whether and how it meets the key elements of the definition of the term

“programmers” (along with several other practices) have prevented competition in Internet distribution of television content.<sup>119</sup>

MVPDs provide live television content in a bundle that includes access to content from a determined set of programmers.<sup>120</sup> As consumers facing the recent recession have sought to retain access to quality programming at lower costs, and technology has offered new and more convenient delivery, MVPDs have faced increasing competition from Online Video Distributors (“OVDs”), which deliver, over the Internet, subsets of the content that the MVPDs offer—often in an “a-la-carte” manner, as opposed to in a pricey bundle.<sup>121</sup> OVDs include popular services such as Netflix, Amazon Instant, and iTunes, but they also include lesser-known services such as Sky Angel, a niche OVD that transmits Christian and “family-friendly” programming.<sup>122</sup>

One need not look deep into the OVDs to see that they offer pricing models and technological systems that could disrupt the stability of the MVPD model. OVDs tend to differ from MVPDs in one or more of the following manners: some OVDs license only a niche segment of the full menu of content that programmer offers; some OVDs only offer content on demand, rather than live and bundled; and content may be available from an OVD’s service at a later timeframe than it is from an MVPD.<sup>123</sup>

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‘MVPD.’”). The scope of MVPD is still a live question that the FCC has sought public comment on. See Media Bureau Seeks Comment on Interpretation of the Terms “Multichannel Video Programming Distrib.” & “Channel” As Raised in Pending Program Access Complaint Proceeding, 27 FCC Rcd. 3079, 3079 (2012).

119. See Ramachandran, *supra* note 117.

120. For a more detailed discussion of the organization of television service, see Holly Phillips, Note, *I Want My MTV, but Not Your Vh1: A La Carte Cable, Bundling, and the Potential Great Cable Compromise*, 28 J. NAT’L ASS’N ADMIN. L. JUDICIARY 321 (2008) and Christopher T. Buckley, Note, *A La Carte v. Channel Bundling: The Debate over Video Programming Distribution*, 20 LOY. CONSUMER L. REV. 413, 416 (2008).

121. OVDs are also referred to as “Over-the-top” (“OTT”) or “Internet Protocol Television” (“IPTV”).

122. See Joe Flint, *Sky Angel Says Cable Won’t Play Fair with Over-the-Top Distributors*, L.A. TIMES (June 26, 2012), <http://articles.latimes.com/2012/jun/26/entertainment/la-et-ct-sky-angel-20120626> (describing Sky Angel’s claims that it was subject to exclusionary conduct on numerous fronts, highlighted by the fact that it lost deals with many programmers as soon as it switched from satellite to IPTV).

123. But see Alex Stedman, *Theater Owners ‘Might Kill Movies,’ Warns Netflix’s Sarandos*, VARIETY (Oct. 26, 2013), <http://variety.com/2013/digital/news/theater-owners-might-kill-movies-warns-netflixs-sarandos-1200765818/> (discussing Netflix chief content officer Ted

Moreover, because the OVDs rely so heavily on the cutting edge of information technology, they have also been responsible for important technological developments such as video compression technology.<sup>124</sup>

In response to the threat that OVDs pose to the MVPD model, MVPDs have developed the “TV Everywhere” system that offers on-demand online television content as a tie-in to subscriptions to the MVPD service.<sup>125</sup> Many of the agreements between MVPDs and programmers include MFNs that guarantee the MVPD the best price on the relevant bundle of content<sup>126</sup> or that guarantee the MVPD any distribution rights offered to competitors, such as online rights, perhaps without additional consideration. These MFNs effectively guarantee that TV Everywhere’s content library can expand coterminously with that of the OVDs, and that both MVPDs and OVDs are subject to the same rates for content.<sup>127</sup>

Representatives of the MVPDs defend their use of MFNs as a mechanism to guarantee a level playing field in the industry.<sup>128</sup> However, recent statements from industry analysts and executives have indicated that MVPDs may be utilizing more direct

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Sarandos’s speech calling for moviemakers to release movies on Netflix at the same time as theaters).

