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Counseling on MFNs After *e-books*

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UNTIL THE DISTRICT COURT'S decision in *United States v. Apple, Inc.* ("e-books"),[2] antitrust attorneys defending the use of most-favored-nation (MFN) clauses had been fond of noting that, despite increased scrutiny in recent years, no U.S. court had yet found an MFN to be unlawful.[3] And in counseling clients on MFNs, it was common to advise that the risk of an antitrust violation is low if the parties to the MFN lack market power.[4] This advice was sound because, until *e-books*, courts and scholars believed that an MFN typically does not cause competitive harm (such as raising rivals' costs, deterring entry, or softening price competition among upstream suppliers) unless the MFN deters discounting, which is unlikely when the MFN beneficiary accounts for only a small portion of the MFN grantor's sales.[5]

In *e-books*, however, the Southern District of New York condemned Apple's use of MFNs in agency agreements with several e-book publishers even though Apple, the new entrant, had no market share, and even though the court did not find that the MFNs deterred any e-book publisher from offering discounts or that the MFN otherwise raised Apple's rivals' costs, deterred entry, or softened competition among the upstream publishers. Rather, the court found that Apple's MFNs facilitated an unlawful "price-fixing" conspiracy among the upstream publishers because the agreements "eliminated retail price competition" in the *downstream* distribution of e-books.[6]

When taken together with other recent challenges to and investigations of "price parity" clauses—which are conceptually similar to MFNs—*e-books* raises the question of whether counselors should reconsider the legal and economic foundations for their advice on MFNs. For example, can MFNs lead to competitive harm even when the MFN beneficiary does not have a large enough market share to deter the MFN grantor from giving discounts to other buyers? Should an MFN in an agency agreement be condemned for "eliminating [intrabrand] retail price competition" regardless of whether it discourages discounting? This article explains why the answer to these questions is "no" and why it is still advisable to focus on the central question of whether an MFN deters discounting.

Competitive Harm and Wholesale MFNs Before *e-books*

Most of the analysis of MFNs prior to *e-books* focused on wholesale models of distribution in which a distributor (the MFN beneficiary) buys the underlying products or services from the supplier (the MFN grantor) and resells them to

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[1] Originally published in 28-3 ANTITRUST 68, Summer 2014.

[2] United States v. Apple Inc., 952 F. Supp. 2d (S.D.N.Y. 2013).

[3] For example, Apple's attorney in the *e-books* trial, Orin Snyder, reportedly stated in his opening argument that "no court has ever held an MFN to be illegal." Roger Parloff, *US v. Apple Could Go to the Supreme Court*, FORTUNE, June 5, 2013, http://tech.fortune.cnn.com/tag/ebooks/; *see also* ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 223 (7th ed. 2012) ("[C]ourts have not found MFN provisions illegal.").

[4] *See*, *e.g.*, Steven C. Salop & Fiona Scott Morton, *Developing an Administrable MFN Enforcement Policy*, ANTITRUST, Spring 2013, at 15, 18; W. Stephen Smith, *When Most-Favored Is Disfavored: A Counselor's Guide to MFNs*, ANTITRUST, Spring 2013, at 10, 11.

[5] *See* Jonathan B. Baker & Judith A. Chevalier, *The Competitive Consequences of Most-Favored-Nation Provisions*, ANTITRUST, Spring 2013, at 20, 22-24.

[6] 952 F. Supp. 2d at 693.

customers at a price determined by the distributor. In the Spring 2013 issue of ANTITRUST, Jonathan Baker and Judith Chevalier enumerated four classes of potential competitive harm associated with MFNs: (1) facilitating coordination among upstream suppliers; (2) dampening competition among upstream suppliers; (3) increasing the negotiating leverage of an upstream durable goods monopolist; and (4) raising downstream rivals' or entrants' costs.[7] Each of these harms stems from an MFN's effect on deterring the MFN grantor from discounting its prices to other buyers, which occurs because the MFN triggers an obligation by the grantor to offer those same discounts to any beneficiary that is currently paying a price above the discounted price. If MFN beneficiaries account for a large portion of the MFN grantor's sales, the grantor may find it too costly to offer the discount.[8] This deterrent effect can lead to competitive harm in a number of ways.

