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THE PRICE POINT

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ABA SECTION OF ANTITRUST LAW PRICING CONDUCT COMMITTEE

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We are pleased to bring you this issue of Pricing Conduct Committee's newsletter, which includes articles by Scott Perlman on the Third Circuit's recent decision in the *Feesers* case and by Scott Westrich on the legality of most-favored-nation contract terms in the health care industry. In addition, Douglas Lahnborg and Elizabeth Turner provide an overview of the European Commission's new regulation and guidelines on vertical price restraints.

If you have comments or questions about THE PRICE POINT, or if you are interested in submitting an article, please contact the Editor, Deborah Croyle, at dcroyle@orrick.com, or Committee Vice-Chair Scott Westrich at swestrich@orrick.com.

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NEW & NOTEWORTHY

New York v. Tempur-Pedic Int'l, Inc., Case No. 0400837 (N.Y. Sup. Ct.) (filed Mar. 29, 2010). The New York state Attorney General has filed a petition against Tempur-Pedic International, a manufacturer of pillows and mattresses, seeking injunctive relief, restitution and disgorgement under state law as remedies for Tempur-Pedic's alleged policy of retail price maintenance. According to the petition, Tempur-Pedic's agreements with its authorized retailers forbid free gifts with purchase, no sales tax to the consumer, and similar credits on sales of its products. Retailers which repeatedly ignore the restrictions or otherwise deviate from Tempur-Pedic's suggested retail price allegedly are terminated. The petition is brought under New York General Business Code section 369-a, which makes "any contract provision that purports to restrain a vendee of a commodity from reselling . . . at less than the price stipulated by the vendor or producer" unenforceable.

California v. DermaQuest, Inc., Case No. RG10497526 (Cal. Super. Ct., Alameda County) (filed Feb. 5, 2010). California's Attorney General recently settled its claims against DermaQuest for resale price maintenance in violation of state law. DermaQuest, a cosmetics manufacturer, allegedly entered into a number of contracts requiring resellers to sell its products for no less than DermaQuest's "suggested retail price." The Attorney General's complaint alleged that this conduct constituted "vertical price-fixing in per se violation of the Cartwright Act" (Cal. Bus. & Prof. Code § 16720 *et seq.*) as well as a violation of California's Unfair Competition Law (Cal. Bus. & Prof. Code § 17200 *et seq.*). A consent judgment enjoining DermaQuest from agreeing with any third party to fix or raise prices and imposing a civil penalty was entered on February 23, 2010.

CALL FOR ARTICLES. THE PRICE POINT is seeking submissions for its Fall 2010 issue. Consistent with the Pricing Conduct Committee's new broader focus, articles on resale price maintenance, predatory pricing, bundled pricing, price squeezes, or other pricing-related topics are welcome, as of course are articles on price discrimination and Robinson-Patman Act issues. Articles should be approximately 3,000 words in length, excluding notes. Submissions will be due September 30, 2010. If you are interested in writing for THE PRICE POINT, please email a short description of your proposed topic to Scott Westrich at swestrich@orrick.com and Deborah Croyle at dcroyle@orrick.com.

THE PRICE POINT is published three times a year by the American Bar Association Section of Antitrust Law Pricing Conduct Committee. Members of the Section of Antitrust Law may access past issues through the Pricing Conduct Committee's website. The views expressed in this publication are the authors' only and not necessarily those of the American Bar Association, the Section of Antitrust Law or the Pricing Conduct Committee. If you wish to comment on the contents of THE PRICE POINT, please write to the American Bar Association, Section of Antitrust Law, 321 North Clark Street, Chicago, IL 60654-7598.

WHITHER THE ROBINSON-PATMAN ACT? THE IMPACT OF THE THIRD-CIRCUIT'S *FEESERS* DECISION*

By Scott P. Perlman**

The Third Circuit's January 2010 opinion in *Feesers, Inc. v. Michael Foods, Inc. and Sodexho, Inc.*,[1] overturning a bench verdict for Plaintiff Feesers and directing the District Court to enter judgment for Defendants, represents yet another decision in a recent trend of cases that have raised the bar for plaintiffs to bring and sustain price discrimination claims under the Robinson-Patman Act, 15 U.S.C. § 13(a) ("RPA"). The reversal in *Feesers* was particularly significant because it probably was the most prominent recent case in which a plaintiff had prevailed on the merits of an RPA claim. Both the history of the case and the Court's decision provide guidance with respect to the proof required to establish the "competitive injury" element of a price discrimination claim under Section 2(a) of the Act. At the same time, however, the decision leaves open a number of important questions raised by the case.

CASE HISTORY 2004-2009

At the outset, the Third Circuit made the observation in a footnote that as long as the RPA remains on the books, it will continue to "flummox" and confuse the federal courts.[2] This case arguably is a textbook example of such confusion, as demonstrated by the many twists and turns in its complicated procedural history.

