Interview with Howard Shelanski, Director, FTC Bureau of Economics

Editor's Note: *In this interview with* The Antitrust Source*, Dr. Howard Shelanski discusses injunctions for standard essential patents, the role of behavioral economics, contracts that reference rivals, and cooperation across agencies.*

Howard Shelanski became Director of the FTC's Bureau of Economics (BE) on July 1, 2012, replacing Joseph Farrell, who held the position since 2009. Currently, Dr. Shelanski is on leave from Georgetown University Law Center. Previously, he was Deputy Director of the Bureau of Economics from 2009–2011, and was Chief Economist at the Federal Communications Commission from 1999–2000. More recently, he was Of Counsel with the law firm Davis, Polk & Wardwell. Dr. Shelanski holds a Ph.D. in economics and J.D. from the University of California, Berkeley, where he was a member of the law and business faculties from 1997–2011.

Editor Kevin W. Christensen conducted this in-person interview for The Antitrust Source *on November 9, 2012.*

ANTITRUST SOURCE: You have both a Ph.D. in economics and a law degree. Can you describe for us how your legal training might play a role in your day-to-day duties and responsibilities at the helm of the FTC's economics staff?

HOWARD SHELANSKI: I think it is helpful because lawyers and economists tend to view things a bit differently and sometimes having both kinds of training helps me to better understand the legal staff's point of view. On the other side, I sometimes have an ability to understand, not always, but sometimes, what is not getting across from the economics staff to the attorneys because of the different frameworks in which they might be evaluating a case, and can try to tie the Bureau of Economics' analysis more closely to the framework that the legal staff is using.

So there are definitely some benefits to having the legal perspective in translating between the two Bureaus [BE and the Bureau of Competition] and in making judgments about the relative weights of different kinds of evidence or the extent to which the economic evidence does or does not support the relevant legal standard.

ANTITRUST SOURCE: Is there a specific instance where you think that might have been on display?

SHELANSKI: There have been a couple of instances in the past where there were documents that looked very incriminating in an anticompetitive practices case. For a long time the documents were persuasive to the legal staff because they appeared to show the company was trying hard to monopolize a local distribution market in a particular line of products.

On the other hand, the economics evidence was able to show that the prices for the products at issue were actually going down at the same time the company was apparently trying to do things that should have been pushing prices up. Also, there was additional entry in the market. So despite the documents, the firm we were investigating didn't appear to be succeeding in its allegedly monopolistic scheme. And so there was a real conflict between what the economic data were showing in terms of price movements and entry and output in the market and what the internal documents were showing about the motives of the target in the investigation.

That was a case where the lawyers had what they thought were very hot documents and the economists thought they had what was very hot evidence. It was very helpful to have the legal perspective to try to work through with the legal staff why they thought there was still a case and to move back and forth between the Bureaus. Eventually, the Bureau staffs worked together to look at each other's evidence and reach a resolution in the investigation.

ANTITRUST SOURCE: Your return to the FTC has coincided with several important matters related to the relationship between intellectual property and competition. These include pay-for-delay agreements in the pharmaceutical industry, International Trade Commission (ITC) injunctions, and hold-up in standard-setting organizations. Do you believe these will be the primary issues of your tenure as Director, or do you anticipate other issues to rise in prominence?

SHELANSKI: These issues will certainly stay high on the list. There are cert petitions before the Supreme Court on the pay for delay matters and we've got a couple of other pay-for-delay matters that are active at other procedural stages. There is obviously the investigation of Google, which involves some standard essential patent issues, and we are looking at "patent assertion entities" to try to learn more about what they do and how they might affect competition and innovation. But while I think IP and pharma are key areas of the FTC's focus now, and are likely to remain such over the course of my tenure, you've got to keep in mind we still have a much broader docket with many other important issues.

There are important matters on the consumer protection side. There are very important matters in health care markets. And then there are our merger investigations that cover a whole variety of issues and industries, which take up a lot of our time and attention. Some of those investigations are in industries that may look rather old-fashioned and mundane when compared to the newer, high-technology markets, but they are nonetheless vitally important to the economy and to consumers.

ANTITRUST SOURCE: Focusing on the injunctions and the ITC, what are the major economic issues and how has BE helped to guide the discussion?

