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I. INTRODUCTION

"We will match our competitor's price!" sounds like the most competitive of slogans. And to a consumer who has just found out that there is another store with a lower price, it looks like opportunity. Unfortunately, this is one of those deals that is not as simple as it sounds. After all, why was it that, until a rival with a lower price was discovered by some consumer, the price was high? Could it be to catch the less savvy consumers out? Or would it ever be the case that you would be put in a position of having to comply with that promise? After all, your competitor does not gain from driving customers into your hands with their own lower price. That lower price is only valuable to them if they ensure your business. Otherwise they too may as well keep prices higher.

In broader business terms, price-matching guarantees have been given the name "most favored nation" clauses or MFNs. The origin of the name is in international trade negotiations where purchasing countries insisted on such clauses to profit from potential competition although, like my example above, these clauses did not necessarily produce that consequence. These days it is antitrust authorities who are taking a closer look at MFNs.

The reason for this new antitrust attention has to do with MFNs that are associated with platforms. While these fall under the general class of what former DOJ economist, Fiona Scott Morton, called "contracts that reference competitors" it is their association with platforms that leads to some difficult choices and trade-offs. This article will examine that association in more detail.

II. PLATFORM SIPHONING

A platform, or as it is sometimes termed in economics, "a multi-sided market,"[2] is a business that brings together two or more groups of customers. A canonical example is a website that provides content to readers and, along with those readers, fodder for advertisers. Importantly, as is often the case, the business model associated with a platform focuses on one customer group. For many websites (particularly, news media), readers can visit freely while advertisers pay to place ads in front of them. In broad terms, the website has two products—a monetization product (in this case, hosting ads) and a referral product (in this case, content). The referral product is designed to attract consumption that is of value to customers purchasing the monetization product.

The issue that arises for platforms is that customers, who are either paying or suffering from some other disadvantage, may look for ways to minimize those costs. In the case of

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[2] Joshua S. Gans, *Price Signals in Two-Sided Markets*, CPI ANTITRUST CHRON., (July (2) 2010).

websites, readers who dislike ads may install pop-up or ad-blocking software that allows them to view content without the associated ads. In this regard, such software acts like a siphon, allowing consumers to by-pass ads and, in the process, threaten the value the website was bringing to its monetization customers—the advertisers.[3] If this becomes pervasive then the business model that placed all of the revenue gathering of the website on advertisers could be threatened.

III. eBOOK RETAILING PLATFORMS

In some situations, the potential for a siphon is more subtle. Consider eBook retailing and device platforms such as Apple's iBookstore or Amazon's Kindle. The business model for these is to have readers as the sole monetization customers with publishers being the referral customers, being paid for delivering customers to the eBookstore by providing content.

An issue arises when publishers can access a device (associated with an eBookstore) without actually selling through the eBookstore. For instance, a customer may see a book displayed on Apple's iBookstore but then look at prices on other eBookstore apps (such as Kindle) and purchase the book directly from them if it is cheaper. If there is a persistent price differential, a siphon may arise making the more expensive eBookstore unviable as a business model.

That, of course, isn't a problem in itself, but it may be a problem if rivals have very different business models. This was the case for eBooks before Apple came along in 2010. Amazon dominated the market with a wholesale model whereby it set prices to readers while paying publishers their posted wholesale price. This was precisely the same model publishers used with physical bookstores. As they had long been with larger retail book chains, publishers were concerned with the eBook prices set by Amazon; specifically that they were too low and this would end up coming back to bite them. While they could raise their wholesale prices somewhat, this didn't appear to deter Amazon, which was happy for some best-selling books to act like loss leaders.

When it was developing the iPad, Apple considered entering with its own iBookstore and associated app, iBooks. However, it had no interest in the business model used by Amazon as it did not want to earn losses on any book titles. In addition, it did not really want to set book prices to the consumer. Like its successful App Store, it wanted the publishers to set those prices. Thus, it offered publishers an agency model that did just that. Publishers would set prices but Apple would receive a 30 percent cut of the revenue.

As we now know, the way Apple coordinated the major publishers on to those agency contracts allowed the publishers to facilitate higher prices across the board. Ironically, Apple was concerned about that and capped the prices that publishers could list; thus, it was only a quasi-agency model that was implemented.

Had Apple just offered agency contracts, then that may have been the end of the matter. However, Apple were concerned about a potential siphon. The iBookstore would not attract any consumers if other platforms available on the iPad (including Amazon's Kindle and Barnes and

[3] Simon P. Anderson & Joshua S. Gans, *Platform Siphoning: Ad-Avoidance and Media Content*, 3(4) AMER. ECON. J.: MICROECONOMICS, 1-34. (Nov. 2011).