Facilitating Upstream Coordination

An MFN that deters discounting can facilitate coordination among upstream suppliers. If the MFN is set at the cartel price, it can become more costly for the grantor to undercut the cartel price, thus stabilizing the cartel.[9] In addition, a firm that is otherwise perceived as a "maverick" might use MFNs to signal to competitors that it has reduced its own incentive to undercut the cartel, and the incentive of MFN beneficiaries to detect violations of the MFN could make it easier to detect "cheating" on the cartel.

Dampening Upstream Competition

Even without facilitating explicit or tacit coordination, if enough upstream suppliers adopt MFNs that deter discounting, the suppliers may each independently, but in parallel, compete less aggressively on price. In addition, customers who are aware of the deterrent to discounting, or who believe they are at least getting the same prices as their competitors due to an MFN, may become less aggressive in competing for lower prices from their suppliers.[10]

Increasing Negotiating Leverage of an Upstream Durable Goods Monopolist

A durable goods monopolist might find it difficult to charge a monopoly price because purchasers of durable goods may be able to wait until the monopolist reduces price in order to make additional sales. However, if a durable goods monopolist adopts MFNs that discourage future discounting, the monopolist can signal to buyers that there is no benefit in waiting, thus forcing buyers to purchase earlier and at the monopoly price.[11]

Raising Downstream Rivals' or Entrants' Costs

In several ways, an MFN in a wholesale model can raise rivals' costs, which in turn can deter entry and otherwise reduce competition in the downstream market in which the MFN beneficiary competes. For example, an "MFN plus" provision (which requires the upstream supplier to charge higher prices to other buyers) will necessarily raise rivals'

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7 Baker & Chevalier, *supra* note 4, at 22-24.

8 *Id.* at 22-23 (noting that an MFN can "raise the seller's cost of cutting price to buyers other than the buyer that is the beneficiary of the MFN," and providing an example to illustrate the seller's calculus).

9 *Id.* at 23.

10 *Id.*

11 *Id.* at 24.

costs.[12] Even when an MFN does not require other buyers to pay higher prices (an "MFN equal" clause), the MFN can set an effective price floor above the competitive price if the MFN beneficiary agrees to pay a supracompetitive price in exchange for the MFN. This effect will only occur, however, if the MFN deters discounting.[13] If the MFN does not deter discounting, the supplier will later discount the price to the other buyers and to the MFN beneficiary, thus eliminating the supra-competitive price floor.

Some have suggested that even when an MFN does not deter discounting, it can deter entry because a new entrant will never be able to get a better price than an incumbent beneficiary, thus preventing entry of a firm that might need a cost-advantage in order to price lower than the incumbent in order to win business.[14] This theory, however, requires a conclusion that the antitrust laws should protect less efficient competitors that would not be able to compete unless incumbents are forced to pay higher prices for inputs. The validity of such a concern is at the very least debatable.

Based on this analysis, the well-accepted theories of harm associated with MFNs apply only when the MFN acts as a deterrent to discounting. An MFN clause that applies only to a buyer with a small market share in its downstream market (and thus likely a small share of the MFN grantor's sales) is not likely to deter the grantor from discounting its prices to other buyers.

Consequently, counselors have traditionally used a market-share screen when analyzing the risk that an MFN would be found unlawful. Some commentators have noted, however, that pervasive use of MFNs with many small buyers will deter discounting even if none of the beneficiaries has a large share.[15] A market-share screen is still useful, however, because courts have generally been hesitant to aggregate the effects of individual vertical contracts, even with the same upstream supplier, unless there is some evidence of a downstream conspiracy linking the individual contracts together.[16] Absent such a conspiracy, it would be difficult to hold a downstream distributor liable for the aggregate effects of other, likely confidential, contracts to which it is not a party. Therefore, even if an MFN beneficiary's low market share does not function as a complete safe harbor, it is still highly useful as a screen in analyzing the risk of liability.

Although rarely emphasized in discussions of MFNs, counselors should consider the role of interbrand competition when analyzing competitive effects. Much of the scholarly analysis of MFNs implicitly assumes that a grantor can withhold a discount from a prospective buyer without losing the sale to another competitor willing to offer a lower

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12 Even when an MFN plus provision raises rivals' costs, one must still analyze the procompetitive justifications for the provision as these may outweigh an increase to rivals' costs. For example, where rivals are likely to free-ride on the MFN beneficiary's investments, an MFN plus clause may be reasonably necessary to encourage that investment.

13 Baker & Chevalier, *supra* note 4, at 24.

14 Fiona M. Scott Morton, *Contracts that Reference Rivals*, ANTITRUST, Summer 2013, at 72, 76.

15 *Id.* at 75.

