The Competitive Consequences of Most-Favored-Nation Provisions

Jonathan Baker
Judith A. Chevalier

Follow this and additional works at: https://digitalcommons.wcl.american.edu/facsch_lawrev

Part of the Antitrust and Trade Regulation Commons, Contracts Commons, and the Health Law and Policy Commons
The Competitive Consequences of Most-Favored-Nation Provisions

by Jonathan B. Baker and Judith A. Chevalier

Most Favored Nation” (MFN, also termed “most favored customer”) contractual provisions have come under scrutiny in recent years by antitrust authorities in both the US and the EU. Under an MFN, one party to a transaction promises to give the other party at least as favorable contractual terms as it gives any other counterparty. For example, a seller may promise at least one customer not to sell to any other customer at a lower price. These MFN provisions appear in a variety of commercial agreements.

MFNs are a type of vertical agreement between suppliers and buyers. The economics literature on this issue, led by the “Chicago School,” has documented many efficiency rationales for vertical arrangements, though substantial subsequent work recognizes their anticompetitive potential. In contrast, the economics literature on MFNs has a different emphasis: this literature highlights the anticompetitive potential of MFNs, although some papers document a range of possible efficiency benefits for such provisions. Our article distills the economics literature on MFNs to explore both possibilities.

Features and Varieties

The MFNs that receive antitrust attention most often involve commitments by sellers, but they may also involve commitments by buyers. In the most common example, the seller promises a buyer that if it sells to some other buyer for less, it will also extend that lower price to the first buyer. We will illustrate various features of MFNs using a hypothetical example involving the production of bottled beer.

Suppose a brewer purchases a three-month bottle supply from a bottle maker. If the parties adopt a contractual MFN provision, the bottle maker may promise the brewer that it will not sell bottles at a lower price. Typically, the contract will specify the scope of the MFN. For example, the bottle maker may promise not to offer a discount to any other brewer or the bottle maker may further promise not to discount to juice and soft drink producers.

MFNs may vary in a number of respects. An MFN could be negotiated bilaterally and appear as an explicit contractual provision. This is the likely route by which a bottle maker would commit to an MFN with one or more brewers. However, an MFN could also be adopted unilaterally by a firm, simply by announcing it as a policy that will apply to all buyers.

An MFN must specify the period when the price comparison takes place. If the bottle maker promises not to give another brewer a lower price this week, the MFN is essentially contemporaneous. If the bottle maker instead agrees that if it cuts the price of bottles any time during the next three months, it will refund the difference to the brewer, the MFN is retroactive.

MFNs can be used in contracts at different levels of distribution. Most antitrust scrutiny has focused on MFNs that operate between suppliers and intermediate goods producers, as in the bottle example above. For example, recent Department of Justice cases or investigations scrutinize the relationships between hospitals and insurers and between cable companies and television networks. However, MFNs may also be used by retailers selling to end consumers—perhaps, for example, automobile dealers, appliance stores, or airlines.

Efficiency Rationales

While MFNs have been subject to antitrust scrutiny, there can be efficiency reasons for employing this contractual provision. The efficiency rationales fall into three major categories: MFNs that mitigate “hold up” problems, MFNs that counteract incentives to delay in contracting, and MFNs that reduce transaction costs. An MFN’s efficiency rationales and its anticompetitive effects are not mutually exclusive. That is, an MFN undertaken to capture an efficiency could nevertheless harm competition, and an MFN undertaken for an anticompetitive reason could also achieve an efficiency.

