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Linking Prices: Risky Relationships?

Agreements which set prices by reference to other transactions – such as sales of rivals' products, sales to other customers, or sales on different platforms - are of increasing interest to antitrust authorities on both sides of the Atlantic.

Enduring relations

Price relationship agreements (PRAs) - including most favoured nation (MFN) clauses - are not new. They have been present in contracts and accordingly subject to competition law for decades.

Recently, however, competition authorities in both the UK and US have shown renewed interest in them in the online world. On 10 September 2012, the OFT published a report it had commissioned from Laboratorio di economia, antitrust, reglamentazione (Lear) which examines the possible competition concerns that may arise from PRAs. In the US, the Department of Justice (DOJ) and the Federal Trade Commission held a joint workshop entitled "Most-Favored-Nation (MFN) Clauses and Antitrust Enforcement and Policy".

So why the renewed interest? One explanation could be the rise in this type of clause in contracts relating to online services, which have been the subject of a number of recent competition cases, such as the *e-books* cases in the US, EU and UK (the latter now closed).

This briefing summarises the conclusions of the Lear report, as well as the recent cases which have been the object of scrutiny of the antitrust authorities in the EU, UK and US.

LEAR Report - Can 'Fair' Prices Be Unfair?

The Lear report divides PRAs into three categories:

- *Cross-seller agreements*: where the price offered by a seller depends on the prices offered by its competitors. They may be either an unilaterally advertised price-promise to customers, or embedded in a long-term contract (so-called "English clauses" or meeting competition clauses).
- *Cross-customer agreements:* where the price offered by the seller to a customer depends on the prices charged by the same seller to other customers, or to the same customer over time (also known as *wholesale MFNs*).
- *Third party agreements*: where the party who pays the price determined by the PRA is not a party to the agreement/promise. The report differentiates two sub-types:
  - *price relativity agreements*: where a retailer undertakes to set the price at which it resells one manufacturer's products with reference to the price at which it sells the products of another manufacturer;
  - *Cross-platform parity agreements* (also known as *retail-MFNs*): these require the seller to sell a good or service on a platform at a price that is not higher than the price the seller charges on other platforms.

The Lear report pays particular attention to the first two types of agreements. Lear suggests that the factors which should influence an assessment by competition authorities include:

Key issues

- Why are price relationship agreements under increased scrutiny of antitrust agencies?
- How have they been assessed in recent cases?
- When might they give rise to competition risks?
- How can companies address those risks?

- market structure (including degree of concentration, degree of heterogeneity of sellers and buyers, level of barriers to entry and type of contracts);
- characteristics of the sellers adopting the PRAs (market power, level of prices including dispersion and number of firms); and
- the characteristics of the PRA (for example, promise to meet or beat in across-sellers PRA).

Main theories of harm identified

The Lear report identifies the following theories of harm:

- Foreclosure effects: PRAs may impact on the ability of new entrants to enter the market.
- Softening of competition: PRAs will often have the effect of reducing the incentive of competitors to lower prices.
- Facilitating collusion: PRAs may increase transparency in the market, also potentially making deviation from a collusive strategy easier to detect.

Although these theories of harm are similar across the types of PRA, the effect is likely to be at different levels of the market: in cross-customer PRAs, the effect will be upstream; in cross-seller PRA, the effects will be downstream; in pricing relativities agreements, the effect will be both upstream and downstream; and in cross-platform parity agreement, the effect will be on competition between platforms.

In addition, in relation to price relativity agreements, the Lear report suggests that some of the competition concerns surrounding resale price maintenance (RPM) agreements may also apply.

Price relationship agreements in practice

In the press release announcing the recently held MFN workshop, it was stated that "*although at times employed for benign purposes, MFNs can under certain circumstances present competitive concerns. This is because they may, especially when used by a dominant buyer of intermediate goods, raise other buyers' costs or foreclose would-be competitors from accessing the market. Additionally, MFNs can facilitate collusion and stabilize coordinated pricing among sellers*".

Similarly, upon publication of the Lear Report, Amelia Fletcher, OFT Chief Economist stated that "*in recent years, the OFT has focused more closely on the possible anti-competitive impact of these agreements, and will continue to consider enforcement activity where we find that competition is harmed*."

Despite this increased interest from antitrust authorities, there continues to be little recent case law on PRAs. The area in which scrutiny appears to be focused is third party PRAs and, in particular, those relating to online services.

