Most favoured nation clauses: in need of an effects-based approach

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I. Introduction

1. As is now well documented, the rise of e-commerce and online services has fundamentally changed business practices and consumer behaviour. The online environment has led to increased transparency and significant reduction in search costs for consumers, as well as increased opportunities for businesses to reach larger and more varied audiences. These changes have caused shifts both in consumer behaviour and in business practices including changes in entire distribution models used by suppliers.

2. There appears to be a broad consensus that revisions to the Vertical Block Exemption Regulation (VBER) and the accompanying Vertical Guidelines are needed to ensure that they remain relevant and effective. Specifically, the increased scope of free riding by consumers potentially strengthens the pro-competitive justifications of many vertical agreements. At the same time, the benefits of higher online competition increases potential concerns around any restriction of this competition. These changes are relevant to most vertical agreements. For example, as found by the Commission’s 2020 support study, selective distribution systems are the most commonly used agreement in recent years, triggered by manufacturers’ need to have more control of the distribution of their products online. The developments of the last decade have also seen a rise of other agreements that are not discussed in the current VBER. Most-favoured-nation (MFN) clauses or parity clauses is one such example.

As the Commission’s support study found, there has been a large-scale growth in the use of MFNs across sectors. We have also witnessed myriad MFN investigations in the online hotel booking sector by national competition authorities across Member States, which, according to some, led to widely different and sometimes inconsistent approaches and findings (as discussed below). The new VBER and guidelines will therefore be critical for developing a consistent approach towards MFNs across Europe.

3. In this article, we discuss some of the key economic aspects that are relevant for the assessment of these clauses, and should be taken into account in developing the revised guidelines in relation to MFNs and more broadly, in relation to free riding justifications. We show why it is critical that MFN clauses (both wide and narrow) benefit from the block exemption, and importantly, are assessed using an effects-based approach. In doing so, we comment on the latest empirical analyses of MFNs conducted in the support study. We also discuss the economic analysis of free-riding and posit that such analysis needs to be undertaken within the effects-based analysis of MFNs and other agreements such as selective distribution systems.

1 See, for example, responses to the Commission’s consultation by industry participants and practitioners, views from national competition authorities and findings of the survey conducted in the support study published by the Commission on May 2020. Available at: sections 2 to 5 of https://ec.europa.eu/competition/consultations/2018_vber/index_en.html, and summarised in the Commission Staff Working Document published on 8 September 2020. Available at: https://ec.europa.eu/competition/consultations/2018_vber/staff_working_document.pdf.


3 This is consistent with recent commentary from legal practitioners, including recent case law such as Budapest Bank and Generics (UK). Case C-307/18, Generics (UK) Ltd and others v Competition and Markets Authority; Case C-229/18, Gazdasági Versenyhivatal v Budapest Bank Nvt. and Others. For a detailed legal analysis of this point, see ‘Vertical restraints after Generics and Budapest Bank’ by Pablo Ibáñez Colomo, in ‘The VBER and Vertical Guidelines: Revision or reform? Reflection on critical issues’, Concurrences N° 1-2021, Art n° 98100.
II. Most-favoured-nation (MFN) or parity clauses

4. The use and antitrust scrutiny of MFN clauses have increased significantly in the last decade. This includes the case of Amazon and publishers of e-books, which culminated in commitments by Amazon to remove their MFN clauses. National competition authorities have scrutinised MFN clauses in motor insurance, home insurance, and retailing of consumer goods such as running shoes. It would be fair to say that MFNs have been brought to the limelight most by the series of separate investigations by national authorities into MFN clauses between hotels and online travel agent (OTA) platforms.

1. Online hotel booking: comments on recent developments and learnings

5. The first of these investigations was led by the Bundeskartellamt (BKA), which was subsequently followed by multiple other investigations (e.g., in Austria, France, Italy, Switzerland and Sweden). While the precise scope varied, all of these focussed on the MFN clauses between OTA platforms and hotels, whereby a room of a specific hotel advertised on a specific OTA needs to be offered at a price that is no higher than the price of the same room at other distribution channels such as other OTAs and the hotel’s own website. The key concern was that these MFN clauses offer the OTA in question protection from competition from other OTAs and from the hotel’s own website, and therefore, reduces intra-brand competition, which may increase the commissions the OTA charges the hotel.