The “Hold Up” Problem. An important source of efficiencies for vertical contracts derives from the role of such
agreements in controlling “hold up” problems. When one firm makes substantial investments specific to trading with a given counterparty, the counterparty may try to “hold up” the investing party by worsening the terms of trade. For example, consider again the brewer and bottle maker. Suppose that the bottle maker has invented a distinctive and convenient new specification of bottle. Adoption of a specific type of bottle provided by a particular seller may require investments by the brewer. Specifically, the brewer may need to retrofit or replace its filling infrastructure to handle the new bottles. Further, the brewer may need to make investments in training employees to handle the bottle, and may possibly make changes in labeling and advertising of the new bottle type. All of these investments are specific to the relationship and would be wasted if the brewer were to later switch to a different type of bottle. If the brewer were simply to make these investments without getting any assurances or a long-term contract from the bottle maker, and if the bottle maker understands that the brewer would be unlikely to switch the bottle type once the investments had been made, the brewer could be susceptible to exploitation or “hold up” by the bottle provider.

Once the brewer agreed to adopt the new bottle, and made investments predicated on a continuing relationship with the bottle maker, it would be costly for the brewer to change its bottle provider. Then the bottle provider could take advantage of the brewer by giving a competing brewer a better deal. Recognizing this prospect, the first brewer may be unwilling to adopt the new bottle in the first place, notwithstanding the new bottle’s innovative design. Moreover, no other brewer may adopt the new bottle for the same reason, so the bottle maker may be unable to profit from its new design. To eliminate this possibility, the bottle manufacturer might agree to an MFN in its contract with the first brewer, promising not to give a competitor a better deal. Here, the MFN operates similarly to a weaker version of an exclusive territory or a non-encroachment contract. The supplier (bottle producer) does not agree that it will not supply a competitor (as would happen with an exclusive territory), but it agrees that it will not give a competitor better terms. As may sometimes be the case for exclusive territories, the goal here is to encourage investments in the relationship; this efficiency rationale has been examined in the economics literature investigating exclusive territories. In this example, the MFN is welfare enhancing: it allows the bottle manufacturer and the brewer to contract efficiently. Similarly, in other settings, the MFN could be used by a manufacturer to induce a retailer to invest in a product’s reputation or provide expensive point of sale services.

A second example is the case of a coal-burning generating facility constructed at the mouth of a coal mine. Once the generating facility is built, the owner of the coal mine would be tempted to raise the price of coal to the generating facility, recognizing that the generator would bear substantial transportation costs in attempting to obtain coal from elsewhere. The threat of this hold-up possibility could discourage the initial investment by the generating plant. To avoid this threat, and make the investment possible, the parties may write a long-term contract for the mine to supply coal to the generator. But a long-term contract specifying prices and quantities of coal cannot adjust flexibly to changing market conditions. To address this difficulty, the mine owner may agree to meet the generating facility’s coal requirements at the same price that the coal mine is receiving from its other buyers. The MFN provision allows the price to adjust when costs or demand change while limiting the ability of the mine to take advantage of the generator. In this scenario, the most favored customer clause operates as a substitute for including escalation and indexing provisions in the contract, and allows the contracting parties to pin the transaction price in the long-term contract to the market price.

**Reduce Delays in Transacting.** A related but distinct rationale for MFNs is to prevent delays in transacting. For example, suppose a land developer wants to create a project that can only be completed if a number of small parcel holders sell their property. Each seller may want to be the last to make a deal. Once the other parcels are secured, after all, the developer may be willing to pay the last hold out much more than market value of the seller’s property in order to ensure that the project would go forward. Under such circumstances, every seller has an incentive to hold out to become the last seller, thus endangering the whole project. An MFN can solve this hold out problem. If the developer promises initial sellers to pay the difference between the price they received and the price later sellers receive, that contractual provision could eliminate the incentive to delay and, perhaps, allow a project to go forward when it otherwise would not, generating an efficiency.

An MFN may also be used to reduce transaction delays in other settings. In some markets, for example, customers have an incentive to delay buying because they expect the price of a good to fall over time. This can occur at the introduction of a new product, such as a new electronic gadget. It can also occur if consumers delay purchasing because they suspect that the seller will end up with unsold inventory that it will discount. For this reason, consumers sometimes wait to purchase a seasonal fashion item in the hope that it will go on sale as the season progresses. Similarly, consumers may decline to purchase theater tickets in advance, with the hope of buying an unsold ticket at the last minute through discount outlets such as TKTS.