124. See *Netflix Leads with Superior Compression Algorithms*, MODELLING DESIGN PARTNERS (July 23, 2013), <http://www.modellingdesign.com/netflix-leads-with-superior-compression-algorithms/>.

125. David Carr, *Faith in Its Shows, on Any Medium*, N.Y. TIMES (Aug. 23, 2010), <http://www.nytimes.com/2010/08/23/business/media/23carr.html>.

126. See Amended Complaint at ¶ 14, *Dish Network L.L.C. v. ESPN, Inc.*, No. 09-CV-06875 (S.D.N.Y. Apr. 27, 2010), ECF No. 17 (reciting the terms of the MFN between Dish and ESPN, including prohibiting ESPN from entering into agreements with a lower “net effective rate”).

127. See Todd Spangler, *Pay TV Ops Set Conditions on Cable Nets in Inking Video Pacts*, VARIETY (June 12, 2013), <http://variety.com/2013/digital/news/pay-tv-ops-set-conditions-on-cable-nets-in-inking-internet-video-pacts-1200495726/> (“In some cases, pay TV operators’ agreements essentially prohibit programmers from distributing their TV services to OTT providers because the larger distributors have the right to drop networks from the lineup unless they are extended the same rights, according to sources.”). See also *Dish Network Amended Complaint*, *supra* note 126, ¶ 25 (detailing distribution rights that ESPN allegedly granted to Comcast including a-la-carte distribution to bars).

128. See Spangler, *supra* note 127 (“A DirecTV spokesman declined to discuss the issue but said, ‘We just want fair and equal treatment across the board.’”).

mechanisms to prevent competition from OVDs,<sup>129</sup> so the link between exclusion and MFNs hardly strains credulity.

Because the MVPDs license content from programmers in large bundles, the prices they receive on individualized content may not reflect the actual market value of that content. OVDs, on the other hand, tend to seek content à la carte, or at least in a more individualized bundle, and thus they may seek lower prices that better reflect the actual market price for content. Alternatively, the OVDs might offer a model with certain advantages to a programmer, such as more targeted advertisements, which could warrant a discount. However, because the prices for and access to content will likely be constrained by the MFNs that are standard in MVPDs' agreements with programmers, any discount that a programmer might offer to OVDs relative to the MVPDs must be balanced against the rebate it must pay to MVPDs whose contracts are protected by MFNs. Thus, OVDs are faced with raised barriers to entry, and while consumers are deprived of access to preferred content delivery systems and alternative payment structures, the market is deprived of technological innovations that might stem from the proliferation of a new technological system.<sup>130</sup>

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129. See Andy Fixmer & Alex Sherman, *Time Warner Cable Content Incentives Thwart New Web TV*, BLOOMBERG (June 12, 2013), <http://www.bloomberg.com/news/2013-06-12/time-warner-cable-content-incentives-thwart-new-web-tv.html> (quoting Time Warner Cable CEO Glenn Britt's statement that his company may have agreements that bar programmers from providing content to online services); Richard Greenfield, *Does the FTC Need to Investigate the Multichannel Video Industry Tied to Non-Facilities-Based Competition?*, BTIG (June 11, 2013), <http://www.btigresearch.com/2013/06/11/does-the-ftc-need-to-investigate-the-multichannel-video-industry-tied-to-non-facilities-based-competition/> ("We have learned that one or more incumbent MVPDs have added a clause in recent programming agreements (between the MVPD and cable and/or broadcast network programmers) that prevents the programmer from licensing their network(s) to non-facilities based/virtual MVPDs." In his blog post, Richard Greenfield encouraged programmers to raise public awareness of these restrictions.).