6. Despite the number of investigations, it is questionable whether these have led to much clarity around when an MFN clause is likely to be anticompetitive. At one extreme was the BKA, which concluded, based on an extensive analysis of the German market, that the wide MFNs as well as the narrow MFNs between the hotels and the OTA platforms were anticompetitive. Another set of national competition authorities accepted commitments from platforms such as Expedia and Booking.com to remove the wide MFNs but allowed narrow MFNs to be applied.

Yet some others, like the UK CMA,5 considered various aspects of the agreements between hotels and OTAs and ultimately focused on resale price maintenance and not MFNs.

7. Overall, while there is some merit in such a tailored national approach due to differences in national markets (e.g., with respect to consumer behaviour), the use of commitments and lack of substantive decisions by authorities has resulted in significant uncertainty regarding the approach to MFNs, particularly as platforms often have a European-wide approach to such commercial agreements (which may have contributed to Booking.com and Expedia voluntarily committing to remove wide MFNs across Europe whether or not there has been a national investigation).

8. The debates in the hotel cases are far from over. The latest development on the BKA case adds further twists and shows that further guidance and clarity in the revised VBER is more important than ever. In particular, the BKA’s decision to ban narrow MFNs (in addition to the ban of wide MFNs) was reversed in 2019 by the Düsseldorf Higher Regional Court following an appeal by Booking.com. The Court found that the narrow MFNs are not anticompetitive, and in doing so, accepted the reasoning put forward by Booking.com that these were needed to avoid free riding by hotels. In other words, the Court accepted that, without the narrow MFN clauses, hotels could use the OTAs service to advertise themselves but subsequently incentivise consumers to book directly on their own websites through the lower prices, which would reduce commission payments to the OTA.6

9. The other body of analysis of MFNs at the European level comes from ex post assessments of the interventions in the hotel sector. One was carried out by a group of national competition authorities and the European Commission to examine the effect of the ban of the wide MFNs (the ECN study).7 The second and very recent analysis was undertaken as a part of the support study prepared for the evaluation of the VBER, this study includes an assessment of the impact of a ban on narrow MFNs in certain European countries).8

5 The commitments were to remove all wide MFNs across Europe and to reduce the scope of narrow MFNs to only the hotel’s price on its online direct sales channel. Therefore, following the commitments, hotels could set prices freely on other OTAs and on offline channels (such as telephones, walk-ins) and within their loyalty programs. The Europe-wide removal of wide MFNs followed Booking.com’s commitments to the French, Italian and Swedish competition authorities in 2015. Subsequently, narrow MFNs were also banned in four specific countries (Austria, Belgium, France, Italy) through amendments in law.

6 This judgement is in the process of being appealed by the BKA at the time of writing this article. Interestingly, the BKA has recently made public an analysis of the narrow MFNs it conducted during the course of the proceedings, and the results of which the Court did not accept. While the last word has not been said about this study and the BKA’s case, this publication is interesting for various reasons, including its aim of empirical measurement of issues such as free riding. Available here: https://www.bundeskartellamt.de/SharedDocs/Publikation/EN/UnsereArbeiten_Digitales_VII.html

7 European Commission and the Belgian, Czech, French, German, Hungarian, Irish, Italian, Dutch, Swedish and UK national competition authorities (2017). ‘Report on the monitoring exercise carried out in the online hotel booking sector by the EU competition authorities in 2016’. April.

10. Like the cases, these studies have contributed their fair share to the debate around the competitive effects of MFN clauses. For instance, some would argue that the ECN study (based on a survey of hotels and market data) showed that wide MFNs did not, in fact, have a harmful effect in the hotel sector; while some others may interpret the results as merely showing that the market was not functioning as it should have in the aftermath of the ban (for instance, due to lack of awareness of hotels regarding the ban) and this is the reason why the study did not find empirical evidence of clear positive effects of the ban of wide MFNs. Overall, the results of this study were not strong enough to draw definitive conclusions about the effect of wide MFNs on commissions paid by hotels and on consumer prices.