Michael Foods manufactured processed egg and potato products sold to institutional customers such as schools, hospitals and nursing homes. Feesers was a regional distributor serving an area of approximately 200 miles around Harrisburg, Pennsylvania that purchased Michael Foods products and resold them to institutional customers who operated their own food services, also called "self-ops." Sodexho (now "Sodexo"), on the other hand, was a food service management company that took over and ran food services for institutions that decided to outsource that function. As part of this service, Sodexo negotiated pricing with suppliers such as Michael Foods and then arranged for a distributor to purchase the food and resell it. Sodexo's services typically were sold through a request for proposal ("RFP") bidding process.[3]

Feesers claimed Michael Foods sold food products to Sodexo at discounts not made available to Feesers, resulting in institutional customers choosing Sodexo and Feesers losing institutional sales.[4] In 2004, Feesers brought suit in the U.S. District Court for the Middle District of Pennsylvania alleging the Michael Foods had violated RPA Section 2(a) by engaging in price discrimination,[5] and that Sodexo had violated RPA Section 2(f) by inducing that discrimination. Feesers sued solely for injunctive relief.[6]

In May 2006, the District Court granted summary judgment to Defendants.[7] The court found that Feesers had established three of the four elements of a *prima facie* price discrimination case under RPA Section 2(a): purchases by two different purchasers in interstate commerce; the product sold to the two purchasers was of the same grade and quality; and the defendants discriminated in price between the two purchasers.[8] However, the District Court found that Feesers had failed to establish the fourth element, that the discrimination resulted in competitive injury.[9]

In August 2007, the Third Circuit reversed, holding that the District Court had applied the wrong standard for concluding Feesers and Sodexo were not in competition.[10] In particular, the Court of Appeals ruled that the District Court had erred by (1) finding that Feesers and Sodexo were not at the same "functional level" in the chain of distribution and (2) requiring Feesers to show proof of actual competitive injury in the form of lost sales to Sodexo based on the different prices they were paying Michael Foods.[11] The Third Circuit remanded the case with instructions to the District Court to apply the correct standard for competitive injury, which it defined as Feesers needing to prove "(a) that it competed with Sodexo to sell food and (b) that there was price discrimination over time by Michael Foods."[12]

In April 2009, following a bench trial, the District Court entered judgment for Feesers and enjoined Michael Foods from discriminating between Feesers and Sodexo.[13] Among other things, the District Court found that Feesers and Sodexo competed for the same customers, and that customers switched between the two; there was a substantial difference in the prices Michael Foods charged Feesers and Sodexo – including a 59% difference for Michael Foods' top 11 products – over a sustained period of time; and that these price differences were a major element of Sodexo's strategic planning and marketing efforts to convert self-op institutions to using Sodexo's food service management services.[14] The District Court also ruled that Michael Foods did not qualify for the meeting competition defense. That defense requires the seller to show that it reduced its price in a good faith effort to meet, but not beat, a competing offer.[15] The court found that Michael Foods failed meet this standard because, while it based its pricing on market intelligence as well as Sodexo's claims that Michael Foods' prices were higher than competitors' prices, it did not seek or obtain more detailed information about the prices competitors were offering.[16]

In response to the April 2009 injunction, Michael Foods terminated its sales to Feesers. As a result, the

District Court found Michael Foods in contempt and ordered it to sell to Feesers on the same terms as Sodexo. Defendants' appealed, resulting in the Third Circuit's January 2010 decision.

THE THIRD CIRCUIT'S JANUARY 2010 DECISION

The Third Circuit reversed the District Court's judgment for Feesers, holding that Section 2(a)'s competitive injury requirement was not satisfied because Feesers and Sodexo were not competing purchasers at the time Michael Foods made the discriminatory sales to Sodexo. According to the Court, the central question was whether Feesers and Sodexo were competing for the same sales from the same customer. In answering that question, the Court relied heavily on the Supreme Court's 2006 decision in *Volvo Trucks*,[17] and the Third Circuit's own 2008 decision in *Toledo Mack*.[18] Both of those cases involved a bid market in which the claimed discrimination related to customer-specific discounts requested by a vehicle dealer from a manufacturer prior to the dealer winning the bid. On those facts, the courts in both cases held that plaintiffs failed to prove competitive injury because the alleged price discrimination did not relate to the same customer. In particular, in *Toledo Mack*, no dealer actually purchased the vehicle from Mack Trucks until after winning the bid, at which point the "relevant market" was limited to the single, winning bidder.[19]

Under *Volvo* and *Toledo Mack*, a court determining whether the plaintiff has established competitive injury must look at both "the nature of the market and the timing of the competition."[20] According to the Court, in the bid markets at issue in those cases and *Feesers*, the competition between the purchasers is complete before the sale of the product is made because there is no sale until the winning bidder is chosen. In particular, Feesers and Sodexo would compete to persuade a customer to use Feesers, a distributor, or Sodexo, a food service management company, but it was only after Sodexo was chosen that the customer would purchase Michael Foods products through Sodexo.[21] As a result, there were no competing purchasers at the time of sale, and Feeser's RPA claim must fail.[22]

The Court also stressed that its ruling was consistent with the guidance in *Volvo* and *Toledo Mack* to interpret the RPA narrowly because it often has "anticompetitive effects" that are at odds with the "broader policies of the antitrust laws."[23] The Court even cited *Toledo Mack* for the proposition that it will narrowly interpret the RPA, "even if doing so will result in "elevat[ing] form over substance."[24] On the other hand, the Court appeared to limit the scope of its decision by stating in Footnote 18 of the opinion that, "[n]otably, we do not hold that the sales of products by the manufacturer to two purchasers must always occur prior to the competition between the two purchasers. Our holding is limited to bid markets that closely resemble the markets in this case, *Volvo Trucks*, and *Toledo Mack*."[25]

Finally, the Third Circuit held that the injunction against Michael Foods for contempt did not survive its ruling, that there was no liability for Michael Foods under Section 2(a) or for Sodexo under Section 2(f), and remanded the case to the District Court with instructions to enter judgment for the Defendants.[26] Because the Court's decision was based solely on the issue of competitive injury, it did not deal with several other issues raised by the Defendants on appeal, including the District Court's ruling regarding the meeting competition defense.[27]

WHAT DOES THE *FEESERS* CASE MEAN FOR COMPLIANCE WITH THE RPA?

