



HEALTH INSURANCE REPORT



REPORT

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Most-Favored-Nation Clauses Fall Out of Favor with Department of Justice



BY DAVID MARX JR. AND HILLARY A. WEBBER

DOJ, Michigan Challenge Health Insurer's Most-Favored-Nation Contracts

In a speech earlier this year Assistant Attorney General of the Department of Justice (“DOJ”) Antitrust Division Christine Varney signaled the DOJ’s intention to closely scrutinize “exclusionary practices by dominant firms” in the health insurance industry, particularly “with respect to most-favored-nations clauses and exclusive contracts between insurers and significant providers that reduce the ability or incentive of providers to negotiate discounts with aggressive insur-

ance entrants.”¹ MFN clauses generally require one party to do business with another party on terms as good as or better than the terms on which the former deals with the latter’s competitors.

The DOJ recently backed Varney’s words up with action when it and the Michigan attorney general challenged Blue Cross Blue Shield of Michigan’s (“BCBSM”) use of most-favored-nation (“MFN”) clauses in contracts with Michigan hospitals on the grounds that they inhibit competition from other insurers and raise both rivals’ and consumers’ costs, in violation of Sherman Act Section 1 and Michigan antitrust law (*United States v. Blue Cross Blue Shield of Michigan*, No. 2:10-cv-14155-DPH-MKM, 10/18/10; see *previous article*).

BCBSM’s widespread use of MFN clauses in its contracts with Michigan hospitals, the DOJ alleges, raises prices for commercial health insurance in Michigan. Although MFN clauses are not *per se* anti-competitive, they can, in certain circumstances, unreasonably re-

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¹ Christine A. Varney, Remarks as Prepared for the American Bar Association/American Health Lawyers Association Antitrust in Healthcare Conference, May 24, 2010.

strain competition or support a claim of monopolization.

The DOJ and Michigan Allegations

The DOJ complaint alleges that BCBSM is the largest provider of commercial health insurance in Michigan, covering more than 60 percent of commercially insured lives. The lawsuit alleges that during the past several years, BCBSM has successfully sought to include MFN clauses in contracts with over half of Michigan's acute care hospitals.

BCBSM allegedly uses two varieties of MFN clauses. Under an "equal-to MFN," BCBSM requires that hospitals charge other commercial insurers at least as much as they charge BCBSM for health care services. BCBSM has allegedly entered into "equal-to MFN" agreements with more than 40 hospitals.

BCBSM also has contracts that include an "MFN-plus" provision, under which BCBSM allegedly requires hospitals to charge other commercial insurers more than they charge BCBSM, often by a specific percentage differential. The lawsuit states that BCBSM has MFN-plus clauses with 22 hospitals and requires some of those hospitals to charge competitor insurers up to 40 percent more than BCBSM for health care services.

The DOJ alleges that, in many cases, BCBSM sought these MFNs in exchange for *increases* in the prices it pays for the hospitals' services. Thus, the DOJ claims that "Blue Cross has purchased protection from competition by causing hospitals to raise the minimum prices they can charge to Blue Cross' competitors, but in doing so has also increased its own costs."

According to the DOJ, the BCBSM MFN clauses have caused hospitals either to raise substantially prices to competing insurers or to demand prices that are too high for competing insurers to compete, effectively keeping them out of the market. The DOJ alleges that the inability of other insurers to compete against BCBSM has likely resulted in higher costs for health insurance to employers and insureds.

The state of Michigan purchases group health insurance through BCBSM for its employees, retirees, and dependents, and claims that, as a self-insurer, it has suffered direct injury in the form of increased hospital costs.

BCBSM responded to the allegations in a press release, stating that, contrary to the lawsuit's allegations, it uses MFN clauses "to negotiate the lowest possible cost for medical care in the hospital."² BCBSM indicated that it would vigorously defend the lawsuit.

Antitrust Analysis of MFN Clauses

MFN clauses are not inherently anti-competitive and, therefore, are evaluated for antitrust purposes under the rule of reason, which requires courts to balance their potential anti-competitive harm against their prospective pro-competitive benefits. Courts have upheld MFN clauses that support a pro-competitive purpose—e.g., lower prices for consumers—and are not misused to achieve anti-competitive ends.

For example, in *Blue Cross & Blue Shield United v. Marshfield Clinic*, the U.S. Court of Appeals for the Sev-

enth Circuit rejected a challenge to an MFN clause that provided that a medical clinic and its parent HMO pay affiliated physicians no more than what the physicians charged other patients. 65 F.3d 1406, 1415 (7th Cir. 1995).

The court remarked:

'Most favored nations' clauses are standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers. The Clinic did this to minimize the cost of these physicians to it, and that is the sort of conduct that the antitrust laws seek to encourage. It is not price-fixing.

Id. Similarly, in *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of Rhode Island*, the U.S. Court of Appeals for the First Circuit held that a MFN provision that guaranteed that Blue Cross would not pay more for medical services than any other private health care purchaser did not violate Section 2 of the Sherman Act. 883 F.2d 1101, 1110 (1st Cir. 1989). Blue Cross estimated that it saved approximately \$2 million through its MFN provisions. *Id.* The court stated that insisting on a supplier's lowest price tended to further competition on the merits, so long as the price was not predatory (below the supplier's incremental cost). *Id.*

On the other hand, federal and state antitrust enforcement officials have successfully obtained consent decrees banning the use of MFN provisions in payer/provider contracts.