130. Baker, *Exclusion*, *supra* note 70, at 535. See also Brief for Public Knowledge et. al. as Amici Curiae in Opposition to Motion for Temporary Restraining Order and/or Preliminary Injunction at 7, *WPIX, Inc. v. ivi, Inc.*, 765 F. Supp. 2d 594 (S.D.N.Y. 2011) (No. 10 Civ. 7415) ("New OVDs entering the market not only broaden the number of competitors for video distribution, they also expand the field for methods and technologies for providing content to consumers."), *available* at [http://www.publicknowledge.org/files/docs/PK\\_Amici\\_Brief\\_ivi.pdf](http://www.publicknowledge.org/files/docs/PK_Amici_Brief_ivi.pdf); *Comcast Corp.*, 26 F.C.C. Rcd. 4238, 4359-62 (2011) (ensuring that the Comcast-NBCUniversal merger would not hinder the growth of OVDs).

The 2010 dispute between Cablevision and Fox for retransmission fees presents one concrete example of the restraints that MFNs present in programming negotiations, albeit one that does not relate to online distribution rights. Cablevision, a local New York-area MVPD, sought arbitration from the Federal Communications Commission for its negotiations with Fox regarding the retransmission rate for Fox's New York stations. Cablevision claimed that Fox's MFNs with the nationwide MVPDs compelled Fox to demand an artificially high price for the local content Cablevision sought to license.<sup>131</sup> Cablevision claimed that the MFN protection granted to national MVPDs effectively decoupled the rates for local channels from "competitive market conditions" and instead tied them to a national market.<sup>132</sup> This dispute led to a blackout of Fox's programming for Cablevision's subscribers for two weeks and was ultimately resolved in confidential negotiations.<sup>133</sup>

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131. Cablevision Sys. Corp. Response to Media Bureau, Fed. Comm'n Comm'n 7 (Oct. 25, 2010), *available at* [http://transition.fcc.gov/cablevision-letter\\_2010-25-10.pdf](http://transition.fcc.gov/cablevision-letter_2010-25-10.pdf).

132. *Id.* ("[T]he rate represented in a national MFN may also reflect other offsets between the contracting parties that are not present in the New York market. For instance, Time Warner Cable's rate may be higher because News Corp. gave Time Warner cable rate discounts or ad availabilities on the News Corp. regional sports networks ("RSNs") that Time Warner Cable carries in other markets. The absence of any News Corp. RSNs in the New York market make such offsets unavailable to Cablevision, rendering the national MFN a poor substitute for market-based negotiation.").

133. Brian Stetler & Bill Carter, *Fox Returns to Cablevision*, N.Y. TIMES (Oct. 30, 2010), <http://mediadecoder.blogs.nytimes.com/2010/10/30/fox-returns-to-cablevision>. The more recent August 2013 dispute between CBS and Time Warner Cable focused on retransmission fees rather than MFNs. However, at least one commentator hypothesized that CBS's demands were motivated by the terms of an MFN in its agreement with FiOS, Verizon's upstart MVPD. See Mike Stein, *What Will End the CBS vs. Time Warner Dispute?*, PONDERINGTV (Aug. 30, 2013), <http://www.ponderingtv.com/2013/08/what-will-it-take-to-end-cbs-vs-time.html> ("Without having seen the contract, I can almost assure you that it includes a "favored nations" clause which dictates lower fees should CBS turn around and sign a discounted deal with another operator, including Time Warner Cable."). For further discussion of this dispute, see Amol Sharma, *Behind CBS's Fight with Time Warner Cable*, WALL ST. J. (July 20, 2013), <http://online.wsj.com/article/SB10001424127887323309404578616012415028642.html> (proposing that the rise of Aereo, which streams broadcast TV over the Internet without incurring the retransmission fees paid by MVPDs, could bring more leverage to the MVPDs in programming negotiations).