There are a number of important take-aways from the Third Circuit's opinion for counsel advising clients regarding compliance with the RPA, including:

- The decision is part of long-standing trend of opinions and commentary expressing hostility towards the RPA and calling for it to be repealed or narrowly construed.[28] The Court's particularly harsh criticism of the RPA in this case is likely to reinforce this trend notwithstanding the Court's attempt to limit the opinion to bid markets.
- With respect to bid markets, however, the opinion can be read as holding that the RPA has no application to such markets. At the very least, it provides greater latitude to parties participating in bid markets that resemble those in *Volvo*, *Toledo Mack* and *Feesers*, in which the competition has ended when the sale is made, with respect to the likelihood that the RPA will be applied to their discount programs.
- The case does not directly address sales made out of inventory acquired before the competition takes place between the parties; however, the author understands from Michael Foods' counsel that product already in inventory was purchased by Sodexo's distributor at a price similar to that charged to Feesers, and Sodexo's discounted price was not applied until Sodexo was chosen as a winning bidder and the product was to be sold to its customer; if that is correct, the Court's reasoning that there was no discriminatory sale until after competition had ended would appear to apply.
- The Court did not address the District Court's ruling on the meeting competition defense, which appeared to require the seller to obtain verification of the competing offer, a ruling arguably at odds with the Supreme Court's holding in *Great Atlantic & Pacific Tea Co. v. FTC*.[29] The District Court's decision, if followed by other courts, could restrict the availability of the meeting competition defense.
- The Court's statement in Footnote 18 that it is not holding that sales by a manufacturer always must take place prior to competition by the purchasers is difficult to reconcile with the rationale for the Court's decision, and may result in those trying to interpret

the case being "flummoxed" as to the meaning of that statement.

FURTHER PROCEEDINGS

The case is not over. Feesers petitioned for a rehearing and rehearing *en banc* but the petition was denied by the Third Circuit in a brief order issued March 4, 2010.[30] On June 2, 2010, Feesers filed a petition for a writ of certiorari in the U.S. Supreme Court[31] that, if granted, will give the Supreme Court an opportunity to provide further guidance regarding the RPA's "competitive injury" requirement. Assuming that the current opinion survives, however, the Third Circuit's January 2010 decision should be seen as yet another blow against the continued viability of the RPA. Nevertheless, as the Court noted, the RPA remains on the books, and parties and their counsel must continue to wrestle with how best to comply with it to avoid lengthy and expensive litigation like that described in the *Feesers* case.

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[1] Feesers, Inc. v. Michael Foods, Inc. and Sodexho, Inc., 591 F.3d 191 (3d Cir. 2010).

[2] *Id.* at 206, n. 17.

[3] *Id.* at 193-96.

[4] *Id.* at 193, 196.

[5] Section 2(a) provides in part: It shall be unlawful for any person engaged in commerce . . . to discriminate in price between different purchasers of commodities of like grade and quality, . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them. 15 U.S.C. § 13(a).

[6] 591 F.3d at 196.

[7] Feesers, Inc. v. Michael Foods, Inc. & Sodexho, Inc., No. 04-Civ-576, slip op. (M.D. Pa. May 4, 2006).

[8] *Id.* at 10-18.

[9] *Id.* at 21-24.

[10] Feesers, Inc. v. Michael Foods, Inc., 498 F.3d 206, 208 (3d Cir. 2007).

[11] 498 F.3d at 213-16.

[12] *Id.* at 213 (citing FTC v. Morton Salt Co., 334 U.S. 46 (1948)).

[13] Feesers, Inc. v. Michael Foods, Inc., 632 F. Supp. 2d 414 (M.D. Pa. 2009).

[14] 632 F. Supp. 2d at 422-23, 434 and 451.

[15] *Id.* at 451.

[16] *Id.* at 452-59.

[17] Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164 (2006).

[18] Toledo Mack Sales & Serv., Inc. v. Mack Trucks, Inc., 530 F.3d 204 (3d Cir. 2008).

[19] 591 F.3d at 201-02.

[20] *Id.* at 197-98.

[21] *Id.* at 203-04.

[22] *Id.* at 203.

[23] *Id.* at 198-99, 204-05.

[24] *Id.* at 199 (citing *Toledo Mack*, 530 F.2d at 228). The Court also argued that the RPA should not be applied to this case because "[t]he price discrimination identified by Feesers bears 'little resemblance to [the] large independent department stores and chain operations' the statute was originally intended to target." *Id.* at 204-05 (citing *Toledo Mack*, 530 F.3d at 227 and *Volvo*, 546 U.S. at 181). This point seems debatable. The Court's opinion identifies Sodexo as the world's largest private food purchaser, while Feesers is a regional distributer, suggesting this case presented the very kind of "David and Goliath" situation the statute was intended to address.

[25] *Id.* at 206, n. 18.

[26] *Id.* at 208-09.

[27] *Id.* at 194.

[28] See *Id.* at 198-99, n. 12, and the authorities cited therein. In addition, in its 2007 report, the Antitrust Modernization Commission appointed by the President called for the RPA to be repealed. *Antitrust Modernization Commission, Report and Recommendations,* http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf, (April 2007), at 313.

[29] 440 U.S. 69 (1979). In *A&P*, the Supreme Court held the requirements of the meeting competition defense had been met where Borden, the seller, reduced prices to A&P based on A&P's claim that Borden's first bid was "not even in the ballpark," notwithstanding that Borden asked for, but was not able to obtain, the details of the competing bid from A&P. 440 U.S. at 82-84.