11. The most recent analysis in the support study examines the prohibition of narrow MFNs in three countries (Austria, Belgium and Italy). The analysis is based on econometric models of hotel prices over time in these three countries relative to other (benchmark) countries where narrow MFNs continued to be used. It concludes that the ban was followed by significant decreases in hotel prices, thereby indicating the anticompetitive effect of narrow MFNs. As with the ECN study, the analysis and approach of this recent study also suffer from potential limitations. For example, one of the models uses highly aggregated price indices for a set of countries, which can be influenced by a range of factors unconnected to MFNs. For instance, in some countries that are used as benchmarks in the model, the data shows an (unexplained) increase in this price index over time, while such an increase is not seen in the three countries (Austria, Belgium and Italy) where narrow MFNs were banned. This drives part of the finding that a ban on narrow MFNs in Austria, Belgium and Italy reduced prices relative to the benchmark countries without this ban. However, this upward trend was present only in some of the benchmark countries and could have been driven by reasons unrelated to MFNs. Similarly, there are questions around the sample size and representativeness of the part of the empirical analysis (the model which utilises granular, hotel-level prices, covers only 95 hotels across 28 European cities).

12. Overall, many open questions remain regarding the impact of MFNs (wide or narrow) on the competitiveness of the online hotel booking sector, and it remains to be seen what the final verdict turns out to be in this saga. Nonetheless, these cases do inform, to some extent, the broad approach that is likely to be appropriate for MFNs in the context of the revision of the VBER.

2. How should MFNs be assessed under VBER?

13. The revision of the VBER needs to address this gap in the current regulations and guidelines. The first question one may ask is whether MFNs should benefit from the safe harbours of the VBER. Another question is whether MFN clauses can be assessed using a “by object” approach or whether an effects-based approach is warranted.

2.1 By “object” or by “effect”?

14. An economic approach would strongly support that MFN clauses benefit from VBER, i.e. they should not be considered hardcore restrictions. From a theoretical perspective, it is well recognised that MFNs can have both anticompetitive and pro-competitive effects, and that the impact of MFNs depends on a number of factors. In this respect, MFN clauses are no different to other vertical restraints such as selective distribution agreements.

15. The next question is about instances where such clauses cannot benefit from the exemption due to market shares being above the safe harbour thresholds. Can/should MFNs be assessed using a “by object” approach in these instances because they are anti-competitive by their “very nature”? Or should they be assessed using only effects-based analysis? We posit that the lessons from recent cases, the wider economic literature and the various ex-post analyses all suggest the latter, i.e., the assessment of MFN clauses under Article 101 warrants an effects-based approach.

16. First, the academic literature shows that the effect of MFNs depends on a range of factors and the combination of these factors critically influence the net impact on end consumers. This literature includes theoretical papers which model MFNs in various settings, for example, in the context of agency agreements vs wholesale agreements, and with potential entrants with similar or different business models. While a number of these studies conclude that MFNs (particularly wide retail price MFNs) are likely to be harmful in their net effect, some find that MFNs would lead to lower prices (or not lead to higher prices) and can be overall beneficial for consumers. Overall, the theoretical papers show that the results are dependent on the specific market and commercial setup assumed in the models.

12 See for example: Case C-67/13 P. Groupement des cartes bancaires (CB) v European Commission, para 56-58; Case C-328/18, Gazolav/Versenyhivatal v Budapest Bank Székh. and Others, para 76.

13 For example, some early work by Corts (1997) includes a theoretical model which shows that price-matching policies can lower equilibrium prices if firms are adopting a price-beating approach. Corts, K. S. (1997), *On the competitive effect of price-matching policies*, *International Journal of Industrial Organisation*. Johnson (2014) finds in a theoretical model that MFN clauses increase prices when used with an agency model (and not with a wholesale model), although even with an agency model, they may facilitate higher choice without higher prices under certain contractual settings (e.g., if retailers face market-entry costs and when parties use profit-sharing rather than revenue-sharing). There are some other recent theoretical models which show pro-competitive effects, for example when suppliers have a higher bargaining power (See Larrier, T. (2019), *Most Favored Nation Clauses on the Online Booking Market*, Working Paper).
17. Indeed, this increases the importance of empirical testing of the effects of such clauses. In fact, there are many studies that do so, including a large number on the online hotel booking sector, taking advantage of the policy changes mentioned earlier. In addition, academics have examined MFN clauses in e-books, consumer electronics and a range of other consumer goods. Similar to the theoretical papers, the empirical studies show that the effects of MFN clauses vary depending on the specific market context.14 This would suggest that analysing the actual or likely effects of MFN clauses in the specific context of a case is important to be able to appropriately assess the risks and benefits and the net effect on consumers.