16 *See, e.g.*, Am. Airlines, Inc. v. Travelport Ltd., No. 4:11 cv 00224, slip op. at 29-33 & nn.16, 18-19 (N.D. Tex. Nov. 21, 2011), ECF No. 156 (dismissing airline's claims against GDSs based in part on price parity agreements because, absent an allegation of a horizontal conspiracy, "the effects of each alleged vertical agreement . . . must be considered individually, not in aggregate."). At least with respect to the liability of MFN beneficiaries and with respect to any theory of harm based on exclusion of downstream competition, this approach is sensible. Due to the often confidential nature of contracting, the MFN beneficiaries will typically not know whether the supplier has granted MFNs to other industry participants and, in any event, have no control over whether the supplier enters into such agreements.

price. But this will not likely be the case where interbrand competition is vigorous.[17] Thus, in addition to applying a market share screen at the MFN beneficiary level, attorneys should also analyze the strength of interbrand competition at the MFN grantor level.

MFNs in Agency Agreements

Scholarly analysis of MFNs has focused mainly on the use of MFNs in wholesale models of distribution or in health insurance. Many of the recent challenges to MFNs, however, have featured price parity MFNs arising in an agency model of distribution, which are increasingly being used in e-commerce by online selling platforms. For example, in addition to challenges in the United States involving electronic platforms for selling e-books, hotel rooms, and air travel, there have been several investigations in Europe involving price parity MFNs used for e-books, hotel rooms, price comparison websites for motor insurance, and Amazon Marketplace.[18] Although analysis of wholesale and agency MFNs is similar, some important differences between wholesale and agency models of distribution affect the competitive analysis.

In the wholesale model, the MFN governs the price that the distributor pays, but it does not necessarily dictate the price that the end consumer pays. Rather, the MFN primarily helps to ensure that the wholesale distributor has a competitive cost structure. In an agency model, by contrast, the agent does not purchase a good or service from the upstream supplier. Instead, the agent helps to bring the upstream suppliers and end consumers together and receives compensation for that service, typically a commission or fee paid by the supplier. Importantly, the upstream supplier (not the agent) determines the prices of the products the agent helps to sell. Unlike a wholesale MFN, an agency MFN (also called a price parity MFN) does not govern the price the agent pays, but governs the retail price that end consumers pay when shopping on the agent's platform. In addition, the MFN does not affect the agent's cost structure, but helps to ensure that products or services sold on its platform will be priced competitively with prices in other distribution channels selling identical products or services.

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[17] For example, Baker and Chevalier explain that the "Dampening Competition" theory of harm depends critically on how other upstream suppliers will react if an MFN grantor begins to compete less aggressively on price, and they note that, instead of softening competition, rival suppliers may seek to take advantage of a less aggressive rival, causing prices to fall. Baker & Chevalier, *supra* note 4, at 23-24. Similarly, Salop and Scott Morton have noted that MFNs are less likely to raise competitive concerns when the inputs subject to MFNs have close substitutes to which non-MFN beneficiaries can turn. Salop & Scott Morton, *supra* note 3, at 18.

[18] *See, e.g.*, COMPETITION COMMISSION, PRIVATE MOTOR INSURANCE MARKET INVESTIGATION PROVISIONAL FINDINGS REPORT (Dec. 17, 2013) (U.K.), *available at* http://goo.gl/VtL8lc; Competition Commission, *Theory of Harm 5: Impact of MFN Clauses in Contracts Between PCWs and PMI Providers* (Private Motor Insurance Market Investigation, Working Paper 16, 2013) (U.K.), *available at* http://goo.gl/O5R3pD [hereinafter *Theory of Harm 5*]; Press Release, Office of Fair Trading, OFT Welcomes Amazon's Decision to End Price Parity Policy (Aug. 29, 2013) (U.K.), *available at* http://www.oft.gov.uk/news-and-updates/press/2013/60-13; Press Release, Bundeskartellamt, Amazon Abandons Price Parity Clauses for Good (Nov. 26, 2013) (Ger.), *available at* http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Meldungen%20News%20Karussell/26_11_2013_Amazon.html; Investigation into the Hotel Online Booking Sector, OFT, http://www.oft.gov.uk/OFTwork/competition-act-and-cartels/ca98/closure/online-booking (U.K.).; Press Release, Bundeskartellamt, Bundeskartellamt Examines HRS Best Price Clause (Feb. 10, 2012) (Ger.), *available at* http://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2012/10_02_2012_HRS.html; Schaal, Dennis, *Switzerland Probes Booking.com, Expedia and HRS on Hotel Rate Parity*, SKIFT (Dec. 15, 2012, 2:41PM), http://skift.com/2012/12/15/switzerland-probes-booking-com-expedia-and-hrs-on-rate-parity/; see also Nelson Jung, Dir., Markets and Projects, U. K. Office of Fair Trading, Price Relationship Agreements in the UK and EU: A Retail-MFN Enforcement Gap? (Sept. 10, 2012), *available at* http://www.justice.gov/atr/public/workshops/mfn/presentations/286773.pdf.