[30] *Feesers, Inc. v. Michael Foods, Inc. and Sodexho, Inc.*, Nos. 09-2548, 09-2952, 09-2993, order (3d Cir. Mar. 4, 2010).

[31] *Feesers, Inc. v. Michael Foods, Inc. and Sodexho, Inc.*, 591 F.3d 191 (3d Cir. 2010), *petition for cert. filed*, 78 U.S.L.W. 1427 (U.S. June 2, 2010) (No. 09-2548, 09-2952, 09-2993).

MOST FAVORED NATIONS CLAUSES IN HEALTH CARE: ARE THEY LEGAL OR NOT?

By Scott A. Westrich*

A. INTRODUCTION

A most favored nation (MFN) clause is a contractual provision obligating a seller to give a customer the lowest price that it gives any other customer. MFN clauses are also sometimes called "prudent buyer" or "most favored customer" clauses. While MFN clauses can be used in a variety of contexts and industries,[1] much of the focus in the courts and at the enforcement agencies has been on MFN provisions in contracts between insurers and health care providers.

MFN provisions recently have received renewed attention in the context of the national debate about health care. Notably, the Connecticut Attorney General has launched an investigation into the anticompetitive effects of Anthem Blue Cross and Blue Shield's (Anthem) MFN provisions in its contracts with hospitals and other providers. That investigation appears to have been largely motivated by concern that Connecticut's effort to provide coverage for previously uninsured individuals would not succeed if the state could not negotiate more favorable rates from providers than those paid by private insurers such as Anthem.

While this episode raises policy questions about MFN provisions in health care contracts, it does not squarely answer the question of when such clauses are illegal under the antitrust laws.

B. MFN CLAUSES UNDER THE ANTITRUST LAWS

MFN clauses can be challenged under either Section 1 or Section 2 of the Sherman Act. Many, if not most, MFN provisions pose no antitrust concerns, and indeed are procompetitive because they help lower prices to consumers.[2] However, there is a widely held view that MFN clauses can be harmful in certain circumstances, particularly when (1) imposed by providers and used by them as a means of facilitating price collusion; or (2) imposed by a dominant health care plan as a means of blocking entry or expansion by smaller competitors in the market. These concerns have motivated enforcement efforts in this area.

1. GOVERNMENT ENFORCEMENT

The Department of Justice and the Federal Trade Commission summarized their views on MFN clauses in a joint report in 2004.[3] According to the agencies, MFNs may be procompetitive or anticompetitive, depending on the circumstances.[4] As a result, they do not advocate "a counterintuitive blanket rule against MFNs."[5] However, the "equitable" argument in favor of MFNs that the largest buyer in the market is entitled to a quantity discount and the best price is "not supported by antitrust economics."[6] In any enforcement action, the agencies "would weigh the cost savings to the largest buyer against higher costs that may be incurred by that firm's rivals."[7]

The agencies identified two theories of potential competitive harm resulting from the use of MFNs in health care markets. First, MFNs can facilitate coordination among health care providers in situations where the insurer imposing the MFN is controlled by providers.[8] The MFN could make cheating on an agreed price floor more transparent.[9] In determining whether MFNs in this context are anticompetitive, the collective market power of the participating providers is an important consideration for the agencies.[10]

Second, insurers that are not controlled by providers may impose MFNs to deter hospitals or other providers from granting discounts to competing insurers.[11] In such situations, MFNs could create a barrier to entry or expansion or raise rivals' costs, and thereby make them less effective competitors. With MFNs in place, providers have less incentive to accept lower prices from a smaller competing health plan because they will have to lower their prices for the dominant health care plan as well. In this context, the market power of the health plan in the upstream insurance market is central to the agencies' analysis.[12]

The agencies concluded their report by stating that they "will continue to challenge the use of MFN clauses when the evidence suggests that such terms violate antitrust law."[13] The agencies also analyze the effect of existing MFN clauses in reviewing health care mergers, and sometimes require waivers or elimination of MFN clauses as a condition of approving a merger.[14]

State governments also have focused attention on MFN clauses in health care contracts. At least 12 states have passed legislation limited or banning the use of MFN clauses in the health care context.[15]

Most recently, in 2009, Connecticut's Attorney General Richard Blumenthal launched an investigation of Anthem Blue Cross and Blue Shield's MFN provision in provider agreements after the state was unable to build an adequate hospital network for the its Charter Oak health plan, which is administered by Connecticut's Department of Social Services to provide coverage for the uninsured. Hospitals participating in Charter Oak were required to accept discounted rates for services provided to Charter Oak members. Blumenthal said some hospitals refused to participate in Charter Oak "out of concern that Anthem may seek to enforce its MFN rights for any hospital that participates in Charter Oak."[16] Early in 2010, he announced that Anthem had agreed to waive its MFN provisions for hospitals participating in Charter Oak.[17] A short time later, Blumenthal announced that three new hospitals had agreed to join the Charter Oak plan.[18] Blumenthal's investigation of the anticompetitive effects of Anthem's MFN provisions is ongoing.[19]

2. CASE LAW

Despite the fairly regular enforcement activity concerning MFN provisions, there is relatively little case law addressing the legality of such provisions. In a leading case, the First Circuit addressed the legality of Blue Cross and Blue Shield of Rhode Island's ("Blue Cross") alleged efforts to exclude a smaller competing health plan, Ocean State Physicians Health Plan ("Ocean State"), from the market.[20] Blue Cross adopted what it called a "Prudent Buyer" policy after it learned that Ocean State's contracting physicians were accepting 20 percent less for their services from Ocean State than from Blue Cross. The Prudent Buyer policy required providers to certify that Blue Cross was receiving their best rate or face an automatic reduction of 20% in their fees. After implementing this policy, approximately 30% of Ocean State's physicians resigned.