SHELANSKI: There are some broad economic issues pertaining to what the harm from delayed or deterred innovation can be. Those are not really the issues that BE focuses on in a very specific way. Those are background issues. It's well understood that innovation, introduction of new products, and productivity increases are enormously important to economic performance. And there are a lot of results, borne out through many studies, which show that innovation will ultimately move the economy to a much higher and faster growth path and bring better benefits to consumers than will short-term reductions in price and increases in output. So innovation is incredibly important, and BE certainly does things to support the focus generally on innovation because of those economic effects.

More specifically on the injunction issue, the work we have done has focused on how the threat of an injunction might enable a patent holder to get a higher price from the licensee, a price that might perhaps go well out of the FRAND [fair, reasonable, and non-discriminatory] range. And what we've been able to show, and this comes out of some fairly standard bargaining models, is that there is a very high likelihood that because an injunction puts not just a marginal amount of a company's return at stake, but indeed its entire revenue stream on a particular line of products using the IP, that the threat point in the bargaining shifts dramatically. Of course, you have to dis-

count that greatly increased threat by the likelihood that an injunction will be obtained. But, nonetheless, we have found that a rational firm faced with an injunction might be looking at, to paraphrase a popular term these days, a financial cliff whereas before it was looking at a small slide down a hill. And that change shifts one's behavior in the bargaining process.

ANTITRUST SOURCE: Both the FTC and ITC employ economists. Has there been a significant interaction of the economists in these two agencies?

SHELANSKI: I do not think so. The FTC economists have done their analyses independently, in the context of the FTC's own internal investigations and as relevant to the agency's weighing in at the ITC.

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ANTITRUST SOURCE: What about other agencies affecting competition in IP, such as the Patent & Trademark Office and the Food and Drug Administration? How does BE work with economists at these agencies?

SHELANSKI: For the past couple of years the PTO has had a chief economist, Stuart Graham, who has been a terrific partner in thinking through a lot of the economic issues related to IP. The economic service at the PTO is a very small and nascent operation which hopefully will continue to grow given the importance of IP and the current IP policy challenges the U.S. faces. Stuart has been excellent in trying to build that service up, and we certainly coordinate with him as appropriate on areas of policy and broad policy directions.

We more often work with the economists at the Department of Justice. I've worked very closely with my counterpart there, Fiona Scott Morton, on thinking through issues related to standard essential patents, injunctions, SSO [standard-setting organizations] conduct, the meaning of a FRAND commitment. And there's been, I think, quite a bit of interaction between BE staff and DOJ staff and more generally between the two agencies on these issues.

And I also have been coordinating and discussing these issues with Kai-Uwe Kühn, who is my counterpart at the European Commission. So there has been quite a bit of interaction there.

You mentioned the FDA. We certainly have had discussions with the FDA in specific matters. But I think most of the interaction with the Food and Drug Administration has happened through the Bureau of Competition. I'm sure there has also been some through the Bureau of Consumer Protection. To my knowledge, the economics function at the FDA is very different from what we have here, so while we've been involved with discussions, and worked with them on various issues, I wouldn't say there's been a terribly deep interaction on the economic side between the two agencies.

ANTITRUST SOURCE: What about the Federal Communications Commission? Given the FCC's strong interest in journalism and media, privacy, mobile applications, and various other online consumer production issues, do you see any opportunities to work with the FCC staff on joint projects?

SHELANSKI: We have had discussions with the FCC on numerous issues, for example, relating to network neutrality and things like that, and certainly on privacy. In terms of joint projects, there are limits to what the two agencies can do together, other than to coordinate to make sure that they don't step on each other's jurisdictions or have policies that are mutually inconsistent.

ANTITRUST SOURCE: You mentioned Fiona Scott Morton, Deputy Assistant Attorney General for Economic Analysis at DOJ's Antitrust Division. She recently opined on the competitive risks of contracts that reference rivals.[1] In broad strokes, what factors play in BE's assessment of the pros and cons of CRRs?

SHELANSKI: CRRs are contracts that will have terms that may involve competitors of the buyer, possibly of the seller, but typically of the buyer. And the most common form of CRR is a most favored nation clause, in which the seller usually promises that no other buyer will get a better price. That seems like a very normal kind of thing for a buyer to want, to have the comfort that it has gotten the best price a buyer can get.

There are some potential problems, though, with this kind of constraint. For one thing, the incentive of a seller to cut price diminishes every time there is a most favored nation clause. You can't cut price to a subsequent buyer without cutting price to all of the previous buyers that had most favored nation clauses. So there's a real penalty for making a particular bid at a lower price to a particular buyer. Over time, the effect of a contract that references rivals or most favored nation clause can actually be to raise the price floor on the product being sold, which is a concern.