Like MFNs in wholesale models, price parity MFNs in agency models could deter the upstream supplier from discounting because a supplier that wants to offer a discount to end consumers on one platform would have to offer that same discount to consumers shopping on the MFN beneficiary's platform. But again, this deterrent effect will occur only if the MFN beneficiary's platform, or the platforms of multiple smaller MFN beneficiaries, account for a large portion of the MFN grantor's sales. And, even when the MFN might otherwise deter discounting, it will only do so if the interbrand competition among upstream suppliers is insufficient to force the MFN grantor to offer the discount in both channels.

Thus, a market share screen for the MFN beneficiary and a consideration of interbrand competition at the MFN grantor level should also be applied when analyzing price parity MFNs in an agency model of distribution. The likely competitive effects of a price parity MFN, however, differ from wholesale model MFNs in four significant ways.

First, price parity MFNs do not raise rivals' costs because they govern only the prices that end consumers pay on the MFN beneficiary's platform. The only theory of *exclusionary* harm that could apply to a price parity MFN is the theory that such an MFN would deter entry of a firm that would not be competitive unless the upstream supplier prices its products or services on the entrant's platform at lower prices than on incumbent platforms.[19] Again, the validity of this theory is debatable because it would require the antitrust laws to protect less-efficient competitors that are not viable unless incumbent competitors are forced to offer products or services to consumers at higher prices.

Second, some have argued that a price parity MFN reduces competition among distributors on commissions or fees because the MFN prevents the upstream supplier from offering its goods or services at lower prices on platforms that charge the supplier lower commissions or fees.[20] But this purported concern ignores the fact that distributors can and do compete for the MFN guarantee itself by offering the supplier reduced fees and commissions. Indeed, in cases like *US Airways v. Sabre*, in which airlines challenged "full content" clauses (similar to price parity) in their agency agreements with global distribution systems (GDS), it was undisputed that the GDS offered the airlines significant reductions in booking fees in exchange for the full content commitments.[21] The fact that the MFN prevents the up-stream supplier from rewarding a lower-cost distribution channel *during the life of the contract* is not an antitrust harm, but a problem inherent in all medium or long-term contracting. No one would suggest that a retailer's five-year lease with a shopping mall violates the antitrust laws because it prevents, for five years, the retailer from moving to a mall that subsequently offers a lower rent. Nor would anyone credibly argue that a three-year exclusive distributorship violates the antitrust laws because the upstream supplier cannot, for three years, switch to another distributor that subsequently offers the supplier better terms or service. To condemn price parity MFNs on these grounds would similarly be misguided.

Third, a price parity MFN usually will have compelling procompetitive justifications. For example, to encourage an agency model distributor to invest in the quality of its platform, advertising, and other forms of non-price competition that increase consumer welfare, the agent must have some assurance that the products sold on its platform will be priced competitively with other distributors offering the identical product. Absent a price parity MFN, other distributors that do less to promote the upstream suppliers' products or services can engage in free-riding that discourages

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19 Scott Morton, *supra* note 13, at 76.

20 *Id.*

21 *See* Sabre's Motion for Summary Judgment on US Airways' Remaining Claims, US Airways, Inc. v. Sabre, Inc., No. 1:11 cv 02725, at 20 n.12 (S.D.N.Y. Apr. 2, 2014), ECF No. 204 [hereinafter Sabre's Motion for Summary Judgment] ("The evidence is undisputed that US Airways agreed to give Sabre [the full content agreement], in exchange for lower booking fees.").

investment, thus reducing output and reducing consumer welfare.[22] Indeed, for an online shopping platform agency-model distributor, a price parity guarantee can be necessary for survival.[23]

Fourth, a price parity MFN will often increase interbrand competition in ways that a wholesale MFN does not. For the agency model online shopping platform, price parity MFNs ensure that consumers will be able to find the best offers by using a single platform. This one-stop shopping reduces transaction costs, improves price transparency, and reduces barriers to entry, thus forcing upstream suppliers to compete more aggressively on price.[24] In addition, the ability to find the best offers on any one platform makes each platform a more perfect substitute for others, thus increasing competition on non-price dimensions.