In these settings, a seller can introduce an MFN to discourage buyers from delaying and waiting for a better deal. For example, a theater producer could promise a partial refund to advance ticket holders if the show does not sell well and it offers last minute discount tickets. The existence of the MFN may also signal to the consumer that the theater owner expects strong ticket demand—in which case a buyer that waits for a discount seat may miss the show entirely, and would do better by purchasing undiscounted tickets in
advance. In this example, the MFN could benefit consumers by giving the theater producer the “critical mass” of advance ticket sales needed to justify mounting the production. But the MFN in this example also discourages the seller from reducing price later in the run. Discounting tickets may not increase sales enough to be worthwhile given the seller’s commitment to provide refunds to early buyers. As a result, prices would be higher with the MFN than without, and economic welfare would be lower.  

**Reduce Transaction Costs.** A frequently cited motivation for MFNs is to reduce transaction and negotiation costs. Here, the MFN guarantees that one of the contracting parties will receive the other party’s best price without undertaking costly negotiations. Suppose, for example, that a startup company is launching a new Internet video service. In order to launch, the startup must contract with numerous content providers such as record labels. Given the startup’s uncertain prospects, a small record label may not find it worthwhile to expend the effort to negotiate a deal with the startup, a firm that may not even be in existence in a year’s time. But the small label may be willing to reach a contract with the startup if it can avoid the costs of bargaining over price, as it can by entering into an MFN that requires the small label to sell its content at terms equivalent to those at which a major record label sells its content to the startup. This arrangement may allow the startup to assemble a critical mass of content to launch its service. Absent the MFNs, the transaction costs of contracting may prevent the startup from getting off the ground.

Sometimes the beneficiary of lower transaction costs may be an indirect buyer. For example, consider a pharmacy benefits manager (PBM) that contracts with employers to serve as a middleman between the employer, pharmacies, and pharmaceutical companies. The employer may find it difficult to determine which of the many PBMs it could hire will serve the employees at lowest cost, given the complexity of pharmaceutical pricing and the range of drugs that employees take. If the PBM has an MFN with each major pharmaceutical manufacturer, it may be able to certify to its employer-customers that it will offer the lowest prices, thereby reducing the transaction costs arising in PBM negotiations with employers.

There are at least two limits to the efficiency gains from reducing negotiating costs through MFNs. First, while the MFN lowers the costs in negotiating, the MFN creates other costs: the costs of monitoring (and potentially litigating) adherence to the agreement. In the example of the bottle maker and the brewer, the bottle maker may be tempted to discount secretly to another brewer in violation of its MFN commitment if the brewer with the MFN cannot observe the price the bottle maker charges other brewers. Even if the brewer also negotiates the right to audit the bottle maker’s records, brewer-bottler contracts likely contain many terms other than the per-bottle price. If so, establishing whether or not a competing brewer received better terms overall may be a costly and difficult task. For this reason, litigation over whether an MFN has been violated is common, and that possibility should be considered a cost of entering into an MFN arrangement.  

A second limit to the transactions cost arguments foreshadows our discussion of the anticompetitive consequences of MFNs. Consider a large customer that insists that it be guaranteed the “best price” from a supplier. The customer is trying to benefit from other buyers’ negotiating efforts. However, if many or most buyers ask for MFNs, the seller will have little incentive to offer discounts to the few remaining buyers who are trying to negotiate. Further, the buyers have a diminished incentive to push for discounts because any cost savings they might eke out will be extended to other buyers, including the buyers’ competitors. Given that the other buyers have MFNs, a buyer cannot obtain a cost advantage by negotiating a discount from the seller.

There are also circumstances where MFNs do not appear to generate efficiencies, but also do not necessarily generate the possible harms documented below. For example, MFNs may be negotiated even though the buyer has almost no opportunity to monitor and enforce adherence to the MFN. In this case, it appears that the MFN serves as a “trophy” that the negotiator uses to certify to his employer that he drove a hard bargain. Here, the MFN has likely made no competitive difference.