More nefariously, there are ways that a CRR can be used to support a cartel at the buyer level. CRRs can be used to support a cartel at the seller level as well by having everybody put most favored clauses into their sales contracts. A penalty is built in any time a particular seller might want to cut price to a particular buyer. So there are also ways in which contracts that reference rivals can be facilitating practices for horizontal collusion.

The challenge, as Fiona Scott Morton said in her speech, and as has long been recognized, is that there can be good reasons for a contract that references rivals. There can be good reasons for a most favored nations clause. But Fiona's point was that because of the possible harms from CRRs, there has to be a business justification for an MFN or a CRR where the market context is one in which some harm is plausible.

CRRs are reviewed under the rule of reason, and I think what Fiona Scott Morton was trying to do is to just remind firms that the rule of reason has teeth. And if the agencies see a situation in which there's no valid business justification for a most favored nation clause or other CRR, and see possible harm, they may investigate and enforce.

The Federal Trade Commission does not take a different view. I think that we do recognize, however, that in the vertical context, putting aside the facilitating practice possibility, CRRs are often innocuous. MFNs or CRRs are being dictated by buyers. And there are cases in which sellers don't really have a choice if they wish to do business other than to give the buyers the contract that they want. So the challenge is to sort out when an MFN or a CRR is driven by competition compared to when it is actually restraining and limiting competition.

We examine CRRs in the way we examine all vertical practices, recognizing the efficiency possibilities and the procompetitive possibilities, but also attuned to the circumstances under which they can be harmful.

ANTITRUST SOURCE: In September, the DOJ and FTC jointly sponsored a workshop on particular

[1] Fiona Scott Morton, Deputy Ass't Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Contracts that Reference Rivals (Apr. 5, 2012), *available at* http://www.justice.gov/atr/public/speeches/281965.pdf.

types of CRRs—MFNs—which we discussed earlier.[2] Will BE become more active in exploring the anticompetitive and procompetitive effects of MFNs? And also, in broad strokes, what factors play into the assessment of those pros and cons?

SHELANSKI: The conference raised awareness on both sides of the arguments about contracts that reference rivals and MFNs and about what the most current thinking is about the problem. Participants discussed lots of good questions. What are the reasons for concern? What are the reasons that firms and industries have these contracts? How do they evolve? I think the conference was useful and Fiona's paper was useful in bringing the issue back to the forefront, raising awareness, pushing people to rethink and to reexamine the state of our knowledge about these kinds of contracts.

My own interpretation of Fiona [Scott Morton]'s speech was that it took a stronger, harder line than probably had been articulated by antitrust officials in the recent past. She has done original research showing the effects of MFNs.

But if one were to ask me, have things fundamentally changed in terms of antitrust law's perspective on CRRs and MFNs, I would say the answer is no, the agencies will continue to look at the same factors. What is the market context in which MFNs have arisen? Who has dictated them? Are they from the buyer's side or the seller's side? How did they arise on the buyer's side or the seller's side? What is the market power and the market position of the firm demanding the MFNs or of the firm selling the product? All of these will factor into the likelihood that there is harm, that the likelihood that they are facilitating practice.

My own interpretation of Fiona's speech was that it took a stronger, harder line than probably had been articulated by antitrust officials in the recent past. She has done original research showing the effects of MFNs. And I think by taking that stronger position on the possible harms of MFNs, she has raised a question that the antitrust agencies will be investigating going forward, which is, how likely is it that there is going to be harm from these kinds of vertical practices? If there is good evidence that there has been harm in a number of industries, should we be looking at CRRs more closely? And I think it likely that antitrust agencies will be looking at CRRs more closely over the next few years.

ANTITRUST SOURCE: Since, as you said, the conference pushed "people to rethink and to reexamine the state of our knowledge" of these contracts, do you think it is time for a revision of the vertical guidelines?

SHELANSKI: I do not think that a new revision of the vertical guidelines is essential. In some sense, there are two reasons for that. I do not think it would be easy to write new vertical guidelines right now because I think that the state of the knowledge about vertical practices is that effects are very case-by-case. And other than setting forth some principles and some economic understanding and some burdens, I'm not sure how useful new guidelines would be.

I am not sure at this point there is something sufficiently systematic that we can capture by guidelines that would really be useful for firms, businesses, or the bar. While I don't see that there would be a lot of harm in revising the vertical guidelines, I think that a revision of the guidelines now would end up not being terribly useful because it would end up saying, here are a lot of factors that one might consider, but it's really a very case by case analysis.