Ocean State challenged the Prudent Buyer policy as a violation of Section 2 of the Sherman Act. Blue Cross conceded monopoly power. The First Circuit began its analysis with the principle that "Section 2 does not prohibit vigorous competition on the part of a monopoly."[21] The court went on to state that "a policy of insisting on a supplier's lowest price—assuming that the price is not 'predatory' or below the supplier's incremental cost—tends to further competition on the merits and, as a matter of law, is not exclusionary."[22] The court believed that the policy could not violate Section 2 even assuming that Blue Cross "applied the policy in a way that was in fact directed at the illegitimate goal of destroying Ocean State, rather than at the legitimate goal of lowering costs."[23] "[T]he desire to crush a competitor, standing alone, is insufficient to make out a violation of the antitrust laws."[24]

Although *Ocean State* held that MFN clauses could not violate the antitrust laws "as a matter of law," most courts have applied the rule of reason and left open the possibility that such provisions, under certain circumstances, could violate the antitrust laws.[25] Furthermore, a subsequent district court decision in the First Circuit, *United States v. Delta Dental of Rhode Island*,[26] concluded that *Ocean State* did not stand for the proposition that MFN provisions in health care contracts were per se legal. In *Delta Dental of Rhode Island*, the government challenged Delta Dental's MFN policy as a violation of Sections 1 and 2 of the Sherman Act. The government alleged that the policy created a floor on prices for dental services and pointed out that the dentists themselves apparently were in favor of Delta Dental's Prudent Buyer policy, suggesting that dentists believed the policy helped maintain higher prices.[27] In denying Delta Dental's motion to dismiss, the court distinguished *Ocean State* on several grounds. First, *Ocean State* "involved low consumer prices" whereas the government in *Delta Dental* alleged that the policy increased prices.[28] Second, in *Ocean State*, a competing health plan challenged the MFN policy under Section 2, whereas the principle legal issue in *Delta Dental* was whether the government alleged a violation of Section 1 under the rule of reason.[29] Third, the First Circuit in *Ocean State* noted that Blue Cross estimated that it would save $1.9 million through its policy, whereas in *Delta Dental*, the government alleged that Delta Dental admitted that the policy did not generate "any meaningful savings or other procompetitive benefits."[30] After the district court denied its motion to dismiss, Delta Dental entered into a consent decree with the government under which there was no assignment of liability but Delta Dental's MFN provisions were nullified.[31]

C. CONCLUSION

The analysis of MFN provisions under the antitrust laws has not changed significantly since the handful of cases analyzing such provisions from the 1990s or the Department of Justice's and FTC's joint report in 2004. Although MFN provisions have rarely, if ever, been held to violate the antitrust laws in an adjudication on the merits, they are likely to receive continued scrutiny given the focus on health care costs and the continued debate about the structure of health care in the United States.

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[1] For example, the Department of Justice investigated the effect an MFN agreement among the owner airlines of the Orbitz joint venture (the airlines had agreed that they would market through Orbitz any publicly available fare they offered through their own or third party websites). In that case, the Department concluded that Orbitz had not reduced competition or harmed consumers. *See* Statement by Ass't Attorney General R. Hewitt Pate Regarding the Closing of the Orbitz Investigation, July 31, 2003, *available at* http://www.justice.gov/atr/public/press_releases/2003/201208.pdf.

[2] MFN clauses involving health care insurers are not exempted from antitrust scrutiny under the McCarran-Ferguson Act, because they concern the insurer's relationship with its providers, not its subscribers. *See* Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of Rhode Island, 883 F.2d 1101, 1109-10 (1st Cir. 1989).

[3] Improving Health Care: A Dose of Competition (July 2004) [Improving Health Care].

[4] *Id.* at 20.

[5] *Id.* at 21.

[6] *Id.*

[7] *Id.*

[8] *Id.* at 22-23.

[9] *See id.* at 23. The agencies cited the example of RxCare, a provider network organized by most of the pharmacies in Tennessee. *See In re* RxCare of Tenn., Inc., 121 F.T.C. 762 (1996).

[10] Improving Health Care at 24.

[11] *Id.* at 23.

[12] *Id.* at 24.

[13] *Id.* at 25.

[14] *See*, *e.g.*, Response of Plaintiff United States to Public Comments in the matter of the proposed merger of UnitedHealth Group Inc. and Sierra Health Services, Inc. (July 7, 2008), *available at* http://www.justice.gov/atr/cases/f234800/234820.htm.

[15] *See* Bob Cook, *States Strike at "Most-Favored" Pay Clause*, American Medical News, Nov. 12, 2007, *available at* http://www.ama-assn.org/amednews/2007/11/12/bil21112.htm.

[16] Press Release, Connecticut Attorney General's Office, March 2, 2010, *available at* http://www.ct.gov/ag/cwp/view.asp?A=2341&Q=456392.

[17] Press Release, Connecticut Attorney General's Office, January 28, 2010, *available at* http://www.ct.gov/ag/cwp/view.asp?A=2341&Q=454688.