The Southern District of New York's Approach to Apple's Price Parity MFNs

In *e-books*, Judge Cote did not find that Apple's price parity agreements had any of the adverse competitive effects discussed above. The court did not find that the clauses deterred discounting by the publishers or that they otherwise deterred entry of other e-book distributors, raised rival e-book distributors' costs, or reduced competition among distributors on commissions. Instead, the court found that Apple's price parity MFNs facilitated a price-fixing conspiracy because the MFNs "eliminated retail price competition."[25]

Key Facts

Apple began competing in the distribution of e-books in 2010 with the launch of the iPad and the iBookstore. Before Apple's entry, Amazon had a 90 percent share of e-book distribution.[26] Amazon operated under a wholesale model in which it purchased e-books from publishers and resold them at a price determined by Amazon. Although the court suggested that publishers did not compete on the price of e-books, they all sold e-books at about the same wholesale price, which was between $13 and $15 dollars per e-book.[27] Amazon chose to sell certain new releases and *N.Y. Times* Bestsellers at $9.99, a significant loss from the wholesale price that it paid.[28]

Although the defendant e-book publishers, which settled before trial, received full payment of the higher wholesale price, Amazon's loss leader pricing for e-books was reducing sales of the publisher's hardcover books and reducing the viability of the publisher's other distribution channels.[29] In addition, the publishers feared that Amazon would eventually use its market power to force publishers to reduce the wholesale price to Amazon and that Amazon would

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[22] Scott Morton, *supra* note 13, at 77 (noting that MFNs can prevent free-riding); *In re* Online Travel Co. (OTC) Hotel Booking Antitrust Litig., 2014 U.S. Dist. LEXIS 19691, at *41-42 (N.D. Tex. Feb. 18, 2014) (finding that hotel "rate parity" clauses helped to avoid free-riding); *see Theory of Harm 5*, *supra* note 17, ¶ 15(b) (noting that absent a price parity MFN consumers might shop on a website that invests more on its search functionality, but book on a poorer quality website that offers better prices, causing a deterrent to investment).

[23] *See Theory of Harm 5*, *supra* note 17, ¶ 15(b) (noting that absent an MFN, a price comparison website might go out of business).

[24] *See Id.* (noting that price parity MFNs can benefit consumers by eliminating the need to shop around for a better price).

[25] United States v. Apple Inc., 952 F. Supp. 2d 638, 693 (S.D.N.Y. 2013).

[26] *Id.* at 649.

[27] *Id.* at 656.

[28] *Id.* at 649.

[29] *Id.*

leverage its market power in the distribution of e-books to obtain market power in publishing.[30] The publishers, however, were hesitant to take unilateral actions against Amazon because they (reasonably) feared that it would retaliate.[31]

Apple's iPad offered substantial quality improvements over Amazon's Kindle e-reader—or at a minimum, sufficient product differentiation to appeal to a set of potential customers.[32] But Apple was unwilling to enter the e-books market if it did not have the content of enough of the major publishers to provide a viable alternative to the Kindle, and if it were forced also to take a loss on e-book sales to match Amazon's below-cost pricing.[33] Apple told publishers that it wanted to set retail prices for e-books between $11.99 and $14.99, which was much closer to the prevailing wholesale prices at the time.[34] Apple also determined it would enter the business using the agency model with a 30 percent commission, which is how Apple sold much of the content in its App Store.[35]

Having given up control over price to the publishers, Apple wanted to ensure that its investments in promoting the iBookstore and the iPad would not be undermined by the publishers setting unattractive retail prices for e-books in the iBookstore. Apple thus insisted on certain price caps that would prevent the publishers from charging retail prices that significantly exceeded the prevailing wholesale prices for e-books.[36] Apple also insisted on a price parity MFN that would ensure that publishers were pricing e-books in the iBookstore for not more than the price the publisher charged for the same title elsewhere.[37]

But the Apple price parity MFN also required the publishers to match the pricing of Amazon and any other wholesale model distributor that was independently setting prices for the publisher's e-books.[38] Because Amazon was selling certain e-books below cost, this MFN forced the publishers either to take "disastrous" losses relative to the prevailing wholesale price on certain e-books or to force Amazon into an agency model of distribution, in which the publishers would determine the price of e-books sold in the Kindle store.[39] When Amazon converted to agency, Amazon insisted on the same price parity MFN that Apple enjoyed.[40]