[2] Fiona Scott Morton, U.S. Dep't of Justice, Antitrust Div., Most-Favored-Nation Clauses and Antitrust Enforcement and Policy, http://www.justice.gov/atr/public/workshops/mfn/.

ANTITRUST SOURCE: In two recent speeches,[3] DOJ personnel have suggested policy choices for standard-setting organizations that would promote competition and benefit consumers. Do these policy choices sufficiently summarize the FTC's view, and if not, what is missing?

SHELANSKI: Well, I think I need to be careful about ever saying that I know what the FTC's view is because we understand the agency's view based on the votes of the commissioners, by the speeches of the commissioners, and I don't know to what extent there's consensus among the commissioners on all of the IP issues that are circulating.

There are certainly some differing views, but on the whole I think it is absolutely correct that the Commission views IP issues as very important to the agency's mission. And I think there is probably general agreement about the need for better practices at the SSO level, that is to say, during the standard-setting process, to avoid the ex post, and by ex post I mean post adoption of the standard, problems that we very often find ourselves dealing with here at the agency.

If you look at the cases that we have dealt with, successfully or unsuccessfully, the Rambus case, the N-Data case, the recent Bosch/SPX settlement, or the current Google standard essential patent (SEP) investigation, what one sees very quickly is that there are strong allegations of hold-up by firms that have intellectual property embedded in standards. Sometimes, the conduct is pretty clear, and firms behaved in a really poor way, perhaps not disclosing they had IP in a standard or backing off of apparent commitments to license the standard on FRAND terms. But in a lot of cases what we find is that the SSO agreements are quite unclear about what has actually been agreed to. One typically cannot figure out what the FRAND rate is, or what the understanding or agreement was as to the procedure for establishing FRAND, and so on. These are very difficult but important questions.

Now, as a matter of antitrust law, I think there are good reasons to imply certain non-exclusion obligations in the standard-setting agreements among members of an SSO. Standard-setting organizations can obviously do a lot of good, but they also involve cooperation among actual or potential competitors.

So we like the efficiency of standard-setting organizations because they may bring us a better standard sooner, but what we give up through the SSO is the possibility of competing standards, and such competition can reduce the ability of any particular set of standard-essential IP holders to exclude rivals or follow-on innovators from the marketplace. So we trade off efficiency at the front end against the risk of exclusion and monopoly power on the back end, after the standard is adopted.

What allows that trade off to occur, or what should allow that trade off to occur, are commitments by the standard-setting organization to limit that monopoly power, that ability to exclude competitors, innovators, and other future licensees ex post. What the DOJ has been arguing for, what I have been arguing for, is for SSOs to do a better job clarifying what the commitments are by participants in the standard not to exclude once the standard is adopted and once the market power has vested in the standard. That is where the SSOs do not do a good enough job and part of why we have ex post hold-up disputes.

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[3] Joseph F. Wayland, Acting Ass't Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Antitrust Policy in the Information Age: Protecting Innovation and Competition (Sept. 21, 2012), *available at* http://www.justice.gov/atr/public/speeches/287215.pdf; Renata Hesse, Deputy Ass't Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Six "Small" Proposals for SSOs Before Lunch (Oct. 10, 2012), *available at* http://www.justice.gov/atr/public/speeches/287855.pdf.

So the consensus that you're seeing between the Bureau of Economics at the FTC, the economic analysis group at the DOJ, and the economists at the European Union—I'm referring to the economists because that's who I've been dealing with, but I think this is shared more broadly—is that SSOs should be pushed to adopt clearer and better agreements.

Now, there are challenges in achieving clearer standard-setting agreements. The SSO process is a difficult one. We don't want to require such specificity that we scare off participation in the SSOs. We all recognize that it's a delicate balance, but the balance at this point is too far skewed towards vagueness, so that we may in fact not have the confidence we want to have as antitrust enforcers that the procompetitive benefits of these SSOs on the front end, in getting us a better standard sooner, outweigh the exclusionary outcomes ex post through possible abuses of FRAND commitments.

ANTITRUST SOURCE: One of the ways that SSOs have tried to remove the vagueness, as you say, is to require members to publicly announce their most restrictive licensing terms so that the adopted standards could be based not just on the technological merits but also on the cost. This seems to be something that the FTC agrees with. But do you foresee any potential problems if a SSO adopts this policy?

SHELANSKI: You know, I've never worked inside an SSO and I think that it's hard from the outside to appreciate what all of the dynamics are and what all of the problems might be. So anything I say will be something of an abstraction on this point, and I recognize that.