[18] *Id.*

[19] In a March 8, 2010 letter to Health and Human Services Secretary Kathleen Sebelius, Blumenthal wrote to suggest that Anthem's MFN clauses might need to be investigated at the national level, and pointed out the seeming inconsistency between Anthem's MFN clauses and its large price increases to consumers in Connecticut. *See* http://www.ct.gov/ag/lib/ag/antitrust/kathleensebeliusanthemletter.pdf.

[20] Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of Rhode Island, 883 F.2d 1101 (1st Cir. 1989).

[21] *Id.* at 1110.

[22] *Id.* *See also* 3B PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 768a6 (3d ed. 2008) ("We would never condemn a dominant firm's insistence that it obtain the lowest generally available price for a product, but we would be less categorical about the monopolist's insistence that other firms be required to pay a higher price than the monopolist pays.") (footnotes omitted).

[23] 883 F.2d at 1112.

[24] *Id.* at 1113.

[25] In *Blue Cross and Blue Shield United of Wisconsin v. Marshfield Clinic*, 65 F.3d 1406 (7th Cir. 1995), Judge Posner explained that MFN clauses are "standard devices by which buyers try to bargain for low prices" and as such are "the sort of conduct that the antitrust laws seek to encourage." *Id.* at 1415. He added, however: "Perhaps, as the Department of Justice believes, these clauses are misused to anticompetitive ends in some cases; but there is no evidence of that in this case." *Id.* *Cf. Reazin v. Blue Cross and Blue Shield of Kansas, Inc.*, 899 F.2d 951, 971 & n. 30 (10th Cir. 1990) (holding jury could have concluded that MFN clause contributed to Blue Cross' power over price and thus supported showing of monopoly power).

[26] 943 F. Supp. 172 (D.R.I. 1996).

[27] *See id.* at 177 & n.5.

[28] *Id.* at 176.

[29] *Id.* at 178. This distinction is somewhat opaque.

[30] *Id.* at 179 (quoting the complaint).

[31] *See* Proposed Final Judgment, *available at* http://www.justice.gov/atr/cases/f1100/1183.htm.

EUROPEAN COMMISSION ADOPTS REVISED BLOCK EXEMPTION FOR VERTICAL RESTRAINTS

By Douglas Lahnborg and Elizabeth M. Turner*

INTRODUCTION

On April 20, 2010, the European Commission ("Commission") adopted a new vertical agreements block exemption regulation[1] ("Regulation") and revised vertical restraints guidelines[2] ("Guidelines"). The Regulation replaced the existing regime from June 1, 2010, and applies to any distribution, supply or purchasing arrangement with effect in Europe. The Regulation exempts from the application of Article 101 of the Treaty on the Functioning of the European Union ("TFEU")[3] – which prohibits agreements that restrict or distort competition within Europe – agreements between parties operating at different levels of the supply chain and which contain "vertical restraints" on competition.

This paper explores the Commission's approach to vertical agreements and the exemption provided for by the Regulation and Guidelines, going on to examine, in particular, the more detailed guidance as to retail price maintenance and arrangements for online distribution now provided for.

BACKGROUND

Article 101 applies to vertical agreements that may affect trade between Member States and that prevent, restrict or distort competition ("vertical restraints"). Whilst Article 101(1) prohibits agreements which appreciably restrict or distort competition, Article 101(3), subject to the satisfaction of certain criteria, exempts those agreements whose benefits sufficiently outweigh their anti-competitive effects.

In its Guidelines, the Commission recognises that, in general, vertical restraints are less harmful to competition than horizontal restraints and may provide substantial scope for efficiencies in the distribution chain. Competition concerns can generally only arise for vertical restraints if there is insufficient competition at one or more levels of trade *i.e.* if there is some degree of market power at the level of the supplier or the buyer or at both levels.

Certain agreements will, in any event, fall outside the application of Article 101. Agreements that are not capable of *appreciably* restricting competition by object or effect are not caught by Article 101(1). Subject to the conditions set out in the Commission's *de minimis* notice relating to a number of specified hardcore restrictions and to cumulative effect concerns, vertical agreements entered into by non-competing undertakings whose individual market share on the relevant market does not exceed 15 percent are generally considered to fall outside the scope of Article 101(1).[4] In addition, the Commission considers that, subject again to cumulative effect and the inclusion of hardcore restrictions, vertical agreements between small and medium-sized undertakings, as defined by the Commission, are rarely capable of appreciably affecting trade between Member States or of appreciably restricting competition within the meaning of Article 101(1) and generally fall outside the prohibition.[5]

In the case of agency agreements, as defined in the Guidelines,[6] the selling or purchasing function of the agent forms part of the principal's activities. Since the principal bears the commercial and financial risks related to the selling and purchasing of the contract goods or services, all obligations imposed on the agent in relation to the contracts concluded and/or negotiated on behalf of the principal fall outside Article 101(1). The agreement between the agent and its principal may, however, fall within Article 101(1), since the agent is a separate undertaking from the principal. Whilst exclusive agency provisions are unlikely to lead to anti-competitive effects, single branding and post-term non-compete provisions, which concern inter-brand competition, may lead to foreclosure effects on the market. In addition, where an agency agreement facilitates collusion, *e.g.* where a number of principals use the same agents whilst collectively excluding others from using these agents or where they use the agents to collude on marketing strategy or to exchange sensitive information between principals, this may also fall foul of Article 101.