**Harms to Competition**

The economics literature identifies four classes of competitive harms from MFNs. Two are collusive theories: the MFN may operate as a “facilitating practice” that makes coordination more likely or more effective, or it may simply dampen competition among non-coordinating rivals. The third class is exclusionary: the MFN can be used to discourage competition from entrants or “maverick” incumbents, and thereby allow firms to obtain or maintain market power. In the final class of anticompetitive theories, the MFN harms competition by increasing the seller’s bargaining power.  

**Facilitating Coordination.** The most immediate and direct significance of an MFN for the seller, and the source of competitive harms from facilitating coordination and dampening competition, is to raise the seller’s cost of cutting price to buyers other than the buyer that is the beneficiary of the MFN.
price to buyers other than the buyer that is the beneficiary of the MFN. Suppose, to return to the beer bottle example, the bottle maker agrees in a contract with one brewer that it will sell to it at a per-bottle price of $1. Perhaps the bottle maker’s incremental production and distribution cost is $0.80 (and does not vary with its output); if so, the bottle maker earns a contribution to profit from this contract of $0.20 per bottle. Suppose further that the bottle maker has excess capacity, and is approached by a second brewer seeking to buy bottles. Without an MFN, the additional sale would be profitable for the bottle maker at any price above $0.80, and it would not be surprising if the bottle maker cut its price to make additional sales—and thus that the bottle maker and second brewer would agree on a price of below what the first brewer paid, such as $0.90 per bottle.

But suppose the contract between the bottle maker and the first brewer includes an MFN provision requiring that if the bottle maker sells to some other brewer for less, it will also give that lower price to the first brewer. Now if the bottle maker contemplates selling to a second brewer for $0.90 per bottle, it must consider an extra cost of cutting price: the rebate the MFN requires it to give the first brewer. It is easy to imagine that the contribution to profit the bottle maker would earn from selling to the second brewer absent the MFN would be overwhelmed by this additional cost, leading the bottle maker to decline to sell to the second brewer at any price below the $1.00 per bottle price paid by the first brewer. Put differently, the rebate required by the MFN discourages discounting by effectively “taxing” price-cutting.

To see why a tax on price-cutting facilitates coordination, suppose that coordinated conduct in this industry is inhibited by suppliers’ incentives to cheat—that is, deterring cheating is the “cartel problem” the bottle makers have to solve to make coordination possible or more effective. A bottle maker that adopts an MFN with some or all customers helps the industry solve that problem by tying its own hands. The bottle maker obligates itself to extend any discount it gives to other buyers to all customers with which it has an MFN, thereby raising its own costs of discounting. Accordingly, if the bottle makers that would have the greatest temptation to cheat introduce MFNs in their contracts with some brewers, they can solve, or at least reduce, the bottle industry’s problem of deterring cheating on a coordinated consensus, leading to higher prices.

The buyers in this story—the brewers—may become accomplices in facilitating coordination, for two reasons. First, a brewer may want an MFN, or at least accept one, even when MFNs lead all buyers ultimately to pay higher prices. No brewer wants to be the only one without an MFN. Without an MFN, it may reason, it will not pay less for bottles than any other brewer, and it might end up paying more. Even if the brewer understands that MFNs may discourage bottler discounting generally, moreover, that would probably not be the brewer’s primary concern. Unless the brewer is very large, most of the harm from higher bottle prices would go to other brewers, and the individual brewer’s MFN may make only a small contribution to discouraging bottle maker cheating generally.

Second, once some brewers have MFNs with a particular bottle maker, the other brewers may have less incentive to drive a hard bargain with that bottle maker, whether it is over price or over an MFN term. After all, a brewer is unlikely to spend time negotiating price with a bottle maker that is committed not to discount, or to do so when getting a lower price would not give the brewer a cost advantage over its rivals. Moreover, to the extent that buyers actively monitor their suppliers’ pricing to other customers, they actually help monitor the bottlers’ anticompetitive agreement, to their own detriment.