Only time will tell whether the DOJ will uncover anticompetitive effects that warrant enforcement efforts.<sup>134</sup> The DOJ's analysis, however, appears to be limited to the effects of the provisions when applied by firms with market power.<sup>135</sup> The structure of the television industry could make the DOJ's case easy: the MVPDs generally enjoy monopoly or duopoly status on the regional level, especially when the market is confined to live television.<sup>136</sup> On a national level, however, even the largest MVPD, Comcast, only controls about 21% of the market share,<sup>137</sup> which is far below the 35% said to trigger DOJ scrutiny of an individual firm's MFN.<sup>138</sup> Moreover, at least from public records, there appears to be no agreement among the MVPDs regarding MFNs. Thus, it is possible that the paradigms of liability for monopolistic or collusive behavior may not be available in this case, as the exclusionary harms would be the result of parallel independently adopted MFNs.

It is unlikely, however, that a court would find the "plus factor" required for Section 1 liability in the *Ethyl* case<sup>139</sup> because each MVPD may be able to cite numerous pro-competitive justifications for their independent adoption of MFNs, and it is unlikely that there will be evidence of some agreement among the MVPDs to coordinate the exclusion of OVDs. Further, because an

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134. The most direct evidence of this exclusion would be records of negotiations between OVDs and programmers that failed in part because a programmer was unwilling to offer a low enough price to an OVD, but the record of such negotiations, and one party's impetus behind their failure, would be inaccessible without a subpoena.

135. See Ramachandran, *supra* note 117 ("Department economist Fiona Scott-Morton said in April that such contracts 'have the potential to harm consumers and competition,' especially 'when they involve firms with market power.'").

136. See Gary Wax, Note and Comment, *Cable Company Monopoly: Comcast and Time Warner Control the Board*, 28 LOY. L.A. ENT. L. REV. 159, 188 (2008) ("Cable television is technically not a monopolistic market, but rather an oligopolistic market because a few firms account for a majority of the sales rather than only one. However, as a result of [some mergers in 2005], Comcast and Time Warner were able to create individual regional monopolies in many key markets including New York, Los Angeles, and Washington, D.C.—the financial, entertainment, and political capitals of the United States.").

137. *Comcast*, TREFIS, at 4 (Feb. 15, 2013), <http://www.trefis.com/company?hm=CMCSA.trefis> - /CMCSA/n-0002?from=sankey ("Comcast is the biggest U.S. cable service provider, with nearly 21% share of the U.S. pay-TV market.").

138. See Stenger, *supra* note 72, at 127.

139. *E.I. du Pont de Nemours & Co. v. F.T.C. (Ethyl)*, 729 F.2d 128, 139 n.10 (2d Cir. 1984).

MFN provides independent benefit to a buyer regardless of the behavior of other buyers,<sup>140</sup> interdependence and tacit collusion will not be an appropriate framework for finding liability.

Accordingly, current antitrust doctrine could be limited in its ability to reach the exclusionary harms in the television industry, even beyond the limitations recognized by Posner's "tacit collusion" framework. Where significant harm can be demonstrated, as may be the result of the DOJ's investigation, antitrust doctrine should adjust to address it.

### III. DOCTRINAL OPTIONS FOR ADDRESSING THE EXCLUSIONARY HARMS OF MOST-FAVORED NATION CLAUSES

How, then, should courts handle the exclusionary harms that arise from parallel MFNs? Part III.A discusses several non-legislative mechanisms for such a doctrinal shift and Part III.B offers several indicia of the most harmful examples of parallel MFNs as well as several limiting principles that will help allay concerns of increased false positives as a result of expanded liability.

#### A. Legal Options

It would be quite an untenable position to recommend finding the parallel use of MFNs illegal *per se*.<sup>141</sup> Rather, the doctrine should, as it does with the behavior of a monopolist or a cartel, apply a balanced rule of reason inquiry. Ultimately, the investigation into MFNs may conclude much like it did in *Primestar*: with a consent decree following from allegations of numerous practices that facilitate both price elevation and exclusion coupled with evidence of nefarious motives.<sup>142</sup> Indeed,

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140. Recall, however, that, as discussed in Part I.B, the value of that benefit is diminished as a market becomes saturated with MFNs.