EU

The European Commission has concluded in a number of cases that PRA clauses can give rise to competition concerns such as foreclosure and the exchange of commercially sensitive information (which may lead to collusion).

In practice, however, these cases have generally resulted in settlement without fines, following commitments by the parties to remove the allegedly anticompetitive PRA. This occurred in the *Hollywood studios* case (2004), *E.ON Ruhrgas – Gazprom* (2005) and the *digitisation of European cinemas* (2011), all of which related to cross-customer PRAs.

In the recent *e-books* case (a price relativity agreement), the European Commission is in the process of market testing a set of commitments with Apple and four publishers. If accepted, the four publishers would commit: (i) for a period of two years, not restrict e-book retailers' ability to set or reduce retail prices for e-books and/or to offer discounts or promotions; and (ii) for a period of five years, not to enter into any agreement relating to the sale of e-books within the EEA that contains a price MFN clause.

PRAs were also a focus of concern in the Commission's review of the *Universal / EMI* merger, for which clearance was conditional not only on various divestments, but also a commitment by Universal not to include MFN clauses in its favour in any new or renegotiated contract with digital customers in the EEA for ten years. The Commission considered that this would "*allow Universal's competitors to negotiate more freely*

with digital customers and further levels the playing field between these competitors and Universal."

UK

Most of the recent UK cases concerning PRAs relate to third party agreements:

- *Tobacco*: on 15 April 2010, the OFT imposed fines totalling £225 million on two tobacco manufacturers and 10 retailers, for having entered into price parity arrangements. It found that each manufacturer had a series of individual arrangements retailers whereby the retail price of a tobacco brand was linked to that of a rival manufacturer's brand, and that these arrangements restricted the ability of retailers to determine their selling prices independently. The OFT found the arrangements to be a restriction "by object", meaning that they infringed the law regardless of whether they could be shown to have had harmful effects. This decision has since however been set aside by the Competition Appeal Tribunal, for lack of evidence supporting the OFT's theory of harm.
- *Hotel online booking sector*: the OFT issued a Statement of Objections on 31 July 2012 alleging that Booking.com and Expedia each entered into separate arrangements with InterContinental Hotels Group which restricted the online travel agent's ability to discount the price of room-only hotel accommodation. The OFT's provisional view appears to be that these restrictions include resale price maintenance and therefore are, by their nature, a restriction by "object". In particular, the OFT believes that they could limit price competition between online travel agents and increase barriers to entry and expansion for such agents that may seek to gain market share by offering discounts to consumers.
- *UK private motor insurance market study*: the OFT stated that it was "concerned" that "best price guarantee" clauses in agreements between price comparison sites and private motor insurance providers "*could have the impact of reducing price competition between price comparison sites and other sales channels and possibly between price comparison sites*". Although this concern did not form part of the OFT's conclusions in its final report, it continues to be an area of interest.

US

Recent enforcement action includes:

- *E-books*: in the e-books case, the DOJ argued that the PRAs facilitated collusion between the parties. A settlement was reached with four of the five publishers whereby "*for two years, Settling Defendants shall not restrict, limit, or impede an E-book Retailer's ability to set, alter, or reduce the Retail Price of any E-book or to offer price discounts or any other form of promotions to encourage consumers to Purchase one or more E-books...*".
- *BCBS of Michigan*: in this ongoing case, the DOJ alleges that BCBS of Michigan, a large insurer in Michigan, has MFN clauses in its contracts with a large number of hospitals and that these clauses raise hospital prices to competitors and prevent other smaller insurers from entering the marketplace, thereby reducing overall competition in the health insurance market.
- The US enforcement agencies have also used behavioural undertakings within their merger approval process to remove MFN clauses (in particular, in cases where the buyer is deemed dominant) (e.g. *GrafTech/Seadrift*, 2010).

Comment

There has been a recent increase in interest by the antitrust authorities regarding the use of certain types of price relationship agreements. This is particularly the case in relation to on-line markets, and agreements between sellers and platform providers.

In light of the fact that PRAs can often have pro-competitive effects, this renewed interest by the regulators raises potential legal uncertainty and risk for businesses. Businesses may therefore wish to take a careful look at the use of any PRAs and (re-)assess them from an antitrust perspective to ensure that they do not unduly raise concerns.

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