I don't think that SSOs are trying to do bad things or to be anticompetitive. I mean, if you talk to people in the major standard-setting organizations, they're trying to get good technological standards out there onto the marketplace. Engineers are not typically trying to be anticompetitive, they're trying to get good technology into practice. The companies that participate in the standard have their own incentives and obviously they want to maximize the returns on what they've done.

In principle I like the idea of requiring the most restrictive terms to be announced, so that decisions about which technology to use can be based not just on the capability of the technology but on the price and what it's going to cost investors and innovators and licensees down the road. What would be the harm of this? I don't really know. It might be that some good technology doesn't get into some standards because the firms that hold those patents decide, at the end of the day, that they'd be better off pursuing their own standard or licensing separately. And then the question is: would it be better for consumers to run the risk of getting very restrictive terms but to have the better technology? And by consumers, I include the future licensees. Or would it be better to have the price set up front?

ANTITRUST SOURCE: The America Invents Act provides for several changes to the country's IP landscape, including limitations on litigation and new mechanisms to improve upon patent quality. Going forward, are there specific changes that are of particular interest to the FTC?

SHELANSKI: Well, I think that anything that could improve patent quality is extremely important. And the chance to get post-grant reviews of patents might be very helpful in this regard. Obviously, it is costly for the PTO to engage in these kinds of reviews or take other measures to improve patent quality, but it is a necessary step.

Right now, I think most people acknowledge that the patent system is broken in a number of ways. It can be hard to find out who even owns a patent, who holds the patent, where has it been

transferred, who is the owner of record. So to even discover whether there is particular IP out there and who owns it can be extremely difficult. I can find out who owns virtually any piece of land in the United States, no matter how big or small. I cannot find out who owns a patent with certainty in many cases.

So there are lots of problems with the patent system, and those problems impose costs and risks on moving forward as an inventor, an innovator. So I think that having a patent system that is clearer, more reliable, and easier to navigate would be an extremely useful thing.

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There are other aspects of the America Invents Act that I think are difficult and that are obviously very controversial. The first-to-file change is one that has pros and cons, but certainly when we think about people or enterprises that are accumulators of vast numbers of patents, one has to ask where the balance tips with first to file. Companies that have big patenting operations that have their feelers out there in the marketplace for any kind of new technology that is emerging can run in and file now, get the patent, even if they were not the first inventor. And the incentive for small innovators may be to go to the existing large holders of IP with these large patenting operations and to try to cut a deal up front.

Part of the concern here is that market power through accumulation of IP and the amassing of IP will actually be exacerbated by first to file. This is not to say first-to-file is ultimately wrong, but it raises some hard questions. From an antitrust perspective, one question is whether first-to-file will increase the holdings of already large patent holders rather than allowing new entities to develop IP and compete with and offset some of the market power of some of the large IP portfolios.

So this is just one set of concerns that might emerge. But some of the other things in the America Invents Act I think are very helpful and mark a useful step forward in patent reform.

ANTITRUST SOURCE: In August of this year, the FTC issued a notice of proposed rulemaking regarding the issue of whether a transfer of exclusive rights to a pharmaceutical patent would be a reportable asset acquisition under the Hart-Scott-Rodino Act.[4] The public comment period closed in October. Do you have a sense of how BE will look at this issue and what perspective it will bring to help shape the pre-merger notification office's guidance to parties?

SHELANSKI: We're still in the process of looking at the comments that are coming in and this is certainly an issue that we're thinking about.

IP sometimes is really the business that is being transferred. So what might look like a mere IP transfer might really be a future line of business that is being transferred, and that has the same kinds of market power and competitive effect considerations that a merger has. But there are some offsetting considerations. But this is something that we're still in the process of reviewing, and beyond that I probably don't have a lot of comment on where we're likely to come out.

ANTITRUST SOURCE: It has been over two years since the Horizontal Merger Guidelines were revised.[5] Even though they didn't materially alter the approach of the agencies, have you noticed a change in how merging parties approach the agencies in discussing potential competitive effects?

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4 Premerger Notification: Reporting and Waiting Period Requirements, 77 Fed. Reg. 50,057 (Aug. 20, 2012) (to be codified at 16 C.F.R. pt. 801).