141. See Baker, *Vertical*, *supra* note 16, at 533-34 ("No one proposes making most-favored-customer clauses illegal *per se*. Indeed, enforcers seeking to address the anticompetitive potential of these contractual provisions must grapple with the hesitation of some judges to accept the economic teaching that a vertical relationship including a promise to reduce prices could have the overall effect of increasing them and with the often difficult task of untangling efficiencies from harm.").

142. Indeed the DOJ is likely to find at least some evidence of exclusionary intent. See *generally* Reply to Opposition of Free Press, et. al., Decl. Dr. Mark Cooper and Adam Lynn, Comcast Corp., 26 F.C.C. Rcd. 4238 (No. 10-56) (2011) ("Comcast has done more than just acknowledge the existence of online

in such a case, parallel MFNs with exclusionary effects that outweigh the asserted benefits could, themselves, be considered a “plus factor” in support of an antitrust violation.<sup>143</sup>

The following discussion, however, proposes a mechanism for addressing the exclusionary harms of parallel MFNs in the absence of sufficient “plus factors” to otherwise find a violation. That is, I suggest a true rule of reason approach in which the exclusionary harms are weighed against the asserted justifications for the independent use of MFNs, coupled with a consideration of whether the MFN was necessary to capture those efficiencies.<sup>144</sup>

Section 1 of the Sherman Act makes any “contract, combination . . . or conspiracy, in restraint of trade” illegal.<sup>145</sup> In the scenario as I have presented it, the vertical contracts between a single MVPD and the programmers with which it dealt would not “restrain trade” in violation of Section 1 because, as a premise of the scenario, an individual MVPD does not have market power.<sup>146</sup> Rather, it is only the aggregate of those contracts that restrains trade.

The aggregation of vertical contracts for the sake of finding an antitrust violation is not a wholly novel concept. In *Standard Oil Co. of California v. United States*, the Supreme Court found a violation of Section 3 of the Clayton Act, which deals specifically with exclusivity agreements,<sup>147</sup> based on the fact that a “substantial share of the line of commerce” was affected by the practice at issue, even though there was no agreement among the parties.<sup>148</sup>

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competition. It has taken proactive steps to limit it.”), *available at* <http://transition.fcc.gov/transaction/comcast-nbcu.html>.

143. See Hemphill & Wu, *supra* note 103, at 1242 (“Where direct evidence of a price-fixing agreement is missing, plaintiffs may instead present evidence about the defendants’ conduct or market structure that provides a basis for a fact-finder to infer that a price-fixing agreement is present. This indirect evidence of a hidden price-fixing agreement, often referred to as “plus factors,” can include the observation of parallel exclusionary activity.”).

144. See Baker, *Vertical*, *supra* note 16, at 533 n.69 (“In examining the reasonableness of a most-favored-customer provision one might ask, for example, why a buyer that had enough bargaining power to obtain a most-favored-competitor clause chose not to bargain for a low price instead.”).

145. 15 U.S.C. § 1 (2012).

146. See *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 885-86 (2007) (“Whether the businesses involved have market power is a . . . significant consideration” in determining whether a practice violates Section 1 of the Sherman Act).

147. 15 U.S.C. § 14 (2012).

148. *Standard Oil Co. of California v. United States*, 337 U.S. 293, 314 (1949).