Judge Cote's Characterization of Apple's Price Parity MFNs

Judge Cote found that Apple's simultaneous adoption of price parity MFNs and agency agreements with several publishers constituted a "hub-and-spoke" conspiracy to fix prices because it was designed to raise e-book prices and

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[30] *Id.*

[31] *Id.* at 650. These fears were proven correct when Amazon did in fact retaliate by removing from its website the ability to purchase titles of one of the smaller publisher defendants when it threatened to "window" or delay the release of e-books on Amazon. *Id.* at 679-80.

[32] *Id.* at 655.

[33] *Id.* at 655-56.

[34] *Id.* at 657.

[35] *Id.* at 658-59.

[36] *Id.* at 662.

[37] *Id.*

[38] *Id.* at 664.

[39] *Id.* at 665, 701.

[40] *Id.* at 699.

"eliminate retail price competition."[41] The court's reference to "eliminat[ing] retail price competition," necessarily meant intrabrand retail price competition because there was no allegation that any of Apple's price parity clauses restricted how the e-book publishers set prices in competing against one another.[42]

Moreover, the conspiracy makes no sense as a price-fixing conspiracy among the publishers. As the court noted, even after Amazon converted to the agency model so that it could no longer price below cost, the publishers received lower net revenue from retail sales of e-books than they had previously received under the wholesale model. Apple's price caps effectively forced the publishers to set *retail* prices for e-books at the previous *wholesale* price levels.[43] And, because the publishers also had to pay commissions to Apple, Amazon, and other agents, the publishers were making only 70 percent of their former revenue on each book.[44] A conspiracy to reduce the publisher's net revenue per unit would be a strange form of price-fixing conspiracy indeed.

In the course of its analysis, the court repeatedly condemned Apple for relinquishing pricing power to the publishers and opting to engage in non-price competition as an agent of the publishers. For example, the court found that "agency would give the Publishers the control over e-book pricing that they desired, and ensured that Apple would make a profit from every e-book sale in its iBookstore without having to compete on price,"[45] and that "Apple included the MFN, or price parity provision, in its Agreements both to protect itself against any retail price competition and to ensure that it had no retail price competition."[46] Similarly, the court added:

> Apple, quite simply, did not want to compete with Amazon on price. Apple was confident that the iPad would be a revolutionary and wildly popular device. It was happy to compete with Amazon on that playing field, where it believed its strength resided. It would match its device—the iPad— against the Kindle.[47]

Judge Cote's language seems broad enough to condemn all agency-model price parity MFNs, as agency-model distributors do not compete on price. The court's language would also seem to condemn a distributor that prefers to compete on non-price dimensions instead of competing on price. But this is exactly how most agency-model distributors compete. At the same time, the court refused to credit the argument that, in an agency model, the MFN is necessary to ensure that upstream suppliers will price their products competitively on all of their agents' platforms. Indeed, in response to Apple's argument that the MFN creates a "competitive, level playing field for e-book sellers,"[48] Judge Cote stated that "the word 'competitive' in this and many other contexts . . . means the opposite of competition. It means the eradication of retail price competition."[49]

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41 *Id.* at 706-07.

42 The court stated inconsistently, both that the "publishers did not compete with each other on price," but that each publisher "could . . . expect to lose substantial sales if they unilaterally raised the prices of their own e-books and none of their competitors followed suit"—suggesting that publishers do in fact compete on price. *Id.* at 651, 692.

43 *Id.*

44 *Id.*

45 *Id.* at 659.

46 *Id.* at 692.

47 *Id.* at 663.

48 *Id.* at 666.

49 *Id.* at 666 n.26.

Reading *e-books* as a Group Boycott Case

Before *e-books*, no U.S. court or commentator had suggested that MFNs should be unlawful because they eliminate intrabrand retail price competition. And it is hard to condemn an agency model distributor for not competing on price when the agent has no control over price in the first instance. Moreover, an upstream supplier in an agency model does not engage in "retail price competition" by selling its products at one price on platform A and selling at another price on platform B. While a price parity MFN may limit the upstream supplier's ability to price discriminate among its distribution channels, it does not eliminate retail price competition, which would continue to exist as the upstream supplier competes on retail prices across all of its channels to win sales from competing suppliers.