Noble's Nook) could offer retail prices below those the publishers were setting. What is more, if publishers were on the wholesale price model elsewhere, they would have an incentive to offer lower prices as they would be earning a higher margin there (even with a discounted retail price) than they would on Apple's store.

Initially, Apple wanted to require any publishers on its platform to switch to an agency model elsewhere, seemingly because the publishers would then control retail prices on all platforms. However, it worked out that this was difficult and also not sufficient to prevent a siphon if other platforms offered publishers a higher revenue share.

So Apple dropped the agency requirement and instead required a retail price MFN. If the retail price was higher on another digital platform, the publisher would be forced to lower prices in the iBookstore. For publishers, while they could have persisted with a wholesale model with Amazon under these arrangements, they pressured Amazon to change to an agency arrangement. Somewhat unprecedented for what was later found to be an anticompetitive agreement, the main conspirators actually reduced their short-run profits as a result of these changes.

IV. MFNS AND BUSINESS MODEL EXPERIMENTATION

The consequence of the MFN in eBooks was to allow content to monetize all eBook platforms. But for publishers, the MFN would reduce their incentives for a multi-platform strategy.

A clear example of this arose recently with regard to Amazon's MFN for electronic comic book publishing. Bill Amend, the author of the successful *Foxtrot* cartoon was trying to use the Kindle Comic Creator tool to publish his successful collections on the Kindle. He took a close look at the terms and conditions[4] and found that (a) because his collection was over 10MB the minimum price[5] permitted was $2.99 and (b) to comply with this condition—"You must set your Digital Book's List Price (and change it from time-to-time if necessary) so that it is no higher than the list price in any sales channel for any digital or physical edition of the Digital Book."—he could not set the price of his book more than $1.99. The reason was that his book was listed on the iTunes bookstore[6] for $1.99. The mix of contractual terms appeared to lock Amend out.

This issue arose because Amazon, under the scheme whereby publishers receive a 70 percent share of retail revenues also charges publishers for "delivery." For a comic, this can be large and so Amazon requires a price floor. To be sure, that floor would not allow the publisher to earn any net revenue from sales on the Kindle so it would not be attractive. Instead, to comply with both clauses, a publisher would have to raise prices on all platforms by a large amount.

For Amend, this was not worth the bother. His incentives for a multi-platform strategy were reduced precisely because of Amazon's business model. However, had Amazon been essential for his sales, he would have had to comply and this would have led to higher prices for consumers.

[4] *See* https://kdp.amazon.com/self-publishing/help?topicId=A29FL26OKE7R7B.
[5] *See* https://kdp.amazon.com/self-publishing/help?topicId=A301WJ6XCJ8KW0.
[6] *See* https://itunes.apple.com/us/book/foxtrot-pad-pack-1/id517538296?mt=11.

This illustrates a point theoretically developed by Andre Boik & Ken Corts[7] that platform MFNs typically raise retail prices, especially when imposed by a platform that has a significant degree of market power; i.e., a retail platform that suppliers cannot afford to ignore.

On the flip-side, it demonstrates that entrants can often have little power to experiment with alternative business models in the presence of MFNs. The MFN raises the "price" those platforms must pay to one set of customers to bring them on board. In that respect, like exclusionary discounts in vertical settings, platform MFNs can block entry; [8]especially, entry with a distinct business model (i.e., a different mix of monetization and referral customers) than current incumbents.

V. SUMMARY

MFNs have long been considered part of the toolkit for platforms to prevent siphoning. However, the consequence of such practices has been to make it difficult for business model experimentation, which is the main driver of platform competition. To be sure, as was found at the Federal Court in the recent Apple case, MFNs are not considered anticompetitive in themselves. However, as is discussed here, when utilized by platforms with some degree of market power, they can block potential competition while, when utilized by other platforms, they are unlikely to be effective to prevent siphoning in any case. The point here is that to keep customers from siphoning off a platform, the best advice is to provide them with a competitive quality product than to use a particular contractual term.[9]

[7] Andre Boik & Kenneth S. Corts, *The Effects of Platform MFNs on Competition and Entry*, MIMEO, University of Toronto (2013).

[8] For a description of blocking practices *see* Joshua S. Gans, *Intel and Block Practices*, THE ANTITRUST REVOLUTION, (J. Kwoka & L. White (eds.), 2010, 6th Ed., forthcoming).

[9] This is something Apple has found with its Mac App Store that uses an agency arrangement but does not impose an MFN on software developers.