Competitive Harm from MFNs: Economic Theories

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What are MFNs?

- “Most-favored-nations” clauses
  - Also called “most-favored-customer” or “antidiscrimination” provisions
- A seller promises to treat a buyer as well as the seller treats its best (most-favored) customer
  - Most commonly: no lower sales price

MFNs Have Many Flavors (for example)

- Adoption
  - Explicit contractual provision
    - Product of bilateral negotiations
    - Part of long term contract
  - Unilaterally announced policy
- Timing of comparison
  - Contemporaneous vs. Retroactive
- Type of seller
  - Retailer
  - Intermediate good supplier

Overview: Ways MFNs May Harm Competition

- Collusive Theories
  - Facilitating coordination
  - Dampening competition

- Exclusionary Theories
  - Raising rivals'/entrants' costs

- Increase Seller Bargaining Power

Collusive Theories: Facilitating Coordination

- FTC story in *du Pont* (*Ethyl*)
  - Four firms manufactured no-knock additives for gasoline
  - Two firms had MFNs in contracts with customers
- FTC concluded that sellers using MFNs had less incentive to discount
  - Making tacit collusion more likely
- 2d Cir (1984) rev'd on legal grounds

Collusive Theories: Facilitating Coordination

- MFN discourages cheating
  - Seller has less incentive to cut price
    - Cannot limit discount to single customer
    - Makes cheating more costly
  - Buyer has less incentive to bargain hard
    - Less likely to get competitive advantage over its rivals
  - Cheating may be easier to detect

Collusive Theories: Dampening Competition

- A seller uses an MFN to commit to less aggressive competition
  - Less likely to lower price to any one customer, as must then lower price to all
- If rivals respond by behaving less aggressively too, prices will rise

Exclusion Theories Raising Rivals'/Entrants' Costs

- DOJ story in *Delta Dental of RI*
  - Largest dental insurer in state
    - contracts with 90%+ of dentists
  - MFN: Delta pays dentists the same as the rival insurer with the best deal
  - Rivals could not adopt a selective contracting business model that cuts costs & lowers insurance rates
    - Couldn't pay a panel of dentists low rates in exchange for steering patients

Exclusion Theories Raising Rivals'/Entrants' Costs

- Excludes rival(s)/entrant(s)
  - MFN prevents rivals from obtaining inputs or distribution cheaply
    - By penalizing the supplier/distributor
  - Thereby raising rivals'/entrants' costs
- Harm to competition
  - Dom. firm excludes fringe & entrants
  - Coordinating firms exclude maverick
  - Result: obtain/maintain high prices
- Profitable to seller

Increase Seller Bargaining Power

- Durable goods monopolist
  - Buyers won't pay monopoly price if expect seller to discount in the future
    - Patient buyers will delay purchases, leading seller to price low from the start
  - MFN is a commitment not to discount
    - Makes future discounts expensive
  - Buyers no longer expect to profit from waiting, so pay monopoly price
- Seller makes buyer BATNA worse

Summary: Ways MFNs May Harm Competition

- Collusive Theories
  - Facilitating coordination
  - Dampening competition
- Exclusionary Theories
  - Raising rivals' /entrants' costs
- Increase Seller Bargaining Power