The presence of MFNs may also facilitate coordinated conduct through another mechanism: they may help industry participants deter cheating by making cheating easier to detect. If a bottle maker knows that a rival cannot discount selectively, but must do so to all the brewers that it sells to, that practice may make it easier for the first bottle maker to figure out when its rival is cutting price.

**Dampening Competition.** The introduction of MFNs can also lead to higher prices if those provisions lead all the firms in a market to compete less aggressively. We describe this “dampening competition” theory as a collusive theory even though it does not depend on the idea relied upon in the discussion of facilitating coordination that the sellers are in a repeated interaction and the MFN would help them deter cheating. The dampening competition theory turns instead on a different conception of coordinated interaction, which the 2010 Horizontal Merger Guidelines refer to as “parallel accommodating conduct.”

To explain this theory, we again turn to bottle makers and brewers. As previously discussed, a bottle maker that includes an MFN in its contracts with brewers is committing to compete less aggressively. The bottle maker will not compete as hard because it has obligated itself to pay a penalty for lowering the price to any other brewer. It is less likely to lower price to any one customer when doing so requires it to lower price to other customers as well. A bottle maker might make that commitment if it thinks that rival bottle makers would respond by also competing less aggressively. The first firm might think that because it has observed how its rivals have responded in the past, or because it expects them to think the same way it does, and, in consequence, adopt MFNs too. With all the bottle makers competing less aggressively, the result could be higher bottle prices.

A critical part of the story is how the other bottle makers would react if one bottle maker starts to compete less aggressively. As a matter of economic theory, that reaction could go either way. If a firm knows that its rival does not want to get into a price war, maybe it will back off too, and the firms will reach a comfortable détente in which prices go up; that is what the “dampening competition” anticompetitive theory supposes. But that is not the only possibility. Perhaps the
other bottle makers will instead take advantage of a less aggressive rival and try to steal its business, leading bottle prices to fall. Accordingly, in evaluating a dampening competition theory it is necessary to analyze which way the firms in an industry will respond to the introduction of an MFN.

Exclusion: Raising Rivals’ and Entrants’ Costs. MFNs may also harm competition by assisting an incumbent in foreclosing the entry or expansion of rivals. For example, many health insurance MFN cases have involved claims that a dominant firm that used an MFN to exclude potential entrants and constrain fringe rivals.

To illustrate the use of MFNs for anticompetitive exclusion, suppose that the dominant dental insurer in an area has signed up most of the region’s dentists. The insurer here is a buyer, procuring dental services for insured patients from the dentists. Suppose further that the dominant insurer includes an MFN clause in its contracts with dentists, allowing the dominant insurer to lower the fee it pays to reimburse a dentist to equal the lowest fee the dentist charges any other dental insurance plan.

The MFN may make it uneconomic for an entrant to adopt a business model that features selective contracting, with a limited panel of dentists. The panel dentists would accept a lower reimbursement rate in exchange for a promise that the entrant would steer them patients, and the entrant would pass some of its lower costs through to employers in the form of lower rates for dental insurance. Had this occurred, competition from the entrant would have put pressure on the dominant insurer to lower what it charges employers for dental insurance. In this way, the MFN would insulate the dominant dental insurer from competition and protect its high rates from erosion. If the dominant insurer instead employs an “MFN plus” provision, requiring dentists to give it better rates than they gave any other insurer, that would make it even more difficult for rivals to compete, including rivals that want to adopt the same business model as the dominant insurer (rather than selective contracting).

As the dental insurance example suggests, an MFN can harm competition through exclusion by making it impossible for a dominant incumbent firm’s rivals, including entrants, to bargain with input suppliers or distributors for a low price. When the suppliers or distributors have an MFN with a large incumbent, they would lose too much if they made that kind of deal with a small rival or entrant. In this way, the MFN discourages the rivals from lowering their own costs, and so prevents them from competing aggressively. Harm to a competitor does not necessarily mean competition is harmed. But if the MFN prevents suppliers or distributors from giving a better price to enough of the firm’s significant rivals (including prospective ones), it could be used to confer or protect market power.