Nor would an agency MFN that forces the upstream supplier also to match the retail prices set by independent wholesale distributors ordinarily eliminate even intrabrand retail price competition. It is true that an MFN that forces the upstream supplier to match the prices of a distributor selling below cost might ultimately encourage the upstream supplier to terminate the independent distributor or to remove its pricing authority. Indeed, the *e-books* court found that Apple's price parity MFN was designed to have this effect because Amazon's loss leader pricing meant that the MFN "punished a Publisher if it failed to impose agency terms on other e-tailers."[50] But, if this is what "eliminating retail price competition" means, such an effect is limited to the rare case where a price parity MFN forces an upstream supplier to match the prices of an independent distributor selling at a level of profitability that "punishes" the supplier if it does not remove the independent distributor's pricing authority.

Not only would such a fact pattern be rare, but it is unlikely that such an agreement would be found unlawful if the MFN is analyzed under the rule of reason. Many distribution strategies and distribution agreements that eliminate or reduce intrabrand retail price competition, especially with low-price, low-service distributors, are typically found to be lawful.[51] For example, an upstream supplier could disintermediate its below-cost selling distributor, implement a unilateral minimum resale price maintenance (RPM) policy, refuse to deal with a distributor that sells below cost, or grant an exclusive distributorship to a distributor that sells above cost. Any of these actions would have the same effect of eliminating intrabrand retail price competition and increasing the retail price of the supplier's products, but none of these actions would likely result in an antitrust violation.

The theory of harm espoused in *e-books* thus only makes sense if the case is viewed as involving a concerted refusal to deal or "group boycott" in which each publisher, on the condition that rival publishers did the same, refused to deal with Amazon on wholesale terms. The theory of the case would be that each publisher was unlikely unilaterally to demand that Amazon stop selling e-books below cost, but, with knowledge that Apple's MFNs would "punish" any publisher that did not take such action with respect to Amazon, the MFNs "stiffened the spines of the Publisher Defendants" to do together what they were afraid to do alone.[52]

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50 *Id.* at 665.

51 As recognized by the U.S. Supreme Court when analyzing minimum resale price maintenance, vertical price restraints often tend "to eliminate intra-brand price competition" but "this in turn encourages retailers to invest in tangible or intangible services or promotional efforts that aid [interbrand competition]." Leegin Creative Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 890 (2007). In addition to facilitating interbrand competition, vertical restraints on intrabrand price competition can enhance consumer welfare by encouraging investment in retail services that might be underprovided due to free-riding or other reasons, increase consumer choice by allowing for a greater variety of retail channels, and facilitate entry. *Id.* at 891-92.

52 952 F. Supp. 2d at 665.

Knowledge of the other publishers' agreement to the same MFN is essential to this theory, because parallel, but independent, adoption of vertical agreements that each create the same incentives are not unlawful.[53] The lawfulness of the price parity MFNs in *e-books* thus ultimately depended on the MFN's role in facilitating a *concerted* refusal to deal with Amazon, and not on whether the MFNs themselves eliminated intrabrand retail price competition or raised price within any given publisher's distribution channels. On this reading, *e-books* merely identifies a theory of harm in which MFNs can be used as a tool to enforce compliance with a group boycott. Such a theory would apply only in the presumably rare circumstances in which: (1) a distributor is selling below cost or at an otherwise unprofitable level such that the MFN "punishes" any supplier that does not terminate the distributor's pricing authority; (2) no supplier is willing to terminate the distributor's pricing authority unilaterally; and (3) the suppliers knowingly adopt the MFN as a means of signaling to other suppliers their intention to adhere to the group boycott of the distributor.

The Approach to Price Parity MFNs in Other Cases

Price parity MFNs have been the subject of at least three other private actions in the United States, each involving the travel industry. In February 2014, the Northern District of Texas dismissed on the pleadings a consumer class action challenging "rate parity" MFNs, in which certain hotel companies guaranteed online travel agents (OTAs) that the hotel company would sell rooms on the OTA's platform at the lowest prices charged on any other platform.[54] As in *e-books*, the plaintiffs did not allege theories of harm that stem from an MFN's effect in deterring discounting. Instead, similar to *e-books*, the plaintiffs framed the MFN as integral to a price-fixing conspiracy "to eliminate, on an industry-wide basis, intra-brand competition . . . among each hotel's online distribution channels, including its own website and OTA-run websites."[55] Because the case was framed as a horizontal conspiracy, the sufficiency of the plaintiffs' allegations ultimately relied on whether it was plausible that a horizontal agreement existed at either the upstream hotel level or the downstream OTA level. Finding the plaintiffs' allegations of a conspiracy insufficient, the Northern District of Texas dismissed the case.