For instance, in 1999, the DOJ brought an action against Medical Mutual, alleging that Medical Mutual's use of MFN clauses with hospitals wishing to do business in the Cleveland region violated Section 1 of the Sherman Act. *United States v. Medical Mutual of Ohio*, 1991-1 Trade Cas. (CCH) ¶ 72,465 (N.D. Ohio 1999). According to the DOJ, Medical Mutual was the largest commercial health care insurer in the Cleveland region, covering approximately 36 percent of the commercially insured population. The DOJ claimed that Medical Mutual's MFN clauses required hospitals to charge Medical Mutual's competitors significantly more than they charged Medical Mutual or pay substantial penalties. *Id.* at 2. These clauses, the DOJ alleged, resulted in higher prices for consumers of health care services. Under a consent decree, Medical Mutual was enjoined from adopting or maintaining any MFN provision in its contracts with hospitals in the Cleveland region. *Id.* at 5-6.

In another MFN case, the DOJ obtained a consent decree from insurer Delta Dental after a district court denied Delta's motion to dismiss. In that case, the DOJ alleged that Delta Dental, the largest dental insurer in Rhode Island, engaged in contracts with dentists that required them to offer Delta patients rates as favorable as those offered to any other customer. *U.S. v. Delta Dental of Rhode Island*, 943 F. Supp. 172, 175 (D.R.I. 1996). The district court rejected Delta's argument that MFN clauses, absent predatory pricing, are *per se* competitive and found a rule of reason analysis appropriate. *Id.* at 176.

Thus, the case law, sparse though it is, demonstrates that the court will have to perform a fact-intensive inquiry relating to BCBSM's use of MFN clauses that takes into consideration both the anti-competitive effects caused by the MFNs and BCBSM's pro-competitive justifications for them.

² Press Release, *Blue Cross Blue Shield of Michigan Defends Use of Deepest Discount Contract Provisions To Secure Lowest Hospital Costs For More Than 4 Million Michigan Consumers*, Oct. 18, 2010.

While BCBSM will no doubt deny the allegations in the DOJ's complaint and offer an alternative explanation for its use of MFN clauses as the case progresses, several alleged facts suggest that a court may be reluctant to dismiss this case quickly.

For example, BCBSM's allegedly high market share—60 percent of the commercially insured market—and the number and geographic breadth of the MFNs, arguably support the claim that BCBSM has market power and could potentially foreclose competition through its contracting practices. In addition, the explicit, different, and sometimes sizable price differentials that BCBSM requires from hospitals may raise questions as to BCBSM's motive for the MFNs.

Practical Considerations

Even at this preliminary phase of the litigation, industry participants can take away a number of lessons.

First, insurers who have contracts with MFN clauses, or are thinking about using them, should confirm that the purpose of the contract provision is to obtain low-cost services rather than to disadvantage rivals. This is especially true with respect to insurers who have market power. In the event of investigation or litigation, it will be important that contemporaneously prepared documents reflect the contractual provision's pro-competitive purpose.

Further, providers of health care services that agree to MFNs can also potentially face antitrust exposure simply because they are a party to the agreement. This potential exposure suggests that health care providers should exercise caution in agreeing to explicit price differentials between an insurer and its competitors, particularly if that insurer has a significant market share (more than 50 percent).

A government investigation, even if it does not lead to litigation, is costly, distracting, and time consuming (and it is only getting worse given the widespread use and discoverability of electronically stored information).

Moreover, federal antitrust enforcers are not the only ones who have questioned the propriety of MFNs in the health care context. For example, in March, the attorney general of Connecticut notified Health and Human Services Secretary Kathleen Sebelius that the state was investigating Anthem BCBS of Connecticut for possible antitrust violations relating to Anthem's use of MFN clauses with hospitals.

For those considering a contract with an MFN provision, several questions may be helpful in identifying whether an MFN may raise significant antitrust concerns or attract attention from government regulators. Because MFN clauses are evaluated under the rule of

reason, the analysis for each contract will necessarily be fact-specific.

- What is the market share of the party attempting to impose the MFN? If it is more than 50 percent, then it is more likely that an issue may arise.

- Are there alternative, competitive sources besides the seller that would not be bound by the MFN for the product or service at issue? If yes, then the MFN is less likely to be an issue than if not.

- What is the justification for imposing the MFN? If it is because the buyer of the services who will benefit from the MFN is providing a large quantity of purchases in exchange for a lower price, that is a good fact; if the buyer's purpose is to limit or exclude competitors, then it is a bad fact.

- What is the nature of the MFN? If it is a "pure" or "equal-to" MFN provision, whereby similarly situated purchasers can obtain the same, but not a better price, then it is less likely to raise an issue than if it requires a price differential between the purchasers.

- Does the MFN impose a significant price differential between the favored purchaser and others? The greater the difference, the greater the likelihood that the MFN raises concerns.

- Is the MFN negotiable? If yes, and the party imposing the MFN can demonstrate a willingness to forgo it, particularly when it can obtain lower prices, then that would be a good fact.

Finally, the BCBSM lawsuit highlights the Obama administration's emphasis on health care and the important role that antitrust enforcement plays in the administration's health care initiatives.

As has traditionally been the case, the DOJ continues to focus its enforcement sights on health care insurers while the Federal Trade Commission focuses on health care providers. Both agencies have demonstrated an increasing willingness to challenge conduct that is subject to the rule of reason analysis, whether it is in connection with a merger or alleged anti-competitive conduct that does not implicate the rule of *per se* illegality.

In comments regarding the BCBSM lawsuit, Assistant Attorney General Varney made clear that health care and MFN clauses will remain a focus: "We will continue to monitor this important industry. If we uncover other health insurers with market power that use anticompetitive MFNs to thwart competition, we will challenge them."³

³ Remarks as Prepared for Delivery by Assistant Attorney General Christine Varney at Pen-and-Pad Briefing on Antitrust Health Care Matter, Oct. 18, 2010, available at http://www.justice.gov/atr/public/press_releases/2010/263229.pdf.