5 U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), *available at* http://ftc.gov/os/2010/08/100819hmg.pdf.

SHELANSKI: I have noticed a couple of changes. For one thing, unilateral effects, which became more prominent in the 2010 Guidelines, tend to be part of the early presentation and analysis that we get from merging parties. We often get diversion ratios and upward pricing pressure analyses being submitted early on, when there are differentiated product markets at issue. And this is very helpful to our analysis because it really goes directly to the effects question. And while market definition has remained a very important part of most merger investigations, the very quick and early focus on the likelihood of effects on who the closest competitors are, on what the diversion ratios might be, I think has been very helpful and has actually sharpened the analysis that we do in a number of transactions.

The other area, in section six of the Guidelines, we were much more specific about innovation effects. And so in cases that do involve an acquisition of a firm that is developing technology but might not yet be on the market, or where the incentive to introduce and innovate future products going forward from the transaction is important, we've seen a lot more focus on those issues.

So I think the Guidelines very usefully drove people to focus, to the extent possible, directly on effects and not to come in fighting over market boundaries right off the bat if there is more direct effects evidence. And we've seen more focus on the innovation aspects and the unilateral aspects. So I do think that it's been a useful change. Not a 180-degree turn or any kind of particularly radical change, but just a shift in emphasis that actually accords with the way staff internally had been looking at transactions for a long time. Staff didn't typically get a merger and immediately start calculating HHIs and worrying about market boundaries. What the Bureau of Economics staff typically tried to figure out is: what kinds competitive effects might arise? How do these firms behave toward each other and what might change as a result of the merger?

So I think it has been a useful change and it's led to a sharper focus on effects from the outset in our merger investigations.

ANTITRUST SOURCE: Have you observed areas where more clarity is needed to supplement the revised Guidelines yet?

SHELANSKI: I think that there is a lot that we're learning. We are still refining our application of different ways to analyze potential unilateral effects and to interpret the results of those analyses, as well has learning how to make that analysis more dynamic.

Under the coordinated effects section, we have a renewed focus on non-collusive but nonetheless oligopolistic outcomes, parallelism of a kind that might be natural oligopoly behavior but is non-collusive. We ask if a merger is not just going to increase the likelihood of collusion, but is a merger likely to make it easier for firms not to compete as aggressively against one another because of their ability to follow each another in greater transparency in the market?

We now have to sharpen our understanding of the market factors that are likely to lead to such coordinated effects. We will gain that through experience and through continued study of how markets behave. So, yes, there are areas in which we continue to try to fill in and supplement our knowledge and improve our review of mergers and acquisitions.

ANTITRUST SOURCE: I understand that you have been involved with other jurisdictions that have been considering revisions to their guidelines. Do you see the U.S. effort as a harbinger of change in other countries, or does our approach seem to be an outlier?

SHELANSKI: I don't think our approach is an outlier, but we certainly have differences. There are

jurisdictions that have been engaged in revision of their own guidelines and are very close to us. Certainly, we thought in very similar ways to the folks in the United Kingdom. In the European Union there's a lot of similarity but there are some differences on coordinated effects, between how we look at them and how the EU looks at them, for example.

In a number of jurisdictions that are putting guidelines in place, like Brazil, which has moved to a pre-notification regime, there are still some differences. We talk to them about how they do things. But I think that, at this point, our emphasis on some of the differentiated product market issues and how to analyze those, our somewhat broader notion of oligopoly effects beyond collusion, and our innovation analysis—I wouldn't say they're outliers but I would say we're running a bit ahead of most other jurisdictions on those.

I do think that glib assertions that the error costs of enforcement in high technology industries likely offset the benefits of enforcement need to be resisted, given some of the new research and the new approaches that economists are developing.

ANTITRUST SOURCE: There have been criticisms that standard antitrust analysis does not apply to innovative industries. In 2005 you wrote that "although a coherent and effective approach to innovation in merger policy will be difficult, the analysis suggests that the goal is achievable."[6] Do you still feel that way or do you believe that is has been achieved?

SHELANSKI: Innovation is a big issue for antitrust policy and enforcement. Anyone who thinks that competition policy or antitrust policy is the central issue in promoting innovation is missing the boat. But it's very hard to deny that how markets perform, how competitive markets are, how incumbent firms act, will have an impact on innovation.

It's just that the impact of conduct or transactions on innovation is likely to be more case-specific and harder to assess. Although there is increasing evidence that tends to support the benefits of competition for innovation, at least up to a point, I think that we're still working towards a clearer understanding of the relationship between antitrust and innovation. But I think things are promising and improving for the role that antitrust can play in an innovative industry. Does that mean that we always get it right? Not at all. There are risks of making big mistakes because of unforeseen changes to markets. It is very difficult often to understand what the universe of potential innovators is. It can be difficult to understand what the effect of market structure in a particular industry will be on innovation incentives.

