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Alerts

DOJ Challenges Insurer's Use of "Most Favored Nations" Clauses with Hospital Providers

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Health Care Alert

On October 18, 2010, the U.S. Department of Justice (DOJ), along with the state of Michigan, filed a civil antitrust lawsuit against Blue Cross Blue Shield of Michigan (BCBSM). The DOJ's Complaint alleges that BCBSM's use of "most favored nations" clauses (MFNs) in its contracts with hospitals unreasonably restrains trade in violation of Section 1 of the Sherman Act and the analogous Michigan antitrust statute. This is the latest effort by the DOJ in its heightened enforcement of antitrust laws in the health care industry. If this legal challenge is successful, or if it otherwise causes insurers to reconsider their use of MFN clauses, there could be a meaningful change in leverage between hospitals and insurers in their contract negotiations.

According to the Complaint, BCBSM is "by far the largest provider of commercial health insurance in Michigan and has been for many years." BCBSM covers more than 60 percent of the commercially insured population in Michigan — "more than nine times as many Michigan residents" as its next largest competitor.

The Complaint further alleges that BCBSM has one of two types of MFNs in agreements with at least 70 of Michigan's 131 general acute-care hospitals. "Equal-to MFNs" require hospitals to charge other commercial health insurers at least as much as they charge BCBSM. "MFN-plus" provisions require hospitals "to charge some or all other commercial insurers *more* than they charge BCBSM, typically by a specified differential." The DOJ's Complaint alleges that both types of MFNs inhibit competition.

According to the Complaint, BCBSM's MFN-plus clauses guarantee that its competitors cannot obtain hospital services at prices as low as the prices BCBSM pays, which limits other health insurers' ability to compete with BCBSM. Further alleged in the Complaint is that BCBSM "has sought and on most occasions, obtained MFN-plus clauses when hospitals have sought significant rate increases." In addition, the Complaint alleges that BCBSM has entered into agreements containing equal-to MFNs with small community hospitals, which typically are the only hospitals in their communities. Under these agreements, BCBSM agreed to pay more to community hospitals, raising BCBSM's own costs and its customers' costs, in exchange for the equal-to MFN. The DOJ alleges that in return for MFNs, BCBSM pays more to hospitals than it otherwise would. Even though this raises BCBSM's costs, it is gaining protection from competition (and presumably raising premiums).

According to the allegations in the Complaint, these MFNs "have caused many hospitals to (1) raise prices to [BCBSM's] competitors by substantial amounts, or (2) demand prices that are too high to allow competitors to compete, effectively excluding them from the market." As a result, the DOJ alleges, these MFN clauses are causing anticompetitive effects in numerous local markets for commercial health insurance throughout Michigan.

The suit seeks to prevent BCBSM from including MFN clauses in its contracts with hospitals, to prevent the enforcement of pre-existing MFN clauses, and to void such clauses in BCBSM's existing contracts.

In prepared remarks made on the day the lawsuit was filed, Assistant U.S. Attorney General Christine Varney stated, "When a large healthcare plan with a substantial market share, like Blue Cross, imposes an anticompetitive MFN in the

marketplace, it harms competition and consumers. It prevents others from entering the marketplace and discourages discounting. The end result – fewer options and higher prices." Consistent with the DOJ's expressed concerns with high levels of concentration in the health insurance markets, Ms. Varney added: "Any time a dominant provider uses anticompetitive agreements, the market suffers. This cannot be allowed in Michigan. And, let me be clear, we will challenge similar anticompetitive behavior anywhere else in the United States."

The potential anticompetitive effects of MFN arrangements have been the subject of much recent academic and enforcement agency discussion. Although this case signals greater DOJ scrutiny of MFN arrangements, it is unclear whether this development should cause companies using MFN clauses generally to reassess their contracting strategies. As in most litigation, these issues tend to be fact-specific. The complaint appears to treat MFN-plus clauses as categorically suspect, because they force hospitals to charge competitors more, typically by a specified percentage differential. Still, the Complaint notes that BCBSM's MFN-plus arrangements require hospitals to charge competitors as much as 40 percent more than they charge BCBSM, suggesting that the anticompetitive effects are created when the percentage differential reaches a certain level.

The Complaint does not allege that the existence of equal-to MFNs alone is anticompetitive. Instead, the DOJ focused on BCBSM's particular use of equal-to MFNs — i.e., its agreement to pay *more* to hospitals in exchange for equal-to MFNs. In addition, questions remain as to whether the DOJ will challenge the use of MFNs by insurers that do not have dominant shares in a geographic market.

Finally, although acting pursuant to Sherman Act Section 1, which requires conduct of multiple actors, the DOJ did not include any hospitals as defendants. If, as the DOJ seeks, MFN provisions in existing contracts are voided or determined to be unenforceable, hospitals that are parties to such contracts with BCBSM or other insurers will be affected. Although there has not been any determination on the government's challenge to BCBSM's use of MFNs, hospitals can use the challenge as they determine is appropriate in current and upcoming negotiations with insurers that are seeking MFN provisions.

For further information, please contact your regular Hinshaw attorney.

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