In doing so, the court characterized the purpose and effects of the price parity MFNs in a manner markedly different from Judge Cote's characterization of the analogous MFNs in *e-books*. The Northern District of Texas found it "obvious" that hotels would want to manage their brand by controlling how distributors would price their rooms and that the OTAs, having given up pricing authority, would naturally want an assurance that they "will not be undercut by the hotel itself or by an OTA competitor."[56] Consistent with the analysis of vertical price restraints in *Leegin*, the court recognized that price parity guarantees prevented free riding, thus encouraging the OTAs to invest in services, and the court further noted that there were no allegations that the MFNs reduced interbrand competition among the upstream hotels.[57]

In separate litigations brought by American Airlines and US Airways challenging "full content" agreements signed with GDSs, the plaintiff airlines, which were the upstream suppliers, alleged that full content agreements prevent the airlines from offering lower airfares on GDS alternatives, and thus, during the life of the contract, the airlines could not

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53 *See* Toys "R" Us, Inc. v. FTC, 221 F.3d 928, 932 (7th Cir. 2000) (affirming FTC decision finding unlawful agreements in which toy manufacturers agreed not to sell toys to club stores "on the condition that their competitors would do the same.")

54 *In re* Online Travel Co. (OTC) Hotel Booking Antitrust Litig., 2014 U.S. Dist. LEXIS 19691 (N.D. Tex. Feb. 18, 2014).

55 *Id.* at 1, 3.

56 *Id.* at 16-17.

57 *Id.* at 10, 19.

provide superior (i.e., lower priced) travel content to encourage other selling platforms to offer the airline better fees or as a means to provide an advantage to new entrants.[58]

As discussed above, the viability of these theories of harm is uncertain. One appears to complain about an issue inherent in all mid-term or long-term contracting, and the other requires a conclusion that the antitrust laws should encourage the entry of competitors that would not be attractive to consumers unless incumbent competitors are forced to sell products at higher prices. Although American Airlines settled its litigation, the parties in *US Airways v. Sabre* in the Southern District of New York are awaiting a decision on summary judgment motions as of May 2014. A central argument in Sabre's brief is that parity agreements do not exclude equally efficient competitors, and instead facilitate inter-brand competition among upstream airlines by allowing consumers to compare flights and fares of competing airlines on one platform.[59]

Conclusion

Antitrust analysis of MFNs is still evolving, especially with regard to agency MFNs commonly used in e-commerce. Counselors should not view *e-books* as a template for analyzing such agreements. Despite the court's broad references to "price fixing" and "elimination of retail price competition," the theory of harm in *e-books* is limited to a narrow situation in which an MFN is used as a means of enforcing a group boycott of a distributor pricing below cost.

When analyzed as stand-alone vertical agreements, MFNs should not be condemned solely for increasing prices or eliminating intrabrand retail price competition. As with other commonly used vertical restraints in distribution agreements, any increase in price or reduction of intrabrand price competition must be balanced under the rule of reason with the pro-competitive benefits, such as increasing non-price competition between distribution channels, encouraging services that increase consumer demand, and facilitating inter-brand competition among upstream suppliers. Accordingly, counselors should continue to focus on the central question of whether the MFN deters discounting. Because this effect is unlikely where the beneficiary lacks market power or when there is strong interbrand competition among the grantor and its rivals, counselors should continue to apply a market share screen and consider the strength of interbrand competition.

At the same time, however, counselors should be aware of the other less accepted theories of harm associated with agency MFNs, such as the inability of suppliers to use lower prices to reward other distributors that subsequently offer lower commissions or fees during the life of the MFN contract, or the entry-deterring effect of the MFN on entities that would not be viable unless incumbents were forced to sell at higher prices.

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[58] *See* Letter from Charles P. Diamond to Hon. Lorna G. Schofield, US Airways, Inc. v. Sabre, Inc., No. 1:11 cv 02725 (S.D.N.Y. Mar. 6, 2014), ECF No. 188 (arguing that Sabre's "full content" agreements prohibit US Airways from offering discounts to travelers and travel agents that use lower cost booking channels).

[59] *See* Sabre's Motion for Summary Judgment, *supra* note 20, at 8, 10 n.5.