18. Second, the ex post assessments in the hotel sector as discussed above also provide broad support for an effects-based approach. Indeed, it is by itself interesting that the ECN study (assessing the impact of wide MFNs) and the support study (analysing the impact of narrow MFNs) both carried out extensive econometric modelling to assess the impact of the bans imposed. Whatever the technical merits and robustness of the models and results, at the very least, this provides support for the view that MFN clauses are not anticompetitive by their “very nature”.

2.2 Implications of assessing market definition and market share thresholds in platform markets

19. The definition of relevant markets in the context of online platforms has been and continue to be a topic of much debate, among academics and practitioners alike. While different views regarding the precise boundaries of the relevant market, and therefore market shares, can arise in any market, these are particularly stark in digital markets. This increases the uncertainties around the assessment of market shares in platform markets and hence, the assessment of whether the market shares meet the exemption thresholds. We posit that this makes an effects-based approach even more important (for MFNs and for other vertical agreements).

20. The challenges around market definition for two- or multi-sided platforms was noted during the Commission’s consultation with national competition authorities. For example, a key question is whether the relevant market should be defined on the basis of one side of the platform or both (or more) sides, which raises the question of whether the exemption assessment under the VBER should require the 30% market share threshold to be met on each side of the market or only one side.15 There have been challenges in front of Courts as well. For example, in the Sabre/Farelogix merger, the District Court of Delaware in the US based its conclusions on the finding that Sabre operated in a two-sided platform market, and two-sided platforms compete only with two-sided platforms. The implication was that Sabre and Farelogix did not compete because Farelogix was not a two-sided platform.

21. While this opinion has been criticised by the antitrust community, the learnings from this case are relevant to the assessment of MFN clauses and other vertical agreements such as selective distribution systems. In particular, the court’s view that two-sided platforms can compete only with two-sided platforms may have arisen from an ongoing debate about whether there is a distinction between transaction and non-transaction platforms. Some have argued that the relevant market(s) is likely to be separate single markets on each side if it is a non-transaction platform, and a single market encompassing both sides if it is a transaction platform. However, others are of the view that using such a simplistic approach can lead one to ignore indirect network effects that may exist between the two sides of the platform and the wider competitive constraints on the platform (which is ultimately the purpose of the market definition in the first place).16

22. In the context of MFNs in particular, it is important to keep in mind that distribution platforms which may be facilitating a transaction between suppliers and consumers are often competing with the suppliers’ own direct distribution channels (which are not considered platforms by definition). The interaction and competitive dynamics between the direct channel and the platforms is a key aspect to account for in the assessment of MFNs (and selective distribution systems) given the possibilities of free riding. Whether or not these other distribution channels are considered part of the relevant market, and therefore considered in the application of the 30% market share threshold, will depend on the specific case. In any event, these wider constraints should be accounted for in the overall assessment of these vertical agreements. In this context, a “by object” approach to scrutinising MFN clauses (and indeed, selective distribution systems) increases the risk of a false positive.

3. What factors are relevant to an effects-based analysis of MFNs?

23. As highlighted in the literature, there are a range of factors that affect the impact of MFNs on intra-and inter-brand competition. The support study has a
24. The relative position of the platform and the suppliers is likely to be an important factor to consider in most markets. This is because MFNs could help strengthen the position of one or a small number of larger platforms, which in turn could decrease search costs for consumers and increase competition between the suppliers. For instance, if there are four or five large suppliers with strong brands and significant direct sales, and barriers to switching exist on the side of consumers, online platforms such as price-comparison websites can play an important role in increasing competition between these suppliers. In this case MFNs could benefit consumers by increasing inter-brand competition even if there is a decrease in intra-brand competition.

