

Most-Favored-Nation Clauses

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tl;dr

Background: California Attorney General Rob Bonta recently filed a state-law antitrust [suit](#) against Amazon, alleging that it imposes most-favored-nation clauses (MFNs) on its retailers and wholesalers, and that these dampen competition between Amazon and those firms.

But... The California suit argues that Amazon's MFNs are tantamount to a cartel. This is symptomatic of broader misunderstandings about the competitive effects of MFNs, as well as the legal standards to which they should be subjected.

MFNs are vertical restraints. Barring exceptional circumstances—such as evidence of horizontal collusion—they should thus be analyzed under the rule of reason. This approach is consistent with economic research surrounding these clauses, the U.S. Supreme Court's case law on retail-price maintenance (a close analogue), and the stance taken by competition authorities around the globe, notably the European Commission.

KEY TAKEAWAYS

MFNS ARE VERTICAL RESTRAINTS

Platform MFNs are contractual clauses whereby a retailer or wholesaler agrees not to undercut the price it charges on a given

platform, when it sells the same goods, either on other platforms (so-called “broad MFNs”) or via its own retail channels (so-called “narrow MFNs”). These clauses are ubiquitous in the hotel-booking and online-retail industries.

Despite odd claims to the contrary, there is broad economic and legal consensus that these agreements are vertical in nature. As such, they should be subjected to case-by-case analysis, rather than the *per se* prohibition that applies to cartels.

This last point is easy to understand: a typical MFN clause might see a firm like Nike agree not to undercut the price it charges on Amazon when it sells goods on its own website. This is categorically different from, for example, Nike conspiring with Adidas to fix the price of sportswear. In other words, MFNs are largely an “interbrand” matter. Anticompetitive effects are far less likely in these settings than in the case of horizontal conspiracies that concern the goods of competing producers.

THE COMPETITIVE EFFECTS OF MFNS

A burgeoning body of empirical literature supports this view that MFNs are not presumptively harmful to competition.

In a forthcoming working paper, ICLE scholars surveyed more than a dozen empirical studies looking at the competitive effects of MFNs. Except when these clauses are the result of horizontal collusion among retailers, the empirical literature paints a nuanced picture

and there is little sense that such clauses generally harm consumers. In turn, these findings lead most scholars to recommend that MFNs be analyzed case by case, notably looking at the strength of retailers' and wholesalers' outside options and the extent to which consumers display strong brand loyalty.

These empirical results are neatly encapsulated by a European Commission [market study](#) of independent hotels that did not find “that the laws prohibiting OTA parity clauses have a noticeable effect on hotels' price differentiation strategies.”

But even this nuanced picture offers an overly pessimistic view of MFNs. Indeed, the main justification for these clauses is that they prevent free riders. In turn, this encourages platforms to invest in promotional efforts, user experience, and curation. Once these factors are accounted for, it becomes even less likely that MFNs harm consumers.

The upshot is that policymakers are correct to approach MFN clauses with caution, but they should reject calls to ban them outright.

CALIFORNIA'S PROBLEMATIC LAWSUIT

Given what precedes, Bonta's decision to challenge Amazon's MFNs on grounds that they are cartels appears out of touch with competitive reality. Moreover, as ICLE Academic Affiliate John Lopatka of Penn State Law [has noted](#), Amazon's seller agreements actually do allow sellers to set their own prices, including offering lower prices elsewhere. Amazon just chooses not to highlight those offerings on its own platform, as it pushes to feature the lowest price possible. According to Lopatka, both of these features would tend to foster competition.

Bonta's [complaint](#) charges violations of California's [Cartwright Act](#) and the [California Unfair Competition Law](#). It's not yet clear how courts will interpret the application of state

law in this context, but federal precedent is illustrative here.

Many scholars have recognized that the competitive effects of MFNs are very similar to those of retail price maintenance (RPM). In 2007's [Leegin Creative Leather Products v. PSKS, Inc.](#), the Supreme Court clearly ruled that all vertical restraints—including RPM and presumably MFNs—should be analyzed under the rule of reason. Based on that precedent, the California AG would need to show evidence that Amazon's MFNs harm consumers, which its complaint currently fails to do.

CONCLUSION

While few scholars doubt that MFN clauses may *sometimes* give rise to anticompetitive harm, analogizing them to a price-fixing cartel is deeply misguided. Instead, the competitive effects of these clauses should be carefully examined on a case-by-case basis that acknowledges their ability to reduce free-riding and spur investment.

For more on MFNs, see the forthcoming ICLE working paper “Platform MFN Clauses: Why Should Online Sellers Want Fair Trade?”

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