Several recent cases have indicated a willingness in the judiciary to extend this aggregation theory to find that certain exclusionary practices violate Section 1 of the Sherman Act.<sup>149</sup> This shift towards aggregation of market shares would neatly enable antitrust doctrine to reach the exclusionary harms posed by MFNs adopted by independent firms that would otherwise escape Section 1 liability for lack of market power. Consistent with Hay's model of oligopoly,<sup>150</sup> the aggregation of vertical contracts departs from the formalistic reliance on the meaning of "agreement" under Section 1 of the Sherman Act and the mental culpability inherent in such an agreement, by tying liability more closely to economic harm.<sup>151</sup> Naturally, such a departure from formalism has been met with criticism that such an expansion would punish desirable and pro-competitive behavior.<sup>152</sup>

For the television industry, however, the solution may ultimately be legislative. On November 12, 2013, Senate Commerce Chairman Jay Rockefeller introduced the "Consumer Choice in Online Video Act" which targets industry practices that have resisted a paradigm shift to a la carte programming.<sup>153</sup> Among the provisions of the bill is the following prohibition on most favored nation clauses:

CONTRACT LIMITATIONS.—A multichannel video programming distributor or an online video distributor may

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149. See, e.g., *Genico, Inc. v. Ethicon, Inc.*, No. 5:04-CV-229-DF, 2006 WL 7134667, at \*4 (E.D. Tex. Mar. 23, 2006); *Daniels SharpSmart, Inc. v. Tyco Int'l (U.S.) Inc.*, No. 5:05-CV-169-DF, 2006 U.S. Dist. LEXIS 100158, at \*9-12 (E.D. Tex. Oct. 18, 2006); *Applied Med. Res. Corp. v. Johnson & Johnson*, No. 03-1329, 2004 U.S. Dist. LEXIS 29409, at \*12-13 (C.D. Cal. Feb. 23, 2004).

150. See Hay, *Oligopoly*, *supra* note 53.

151. For a discussion of more aggressive approaches to finding liability for parallel exclusion, see Hemphill & Wu, *supra* note 103 (advocating *inter alia* for courts to treat parallel conduct of multiple firms analogously to the conduct of a single firm in order to find that a "shared monopoly" violates Section 2 of the Sherman Act).

152. See Frank M. Hinman & Brian C. Rocca, *The "Aggregation Theory": A Recent Series of Decisions in Bundled Discounting Cases Threatens to Expand Section One into Uncharted Territory*, ANTITRUST SOURCE, Feb. 2007, at 1, available at <http://www.bingham.com/Publications/Files/2007/03/The-Aggregation-Theory-A-Recent-Series-of-Decisions-in-Bundled-Discounting-Cases-Threatens-to-Expand-Section-One-into-Uncharted>.

153. See Press Release, U.S. Senate Comm. on Commerce, Sci. & Transp., Rockefeller Introduces Bill to Promote a Consumer-Centric Video Marketplace (Nov. 12, 2013), available at [http://www.commerce.senate.gov/public/index.cfm?p=PressReleases&ContentRecord\\_id=633ce61a-ddf1-41f4-a674-3daf594c7f7a](http://www.commerce.senate.gov/public/index.cfm?p=PressReleases&ContentRecord_id=633ce61a-ddf1-41f4-a674-3daf594c7f7a).

not include in any contract with a video programming vendor any provision that requires the multichannel video programming distributor or online video distributor, as applicable, to be treated in material parity with other similarly situated multichannel video programming distributors or online video distributors with regard to pricing or other terms and conditions of carriage of video programming.<sup>154</sup>

Only time will tell how Congress will strike the balance between the pro- and anti-competitive aspects of MFNs in the television industry.<sup>155</sup>

Part III.B presents several principles that enforcement agencies and jurists should consider in considering any expansion of antitrust law to exclusionary parallel MFNs in order to narrow the chilling effect of a longer reach for antitrust enforcement agencies.

#### *B. Limiting Principles*

If the premise that the harms of parallel MFNs warrant a shift in antitrust jurisprudence is to be accepted, such a shift should be carefully crafted to reach only the MFNs that cause substantial harm. Because MFNs have legitimate business justifications, a doctrinal shift towards prohibiting parallel MFNs could chill beneficial conduct.<sup>156</sup> Thus, the strongest cases for enforcement will occur when the justifications for MFNs are weak and the exclusionary effects are sharp. The following suggestions will help narrow any investigation into parallel MFNs to only those most likely to bring about a strong anticompetitive imbalance.