25. Even in the case of a more fragmented supplier market, maintaining the incentives of platforms to invest in reducing search costs for consumers can be beneficial on balance to consumers if this increases inter-brand competition—for example, by promoting growth of smaller suppliers and challenging larger incumbents. In this context, it is interesting that the support study finds (based on interviews with accommodation providers) that OTAs are more important for the visibility of small hotels relative to larger ones. Small accommodation providers estimate their marketing and IT costs necessary for acquiring visibility to be higher than the commissions paid to these platforms.17

26. This relative size between platforms and suppliers is not discussed as widely as other relevant factors. For instance, the report Competition Policy for the Digital Era18 discussed the extent of competition between platforms, stating that: “If competition between platforms is sufficiently vigorous, it could be sufficient to forbid wide MFNs while still allowing narrow MFNs. If competition between platforms is weak, then pressure on the dominant platforms can only come from other sales channels and it would be appropriate for competition authorities to also prohibit narrow MFNs.” This approach, however, offers only a partial view and significantly risks prohibiting beneficial MFN clauses, because it focuses only on intra-brand competition, and not on the overall impact on consumers through intra- and inter-brand competition.

27. There is also a broader question around the extent to which additional competition between platforms, especially platforms which facilitate price comparisons, improves consumer outcomes. While, in principle, higher platform competition should increase intra-brand competition, and potentially reduce commissions, there may be decreasing returns to additional competition if there are sufficient platforms in the market already. For example, it may be that an oligopolistic structure among platforms with three or four comparison websites allows for sufficient intra-brand competition while at the same time keeping each platform popular enough to facilitate and increase inter-brand competition. In this context, it is relevant to consider the potential effects on consumer trust because the quality of service provided by a small number of platforms could reduce consumer trust in the relevant platforms as a group.19 This is another important aspect in striking the balance between the potential anti- and pro-competitive effects of clauses such as MFNs, and in ensuring that both both intra- and inter-brand competition is enhanced to the benefit of consumers.

III. Analysis of free-riding

28. As discussed above, the prevention of free-riding is one of the common pro-competitive benefits of MFNs, and indeed of many other vertical agreements. As shown by the German experience, the evidence of consumers’ free riding on OTAs’ investments was the key reason for the court to overturn the BKA decision.

29. In general, competition authorities, while recognising the free riding justification as one that could be at play in principle, often do not accept the argument because of lack of concrete evidence. This is not surprising. Showing that free riding is occurring in the context of an investigation into a specific vertical agreement in a specific market context (such as an MFN clause or a selective distribution system) is likely to be difficult because the existence of the agreement itself could be preventing such free riding. What is needed in this case is a counterfactual world without the specific agreement, which could be a challenge unless the specific agreement is limited to a few market players or few countries. A further challenge could be that the effect of consumers’ free riding would likely materialise only in the medium to long term. As noted by the Dusseldorf Court in its ruling on the BKA decision on narrow MFNs, the free riding risk will materialise only over time as consumers lose

19 There have been concerns in the past about the reduction of consumer trust in comparison tools, for example, following proliferation of such platforms, and the European Commission led a number of initiatives to address this. See a discussion here: https:// ec.europa.eu/info/sites/info/files/consumer-summit-2013-skate-report_en_8.pdf.
confidence in OTAs as offering the best prices, thereby switching away to the direct channel and weakening the extent to which OTAs can invigorate inter-brand competition.

30. Nonetheless, there is a range of evidence one can bring to bear on this question. Consumer surveys are an obvious one, where consumers are asked about their online searching behaviour including where they start their search, what subsequent steps they take, how many and which websites they use to search, and why they chose the website where they ultimately made the purchase. Data on actual consumer search and browsing behaviour are also available from various sources. These are particularly useful as these sources can indicate, for example, whether consumers typically visit the relevant distribution platform (e.g., OTA) and the suppliers’ websites (e.g., hotels) on the same day. Such cross-visitations and audience overlap analysis indicate the scope of free riding in a world without the agreement (e.g. without MFN clauses or if the selection criteria for a selective distribution network is relaxed to include more online retailers).

31. Whatever the method, it is relevant to take into account the inherent challenges in providing concrete evidence of free riding occurring in the specific market. Arguably, what is necessary is to show the scope or risk of free-riding rather than actual free riding (assuming the MFN or selective distribution in place, one is less likely to observe actual free riding). It is also necessary to account for such free riding analysis in the competitive assessment of the relevant agreement under Article 101(1) and not only under Article 101(3). It is particularly relevant for vertical agreements also due to the various pro-competitive effects and rationale for such agreements.20

20 For a legal perspective on this issue, see ‘Vertical restraints after Generics and Budapest Bank’ by Pablo Ibáñez Colomo, in ‘The VBER and Vertical Guidelines: Revision or reform? Reflection on critical issues’, Concurrences N° 1-2021, Art n° 98100.