That said, I think that we're starting to do a better, not worse, job in innovative industries. And I would point to a number of specific actions that would show that. To me, a great case is our decision to issue a complaint against the merging parties in Thoratec and HeartWare back in 2009. That was a merger in the medical device industry involving surgically implanted, left ventricular assist devices that keep hearts pumping during end-stage heart failure leading up to a heart replacement operation. In that case we were able to do a very nuanced analysis about the relative economic incentives of the merged firm versus the stand-alone target firm to introduce this new product and bring it to market. And that was a very focused kind of analysis that I think was very compelling.

In many cases you don't have the level of data that we had in that case. You can't always do a rigorous analysis of economic incentives to deploy new technology. And in those cases, the analysis remains challenging, but I do think that glib assertions that the error costs of enforcement in high technology industries likely offset the benefits of enforcement need to be resisted, given some of the new research and the new approaches that economists are developing.

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[6] Michael L. Katz & Howard A. Shelanski, *Merger Policy and Innovation: Must Enforcement Change to Account for Technological Change?*, *in* INNOVATION POLICY AND THE ECONOMY 109, 154 (Adam B. Jaffe, Josh Lerner & Scott Stern eds., 2005).

And while we have to be very careful and very modest when we go into digital industries, when we go into biotechnological industries, pharmaceutical industries, any high-technology sectors, information technology, while we have to be certainly modest about what we can and can't know about what the direction of the industry is, we often make good, case-specific decisions about whether a particular course of conduct or a particular transaction is likely or not to be helpful or harmful to that innovative process. Where we can't tell, we need to stand down. But I think we're getting better at telling whether or not something is good or bad for innovation.

ANTITRUST SOURCE: In a recent interview with *The Antitrust Source*, FTC Commissioner Ohlhausen stated that, in addition to competition policy, "economics ought to play an important role in the consumer protection side as well."[7] What role does BE currently play in consumer protection issues?

SHELANSKI: We have about twenty-five economists who are focused on consumer protection issues. So we play an important role in consumer protection issues. On the policy side, we do a lot of studies to try to determine what the incidence of certain kinds of violations of consumer protection laws there are. We examine various kinds of markets, like debt buyer markets and credit reporting markets, to see how well these markets work for consumers. Are consumers getting harassed to pay debts that they don't owe in any kind of systematically large way that would go beyond what is an acceptable level of error? Do they get complaints about mistaken credit reports fixed quickly enough?

So we do work on that front. We do tests and analyses to determine the likelihood that consumers were deceived in a harmful way by false advertising or by advertising that does not have sufficient substantiation in the research. We examine the extent to which consumers understand or might be misled by certain kinds of disclosures that firms make.

We also do a lot of work on the consumer protection side in analyzing what the consumer behavior response is to certain things consumers confront in the marketplace in order to figure out whether there is a likelihood of fraud, a likelihood of deception, a likelihood that consumers have been misled and paid for things that were not what they thought they were getting. So BE does a lot of work both in general policy studies and in specific cases across the board.

The Bureau plays a role in assessing the remedies on the consumer protection side. Remedies can be difficult on the consumer protection side. It's pretty clear that someone who defrauds consumers of their last dollar should be punished to the extent of the law and return the money. You really don't worry about deterring people engaged in outright fraud like that.

But imagine a case where a firm overstates the benefits of an actually beneficial product. So consumers gain by purchasing the product, but they might have overestimated what they would receive based on the advertising.

A remedy in that kind of case has to be more balanced and nuanced. You don't want to say the firm may not advertise the benefits at all, or must withdraw the product, or must issue a complete retraction of everything it has said about this product. The question then is not to over-deter the provision of good information by over-punishing the legal violation of putting forward an under-substantiated ad.

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[7] *Interview with FTC Commissioner Maureen Ohlhausen*, ANTITRUST SOURCE, Oct. 2012, http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/oct12_ohlhausen_intrvw_10_22f.authcheckdam.pdf.

And so we in BE, I think, can play a useful role in trying to help to craft remedies that keep the good information in and benefit consumers while keeping the bad information out. So we play a variety of roles in consumer protection, from policy studies, data analysis and reporting, providing expert support for litigations and support for investigations, and in assessing harm and crafting the remedies.