APPLICATION OF THE BLOCK EXEMPTION

Provided that they do not contain certain "hardcore" restrictions of competition, which are viewed as having the restriction of competition as their object, the Regulation creates a presumption of legality (pursuant to Article 101(3)) for vertical agreements, depending on the market share of the supplier and the buyer. In order for the exemption to apply, the supplier's market share must not exceed 30 percent of the market on which it sells the contract goods or services and the buyer's market share on the market where it purchases the contract goods or services must not exceed 30 percent. The Regulation introduces a 30 percent market share threshold for buyers to take into account the fact that some buyers may also have market power with potentially negative effects on competition. It is hoped that this will also benefit small and medium-sized enterprises which could otherwise be excluded from the distribution market.[7] Above the market share thresholds there is, however, no presumption that vertical agreements are caught by Article 101(1) nor that they fail to satisfy the criteria set out in Article 101(3). Rather, such agreements will fall to be assessed on an individual basis.

The exemption contained in the Regulation applies to both agreements and concerted practices between two or more undertakings each operating, for the purposes of the agreement, at a different level of the production or distribution chain. It does not apply to unilateral conduct which will continue to be assessed under the provisions of Article 102. Nor does it apply to reciprocal vertical agreements between actual or potential competitors, with such agreements being assessed under the Commission's Guidance on the applicability of Article 101 to horizontal co-operation agreements.[8]

A number of hardcore restrictions are set out in the Regulation, the inclusion of which will lead to the exclusion of the entirety of the agreement from the application of the exemption. Including such a restriction in an agreement gives rise to a presumption that the agreement falls within Article 101(1) and will not satisfy the criteria set out in Article 101(3). The Commission does point out, however, that undertakings will have the possibility to demonstrate pro-competitive effects of any such provision under Article 101(3) on an individual basis.

The hardcore restrictions set out in Article 4 of the Regulation concern resale price maintenance ("RPM"), resale restrictions (with certain exceptions) imposed on buyers or their end customers, restrictions of active and passive sales to end users, restrictions of cross-supplies between appointed distributors in a selective distribution system and restrictions which prevent or restrict end users, independent repairers and service providers from obtaining spare parts directly from the manufacturer of those spare parts.

Where vertical agreements contain such hardcore restraints, the Guidelines provide further detail as to the individual assessment of these arrangements under Article 101(3).

The Regulation also excludes certain vertical restraints from the exemption. Although the excluded restraints will themselves fall outside the Regulation, the inclusion of such provisions will not affect the application of the exemption to the rest of the agreement, if the excluded provision is severable from the remaining obligations. Such excluded provisions include non-compete obligations lasting for more than 5 years (or tacitly renewable beyond a period of 5 years), post-term non-compete obligations and limitations on the sale of competing goods in a selective distribution system.

As stated above, where agreements or the provisions which they contain fall outside the Regulation, this does not imply that they are *per se* illegal. It means only that any such arrangements must be assessed on an individual basis to determine whether any efficiencies derived directly from such provisions outweigh their anti-competitive effects. The Commission's guidance to accompany the Regulation provides further details on the way in which the Commission will carry out any such analysis.

GUIDELINES ON VERTICAL RESTRAINTS

As discussed above, the Commission's Guidelines provide an explanation of the Commission's enforcement policy in individual cases for those vertical agreements which fall outside the exemption provided for in the Regulation. The most significant changes to the Guidelines from the Commission's previous guidance relate to pricing arrangements and provisions restricting the use of the internet in exclusive and selective distribution systems.

(a) PRICING PROVISIONS

Under the previous regime, the imposition upon distributors and retailers of minimum or fixed resale prices would amount to price fixing, infringing Article 101(1) as having the restriction of competition as their object.[9] As such, this practice amounted to a hardcore restraint contrary to Article 4(a) of the block exemption. To date, however, it has not been clear whether resale price maintenance ("RPM") could ever satisfy the criteria of Article 101(3). In a past investigation, the Commission appeared to be sympathetic to the idea that a newspaper publisher should be allowed to impose a cover price on newspapers, although the Commission's final decision on the matter was not made public[10] and in *Matra Hachette v Commission*, the General Court ruled that the parties to *any* kind of agreement are entitled to defend it under Article 101(3).[11]

The Guidelines now make it clear that whilst RPM still falls within Article 101(1) and thus outside the Regulation (*i.e.* RPM remains an express hardcore restriction), there may be circumstances where such arrangements may result in efficiencies.[12]

It is incumbent on the parties to substantiate that likely efficiencies result from the inclusion of RPM in their agreement and to demonstrate that all the conditions of Article 101(3) are satisfied.[13] It then falls to the Commission to assess the likely negative effects on competition and consumers before deciding whether these conditions are met.

The Commission explains that RPM may restrict competition in a number of ways. RPM may facilitate collusion between suppliers by enhancing price transparency in the market and thereby making it easier to detect whether a supplier deviates from the collusive arrangement by cutting its price. By eliminating intra-brand price competition, RPM may also facilitate collusion between buyers. RPM may reduce competition between suppliers and may even allow a manufacturer with market power to foreclose smaller rivals as the increased margin that RPM may offer distributors may lead them to favour one brand over another when advising customers. The Commission also remains concerned that RPM may reduce dynamism and innovation at the distribution level by restricting competition between distributors and preventing more efficient retailers from entering the market.