There are also other exclusionary possibilities. For example, a group of firms could obtain or protect market power by excluding entry or expansion by a maverick that would otherwise undermine coordination.

Increasing Seller Bargaining Power. Another idea from the economics literature explains how a durable goods monopolist can raise price from the competitive level to the monopoly level by introducing an MFN. To tell the story, suppose that only one firm sells a durable good like a machine used in a factory. Buyers expect the product to last many years. Most buyers do not give up much of the expected benefit by delaying its purchase; perhaps they can use their old but less good machines for another year. In this setting, the monopolist may not be able successfully to charge a monopoly price. The monopolist may be able to make some sales if it charges a monopoly price, but after it does so, it has a strong incentive to cut price to attract additional buyers. Doing so would be profitable even if the additional buyers are unwilling to pay the monopoly price, so long as the price they are willing to pay exceeds the monopolist’s marginal cost. Patient buyers—who may be most buyers—know that the monopolist has an incentive to cut price to make additional sale, so they delay their purchases, waiting for the monopolist to discount. Indeed, it may be worth it for buyers to delay purchasing even if the monopolist offers them a price only slightly above the competitive price. With many buyers delaying their purchases until the price falls, the monopolist can never profitably charge a price above the competitive price, not even to early buyers, and always prices at the competitive level.

The monopolist can solve this problem if it can find a way to commit to charging the monopoly price, and avoid the temptation to discount to capture additional sales. Introducing an MFN is one way to do that, because it makes it expensive for the monopolist to discount later.

One way to understand why buyers stop delaying their purchases is to interpret their decisions in a bargaining framework. Before the MFN was introduced, each buyer’s best alternative to purchasing at the monopoly price right away was to wait until the seller lowered price. Buyers generally saw that as a good alternative, given them a strong bargaining position in dealing with the monopolist in the first place. Not surprisingly, the bargaining outcome favored the buyers. They could negotiate a competitive price without having to wait. The seller’s introduction of the MFN made buyer’s best alternative much less advantageous, reducing the buyer’s bargaining power substantially. As a result, the seller could obtain a much more favorable outcome, namely charging the monopoly price.

A related commitment problem might make it difficult for a manufacturer with market power to sign up retailers on
terms predicated on the retailer charging a high price to consumers. Once the manufacturer did that, it would be tempted to sign up competing retailers by giving them a better deal, such as a lower franchise fee or lower wholesale price, even though the dealers that sign up later would not charge as high a retail price. The manufacturer would not care whether the dealers it signs up later take business from the dealers it previously contracted with, given that the manufacturer has already been paid a franchise fee by the earlier dealers. But the manufacturer would care about getting the additional business the later dealers can generate, so it will be willing to sign them up even it earns a lower franchise fee from the later dealers. In this setting, the manufacturer may have trouble bargaining for advantageous terms with any dealer in the first place, because each dealer knows that the manufacturer will be tempted to give it better terms if it signs up later, after the manufacturer has locked in other dealers.

The upshot of the story is that the manufacturer has to give advantageous terms to all the dealers, including a low wholesale price, in order to sign up any dealers at all. Then competition among the dealers will keep the price to consumers low, close to the low wholesale price. Thus, the manufacturer may be unable to find a way to ensure that retailers charge consumers higher than competitive price even though the manufacturer has market power. Under such circumstances, the manufacturer can use an MFN to gain bargaining power when negotiating with the dealers. Then the manufacturer can set a high wholesale price, allowing it to dampen retail competition and engineer a high retail price to exploit its market power in much the way that the durable goods monopolist can use an MFN to exploit its market power.