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154. S. 1680, 113th Cong. § 201 (2013), available at <http://thomas.loc.gov/cgi-bin/query/z?c113:S.1680>: (adding, *inter alia*, the quoted text as § 664(b) of Title VI of the Communications Act of 1934 (47 U.S.C. §§ 521-73)).

155. For further discussion of the “Consumer Choice in Online Video Act,” see Bryce Baschuk, *Rockefeller Unveils Aereo Friendly Online Video Legislation for Expanded Choice*, BLOOMBERG BNA (Nov. 13, 2013), <http://www.bna.com/rockefeller-unveils-aereo-n17179880063/> and Hayley Tsukayama, *Rockefeller Announces Online Video Bill*, THE WASHINGTON POST (Nov. 12, 2013), [http://www.washingtonpost.com/business/technology/rockefeller-announces-online-video-bill/2013/11/12/9527a89c-4bb4-11e3-be6b-d3d28122e6d4\\_story.html](http://www.washingtonpost.com/business/technology/rockefeller-announces-online-video-bill/2013/11/12/9527a89c-4bb4-11e3-be6b-d3d28122e6d4_story.html).

156. See *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 575 (1986).

As I have already discussed, a market's structure must exhibit two critical factors in order to be susceptible to exclusionary harms as a result of MFNs: (1) the MFN-protected firms' collective market power must be sufficient to cause a very high percentage of all [suppliers] in the market to feel compelled to contract; and (2) MFN-protected firms must account for such a large portion of a supplier's total billings that the rebate the supplier must pay as a result of the proposed discount exceeds the benefits of expanding output for a discounted price.<sup>157</sup> Any scrutiny of MFNs should be targeted at industries that are structured such that these considerations may be met.

#### *Prevalence of Most-Favored Nation Clauses in an Industry*

The first of these factors will be more likely to be met in concentrated markets where sellers only have a few buyers to choose from. This will be especially true in industries such as the television industry where firms do not have market power on a national level, but a single firm controls access to certain regional markets. This condition may also be met, however, in a less-concentrated industry where MFNs are customary, so the bulk of the market would be closed off if a seller refused to deal with firms that demand MFNs. In either circumstance, a supplier will have no choice but to be bound by some amount of MFNs, and discount-buyers will be unable to negotiate for discounts without triggering a competitor's MFN. Thus, where antitrust enforcement agencies are able to aggregate vertical contracts, the overall ratio of MFN-bound buyers to all buyers should be considered, with a somewhat decreased emphasis on market concentration.

This discussion presents two questions that an enforcement agency should ask when considering launching an investigation into the use of MFNs: (1) Are there firms that alone, or in concert, act as gatekeepers to certain critical sectors of a market? (2) Are MFNs customary in agreements in this industry?

#### *Number of Discounting Newcomers*

As the second critical factor indicates, parallel MFNs are only problematic from an exclusionary standpoint if the suppliers will be unable to cover the cost of reimbursing its customers protected by an MFN by expanding output for the newcomer.

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157. See *supra* note 111.

Even in largely concentrated markets, there are circumstances in which parallel MFNs might not exclude competitors. Where new entrants' models simply do not demand lower prices (or only demand marginally lower prices), the incumbents' MFNs simply will not be triggered, and no exclusionary harms will occur.<sup>158</sup> Secondly, where a supplier is able to maintain a clientele that comprises a "long tail" of small discount buyers, the supplier's gains from increased output may easily exceed the magnitude of the rebate it owes to its MFN-protected customers.