However, as mentioned above, the Commission also recognises that RPM may not only restrict competition but may also lead to efficiencies. The Commission suggests that where a manufacturer introduces a new product, RPM may be helpful during the introductory period to induce distributors to promote the new product. RPM may also provide distributors with the means to increase sales efforts and induce them to expand overall demand for the product. In addition, RPM may allow retailers to provide (additional) pre-sales services. If enough customers take advantage of these services to make their choice and then purchase at a lower price with retailers who do not provide such services, high-service retailers may reduce or eliminate these services to match the lower prices charged by other distributors, reducing demand for the supplier's product. In that situation, RPM may help to prevent such free-riding at the distribution level. The parties will then need to demonstrate that the RPM arrangement can be expected not only to provide the means but also the incentive to overcome this issue and that the pre-sales services offered benefit consumers.[14]

The practice of recommending a resale price to a reseller or requiring the reseller to respect a maximum resale price remains within the exemption provided for in the Regulation where the relevant market share requirements are met and where this does not amount to a minimum or fixed resale price as a result of pressure from, or incentives offered by, any of the parties.[15] Where market share thresholds are exceeded, these arrangements will continue to be assessed under the provisions of Article 101(3).

(b) ONLINE RESTRICTIONS

One of the primary aims of the new Guidelines is to clarify the position of vertical restraints relating to the use of the internet. The Commission acknowledges the internet as a powerful tool to reach more and different customers and advocates that, in principle, every distributor must be allowed to use the internet to sell products.[16] At the same time, the Commission does recognise that running a website may have effects outside an appointed territory or customer group and therefore considers websites as a form of passive selling.

The Commission sets out a number of provisions which it regards as hardcore restrictions on such passive selling for the purposes of the Regulation.

Arrangements which provide that an exclusive distributor shall prevent customers located in another (exclusive) territory from viewing its website or automatically re-routes customers to another distributor's website will prevent the agreement benefitting from the exemption. Agreeing that a member of an exclusive distribution system will terminate consumers' transactions on its site once their credit card data reveal an address that is not within the distributor's territory is also prohibited.

Whilst a supplier is able to require that a distributor (or retailer) sells at least a certain amount of products off-line to ensure the efficient operation of its bricks and mortar shop, the distributor must not be restricted in its portion of overall sales made over the internet. Any provision as to the amount of requisite off-line sales may be applicable either to all distributors or assessed individually for each distributor only on the basis of objective criteria.[17]

Nor can the parties agree that the buyer pays a higher price for products intended to be re-sold online than for products intended to be re-sold off-line. A supplier can agree, however, to provide the buyer with a fixed fee to support the latter's off-line or on-line sales efforts provided that this does not vary depending on the volume of products sold.[18] The Commission may also consider a dual pricing strategy where it can be shown that sales over the internet lead to increased warranty claims for the supplier and such strategy merely involves the recoupment of costs incurred by the supplier in meeting such claims.

The Regulation also provides for the imposition of restrictions on active selling over the internet by members of a distribution system. The Commission will consider online advertising specifically addressed to certain customers as a form of active selling, which will include territory based banners on third party websites and paying a search engine or online advertisement provider to have advertisements displayed specifically to users in a particular territory as active sales into that territory.[19] Restrictions relating to such activities may fall within the exemption.

Similarly provisions such as a requirement for a distributor to have a bricks and mortar shop or the setting of quality standards for websites for the resale of goods may also fall within the exemption when employed as part of a selective distribution system

CONCLUSION

In publishing its new exemption and guidelines, the Commission states that it is responding to both its own experience over the past 10 years and changing market conditions, particularly the increased use of the internet.[20]

The Commission has not only made substantial changes to the previous regime but also from the draft documents circulated back in July 2009. It now remains to be seen whether this will stand up to the changing nature of commerce over the next decade.

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[1] Commission Regulation 330/2010, Application of Article 101(3) of the Treaty on the Functioning of the European Union to Categories of Vertical Agreements and Concerted Practices, 2010 O.J. (L 102) 1 [hereinafter Regulation].

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[2] Commission Notice, Guidelines on Vertical Restraints, 2010 SEC 411 [hereinafter Guidelines].

[3] Dec. 13, 2007, 2008 O.J. (C115) 47.

[4] *See* Commission Notice, Agreements of Minor Importance Which Do Not Appreciably Restrict Competition Under Article 81(1) of the Treaty Establishing the European Community, 2001 O.J. (C 368) 13 [hereinafter *de minimis*]. For agreements between competing undertakings, the *de minimis* market share threshold is 10 percent for their collective market share on each affected relevant market.

[5] *See* Commission Recommendation 2003/361/EC, Annex, 2003 O.J. (L 124) 36.

[6] *See* Guidelines, ¶¶ 12-17.

[7] *See* Press Release, European Commission, Antitrust: Commission Adopts Revised Competition Rules for Distribution of Goods and Services (Apr. 20, 2010), *available a*t http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/445.

[8] 2001 O.J. (C 3) 2. *See also* Commission Draft Communication, Guidelines of the Applicability of Article 101 of the Treaty on the Functioning of the European Union to Horizontal Co-operation Agreements, 2010 (SEC 528) 2.

[9] *See* Treaty on the Functioning of the European Union art. 101(1)(a); Commission Notice, Guidelines on Vertical Restraints, 2000 O.J. (C 291) 1, ¶ 47 (superseded by Guidelines).

[10] Commission Notice, *Agence et Messageries de la Presse*, 1987 O.J. (C 164) 2.

[11] Case T-17/93, *Matra Hachette v. Commission*, 1994 E.C.R. II-595.

[12] *See* Guidelines, ¶ 225.

[13] *See id.* at ¶ 223.

[14] *See id.* at ¶ 225.

[15] *See id.* at ¶ 226.

[16] *See id.* at ¶ 52.

[17] *Id.*

[18] *Id.*

[19] *See id.* at ¶ 53.

[20] *See* Press Release, *supra* note 7.