**Conclusion**

When a seller commits to give a buyer as good contractual terms as it gives any other buyer, that commitment can alter both the seller’s and buyer’s behavior going forward. In some cases, these changes can improve efficiency, as when they induce buyers to make relationship-specific investments. In other cases, however, these changes may be motivated by the collusive and exclusionary potential of MFNs.

An important key to understanding the effects of MFNs is to recognize that contracting parties may ignore the effects of their contract on firms that are not parties to the contract. For example, each buyer in an industry individually may desire, or at least accept, an MFN, even though it harms buyers as a group. Buyers may agree to MFNs that facilitate coordination or protect incumbent seller market power by excluding entrants because most of the harm would be borne by other buyers and no individual buyer can make much difference in preventing higher prices by declining to accept the MFN. Hence, even when firms (sellers or buyers) adopt MFNs for what might appear to be desirable or innocent reasons, the incentives those provisions create could lead to outcomes that harm competition and consumers. In evaluating the consequences of MFNs, therefore, one cannot necessarily trust the views of either buyers or sellers about whether the practice promotes competition. Moreover, the frequency with which MFNs are employed does not mean that they should be presumed to promote competition.

Our survey of the economics literature shows that MFN provisions can promote competition or harm it. Indeed, they may do both in any particular industry setting. As we have shown, to understand their competitive effects, it may be necessary to consider the plausibility of a range of economic rationales.

---

1. If the analogous commitment were made by a buyer, the buyer would promise one seller that it will not pay any other seller more for supplies.
2. The bottle maker, in negotiating with the second brewer, may not care that the second brewer will steal market share from the first. See Leslie M. Marx & Greg Shaffer, *Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity, and Uniformity: Comment*, 94 AM. ECON. REV. 796 (2004).
5. Prices for products sold in advance of consumption may change over time for many other reasons. For example, ticket prices may increase if demand turns out to be stronger than expected for a show that did not originally appear likely to sell out, or if the producer expects late purchasers to pay the most (as with business passengers on airlines). We offer the ticketing example in the text to illustrate a potential efficiency benefit of MFNs, and we do not intend it as a comprehensive explanation for ticket price dynamics.
7. This analysis has implications not only for antitrust treatment of MFNs, but also for firms contemplating whether to adopt them. Both the efficiencies and harms of MFNs we discuss must be weighed against the cost of negotiating and enforcing the MFN. In complex contracts, it can be difficult to ascertain whether the terms granted one buyer are more or less favorable overall than the terms granted to a subsequent buyer, resulting in enforcement costs and potentially leading to litigation.
9. Large buyers sometimes defend their use of MFNs with the claim that because of their size, they “deserve” a supplier’s lowest price. But if a large buyer has an advantageous bargaining position, and uses it to negotiate MFNs with sellers, competition may be harmed even if the large buyer ends up with a lower price than other buyers. If the MFN facilitates seller coordination, for example, the large buyer may have in effect teamed up with sellers to reduce seller rivalry in exchange for splitting the resulting anticompetitive profits.


15 More technically, this theory assumes that decision variables are “strategic complements,” as, for example, prices are with a Bertrand-Nash solution oligopoly concept. Decision variables are strategic complements if best responses slope upward (that is, if a move by one firm leads others to move in the same direction). Hence, if one firm becomes a less aggressive competitor, the others do so too.

16 Under such circumstances, decision variables are strategic substitutes, as with quantities given a Cournot-Nash solution concept. When decision variables are strategic substitutes, best responses slope downward: a competitive move by one firm leads the others to move in the opposite direction. Hence, if one firm grows less aggressive, the others grow more aggressive.


19 Put differently, before the MFN was introduced, a commitment to a high price by the seller would not be “subgame perfect.” That is, once the durable goods monopolist made sales to buyers willing to pay a high price, it would have an incentive to act opportunistically by cutting price. Buyers that recognized the monopolist’s incentive could take advantage of it by delaying their purchases, making a high price unsustainable.

20 See Butz, supra note 6.