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On the Subject

Health Industry Advisory

October 21, 2010

The DOJ and Michigan are challenging Blue Cross Blue Shield of Michigan's most favored nations contracts under federal and Michigan antitrust law.

When Is Most Favored Too Favored?

On October 18, 2010, the U.S. Department of Justice (DOJ), together with the Michigan Attorney General, brought a civil antitrust action against Blue Cross Blue Shield of Michigan (BCBS), alleging that BCBS has used "most favored nation" (MFN) clauses in contracts with Michigan hospitals to inhibit competition from other insurers and raise its rivals' costs. (*United States v. Blue Cross Blue Shield of Michigan, No. 2:10-cv-14155-DPH-MKM, Oct. 18, 2010.*) MFN clauses generally require a party to do business with another party on terms no less advantageous than the terms on which it deals with others. BCBS's widespread use of MFN clauses, the DOJ alleges, raises prices for commercial health insurance in Michigan.

The DOJ's and Michigan's Allegations

BCBS 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 last several years, BCBS has successfully sought to include MFN clauses in contracts with more than half of Michigan's acute care hospitals.

BCBS allegedly uses two varieties of MFN clauses. Under an "equal-to MFN," BCBS requires that hospitals charge other commercial insurers at least as much as they charge BCBS for health care services. BCBS has allegedly entered into "equal-to MFN" agreements with more than 40 hospitals. BCBS also has contracts that include an "MFN-plus" provision, under which BCBS allegedly requires hospitals to charge other commercial insurers more than they charge BCBS, often by a specific percentage differential. The lawsuit states that BCBS has MFN-plus clauses with 22 hospitals and requires some of those hospitals to charge competitor insurers up to 40 percent more than BCBS for health care services.

The DOJ alleges that, in many cases, BCBS 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 BCBS 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 BCBS has likely resulted in higher costs for health insurance to employers and insureds. The State of Michigan purchases group health insurance through BCBS 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. The lawsuit challenges the contracts under both federal and Michigan antitrust law.

BCBS 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." (For more information, see the BCBS 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," dated October 18, 2010.) BCBS indicated that it would vigorously defend the lawsuit.

Analysis and Practical Considerations

MFN clauses are not inherently anticompetitive and therefore are evaluated for antitrust purposes under the rule of reason, which requires courts to evaluate their anticompetitive harm and pro-competitive benefits. While BCBS will certainly offer another side of the story when it files its answer, several alleged facts suggest that a court may be reluctant to dismiss this case quickly. For example, BCBS'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 BCBS has market power and could potentially foreclose

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competition through its contracting practices. In addition, the explicit and differing price differentials that BCBS required from hospitals may raise questions as to BCBS's motive for the MFNs.

Even at this preliminary phase of the litigation, industry participants can take away a number of lessons. First, this lawsuit highlights the Obama administration's emphasis on health care and health care antitrust enforcement. But the federal antitrust enforcers are not the only ones who have questioned the propriety of MFNs in the health care context. For example, in March 2010, the Attorney General of Connecticut notified U.S. Health and Human Services Secretary Sebelius that the state was investigating Anthem BCBS of Connecticut for possible antitrust violations relating to Anthem's use of MFN clauses with hospitals. A government investigation, even if it does not lead to litigation, is costly, distracting and time consuming.

Second, insurers that 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. In the event of investigation or litigation, it will be important that contemporaneously prepared documents reflect the contractual provision's pro-competitive purpose.

Third, providers of health care services that agree to MFNs may also potentially face antitrust exposure as 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, especially if that insurer has a dominant market share.

For those considering a contract with an MFN provision, several questions may be helpful in identifying whether an MFN may raise significant antitrust concerns. 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 that 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" 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 forego it, particularly when it has to pay lower prices, then that would be a good fact.ation.

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