### Scope of the MFN

Beyond analyzing the structure of the market, a balanced analysis of MFNs must also look at the specific terms of the MFNs demanded in a given industry. The broader the scope of an MFN, the less compelling the business justifications become: an MFN that is tailored to a limited geographical market, applies only to transactions of similar volume or duration, or that applies only to contemporaneous offers, may serve as a reasonable index for actual market price, which can save on search costs and general transaction costs.<sup>159</sup> Where, however, an MFN covers an expansive market, applies to transactions that vary drastically from those protected by the MFN, or requires retroactive reimbursement for subsequent market conditions, particularly over an extended time period, the MFN becomes a reasonable approximation of the market price it is meant to substitute for.<sup>160</sup> In such circumstances, the pro-competitive benefits of the MFN should be suspect.<sup>161</sup>

Similarly, where an MFN demands more than just non-discriminatory pricing, such as Blue Cross Blue Shield of Michigan's "MFN-Plus" or Apple's MFN coupled with its agency

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158. This is essentially the other side of the coin from Orbitz, discussed *supra* Part I.A.. Orbitz was able to successfully enter the Internet travel agency market because Orbitz's own MFN guaranteed that it would receive the same prices as competitors, while it managed to offer an improved service.

159. See Crocker & Lyon, *supra* note 11, at 308.

160. See Steven C. Salop, Presentation at the Department of Justice and Federal Trade Commission Joint Workshop on Most-Favored-Nation Clauses and Antitrust Enforcement and Policy, *Developing Administrable MFN Enforcement Policy* (Sept. 10, 2012) (slideshow at 7), available at <http://www.justice.gov/atr/public/workshops/mfn/presentations/286834.pdf>.

161. This is not, however, to say that expansive retroactive MFN clauses are always anticompetitive. Indeed they may serve the very important task of protecting a buyer in a long-term contract as discussed *supra* text accompanying notes 18-21.

model, the exclusionary harms of those terms may be especially pronounced because the rebate a seller would owe due to any discounts it offers will be increased.

#### *Customer Captivity and Switching Costs*

The example of the television industry illustrates a quality of industries that might be more susceptible to exclusionary harms as a result of parallel MFNs. The television industry relies primarily on content that has a high degree of customer captivity and distribution systems that may result in significant switching costs.<sup>162</sup> As OVDs enter a market controlled by MVPDs, they must overcome several barriers; that is, a customer will not likely bear the cost of switching to an OVD unless he can find much of the same content he consumed via the MVPD's system. Thus, even an OVD that utilizes innovative technology may not be able to find a foothold unless it can cut costs and offer lower prices. One can easily see, then, an industry in which incumbents enjoy a high degree of customer captivity will be more susceptible to exclusion as a result of MFNs.

#### *Low Marginal Cost*

Where an industry relies largely on a product with low marginal costs, such as content, the viability of the common justification for an MFN—facilitation of long-term or high-volume contracts—is diminished. In such circumstances, a seller will not experience minimal efficiency savings from dealing with a buyer on a repeated basis, nor will it experience any savings from operating at a larger scale due to a higher volume commitment. Thus, the business justifications may not sufficiently outweigh any exclusionary harms where the product involved entails minimal marginal costs.

### IV. CONCLUSION

In the past several decades, antitrust doctrine has been anything but shy about addressing the exclusionary harms that result from MFNs. An analysis of the MFNs used independently by MVPDs in the television industry, however, demonstrates that the reach of current antitrust doctrine may fall just short of preventing the exclusion of the alternative business models and innovative

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162. JONATHAN KNEE ET AL., *THE CURSE OF THE MOGUL* 38-39, 118 (2009).



technologies that OVDs seek to bring to that industry. This doctrinal limitation in turn, harms consumers. By cautiously reviving and broadening the theory of aggregation of vertical contracts, the DOJ and the FTC may be better equipped to face these harms not only in the television industry, but in the many other industries that may be susceptible to competitor exclusion as a result of parallel MFNs.