I think that consumer protection is going to be the area where behavioral economics plays a larger role sooner, and antitrust is an area in which we will continue to look at behavioral economics, and as systematic predictions develop, as robust results emerge, it may come to play a bigger role.

ANTITRUST SOURCE: There appears to be a significant interest in applying behavioral economics to competition policy. However, some have expressed reservations that it does not yield predictive models on which to base policy.[8] Is there a role for behavioral economics in antitrust? And, if so, what is it?

SHELANSKI: I think there is a role, but one needs to be very modest and cautious. There has been a lot written and a lot said about how behavioral economics fundamentally undermines the models on which we do antitrust analysis. And I think most people involved with antitrust enforcement, most people who think about competition issues, would disagree that there is some fundamental new paradigm shift in the works. But behavioral economics does supply insights into how consumers might respond to certain kinds of information, contracting practices, or pricing schemes. This can be very useful to understanding certain kinds of market performance and has led to greater modesty about imputing perfect foresight or rationality to consumers.

But one needs to understand that that is not the sign of a broader behavioral economics revolution in antitrust. That's something that's been happening for some time, at least since the Supreme Court's decision in the *Kodak v. Image Technical Services* case twenty years ago.

I think that consumer protection is going to be the area where behavioral economics plays a larger role sooner, and antitrust is an area in which we will continue to look at behavioral economics, and as systematic predictions develop, as robust results emerge, it may come to play a bigger role.

ANTITRUST SOURCE: You mentioned that consumer protection is the area where behavioral economics will play a role sooner. Is there a specific example of where you think that has been the case?

SHELANSKI: Well, you know, we had our drip pricing workshop here.[9] Behavioral economics has much to say about the ability of consumers to understand what they are buying, to make calculations about what the total price of a product is when they're subject to drip pricing. You know, you buy your airline ticket and then you've got to pay to get a bag on board, all these little things that occur in a variety of industries where the price that is quoted up front doesn't actually correspond to the total price you will pay by the time you are done. Behavioral economics can help us to understand the effects on consumers of these kinds of practices.

If consumers actually are misled for reasons that can be systematically discussed and systematically predicted, that would factor into our findings of harm for particular practices out there

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[8] *See, e.g.*, Joshua D. Wright & Judd E. Stone II, *Misbehavioral Economics: The Case Against Behavioral Antitrust*, 33 CARDOZO L. REV. 1517, 1548 (2012) ("Behavioral economics does not add significant explanatory power concerning the behavior of firms over and above existing theories. . . . Put bluntly, we do not believe that behavioral economics currently offers antitrust policy-relevant insights.").

[9] Fed. Trade Comm'n, A Conference on Drip Pricing, http://ftc.gov/be/workshops/drippricing/index.shtml.

in the marketplace and may affect the kinds of regulations we put forward or the kinds of enforcement actions that we bring.

ANTITRUST SOURCE: BE, and the economics profession generally, get a lot of attention when quantitative techniques can yield valuable insights into the likely impact of a particular transaction. But I'm sure there are cases in which there's just not a lot of data out there with which you can work your magic. What's the role of BE in those cases?

SHELANSKI: One role that BE would play would be to look at all of the factors we can know about the market. We can learn a lot about the characteristics of the market. Not just structural characteristics, but historically how the market and its participants have behaved, both on the supply and demand sides of a market. And so we can do a theoretical analysis of whether there is likely to be harm from a particular practice or transaction, given the state of economic knowledge and economic modeling.

The other thing we can do is to be creative in the data sources that we use. There may not be data from these particular firms or even from this particular market, but we may have experience and data from similar or related markets, from similar or related firms.

The other problem that we face, even when there is data, is that there are often multiple sources of data, multiple ways of looking at the data. And so a lot of what we do in BE, even when we have the data, is to slice and dice all the different sources of data every which way to see whether the results we get are robust or are sensitive to small changes in particular observations, particular sources, particular ways of dividing up the data.

In the end, even if we have the data and we can make the data tell a story that goes in a particular direction, we're not interested in blocking mergers that shouldn't be blocked. We're not interested in letting through mergers that should be blocked. We're interested in good results for competition, for innovation, and for consumers. So what we're always doing at BE is analyzing and investigating. And the question we're asking ourselves is, do we believe as an economic matter, using the best available theory and data and taking account of particular market facts, that there is a likelihood of harm in a given case? That will involve data, that will involve theoretical modeling, that will involve our experience with past cases, and it will involve the documentary evidence and testimony that the attorneys and economists here at the FTC obtain through the process of an investigation. ●