Sonos Statement for the Record
Online Platforms and Market Power Part 5: Competitors in the Digital Economy

<u>How Sonos would change current predatory pricing rules</u>

Sonos believes that the current standard for evaluating predatory pricing claims does not adequately capture the competitive realities of digital markets. The governing standard established in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, [509 U.S. 209](#) (1993), requires a showing of below-cost pricing and "a dangerous probability" of recoupment. *Id*. at 222-24. Because *Brooke Group* involved a physical good in an oligopolistic market, this standard unnecessarily places too high of a burden for a showing of harm when applied to digital markets.

Unlike physical goods, digital markets can exhibit network effects and investors like VCs are often willing to make long term bets on products or companies that lose money until their dominance is established. *See* Lina M. Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710, 786-790 (2017). The network effects of digital markets make recoupment hard (if not impossible) to observe, much less demonstrate.

For example, Google gets more consumer data as a result of underpricing its speakers, which allows it to strengthen its targeting algorithms and thereby maintain its margins in search advertising against what might otherwise be price erosion. The result is that predation and resulting harm to competition is both more likely and more unlikely to be captured by the *Brooke Group* framework.

Three considerations, when applied to conduct by dominant firms in digital markets, warrant an update to how recoupment should be evaluated:

First, the time frame for evaluating recoupment should be extended beyond the two-year horizon usually relied upon to predict competitive harm. A targeted underpricing strategy for many years can be especially effective in digital markets, where network effects may accelerate (or increase the probability of) a platform's dominant position. The time horizon for showing recoupment under current law does not reflect the harm that stems from a targeted long-term underpricing strategy.

Second, the assessment of recoupment should not be limited to the market in which the below-cost pricing occurred. Dominant companies increasingly are recouping below-cost pricing in other product markets. Recoupment has and will continue to occur in markets for substitutes, complements, and replacement goods. *See* Christopher R. Leslie, *Predatory Pricing and Recoupment*, 113 COLUM. L. REV. 1695, 1721 (2013). Importantly, companies like Google and Amazon have numerous ways in which they can recoup, some of which may be difficult for plaintiffs or enforcers to capture fully because of Google and Amazon's many business lines and use of data.

Alternatively, the recoupment requirement could be eliminated for digital markets that exhibit strong network effects. This would be consistent with the common-sense notion that a monopolist only would engage in below-cost pricing if it intends to recoup the resulting short-term losses. Further, the remaining requirements to demonstrate below-cost pricing -- market power and strong network effects -- would substantially reduce the risk of condemning genuinely pro-competitive behavior.

How to think about IP misappropriation in the context of antitrust

IP misappropriation, on its own, is not normally an antitrust violation. Sonos recognizes that it is important to distinguish pure IP or contract issues from antitrust issues. But when a dominant firm uses its market power to obtain access to, refuse to pay for, or otherwise prevent the enforcement of patented technology that the monopolist incorporates into its products, that infringing activity can harm competition just like other competitive disputes involving contracts (e.g., exclusive dealing provisions) or hiring practices (e.g., agreements not to poach employees).

Sonos believes that the antitrust or patent law should be refreshed to make clear that the antitrust laws should be used to remedy the following IP-related conduct that also can result in harm to competition:

When a company leverages its dominance to immunize itself from paying for infringing IP, such as through overbroad defensive termination provisions in business partnerships. This practice, which is becoming increasing common by dominant firms, has the effect of artificially decreasing the dominant firm's product input costs relative to competitors. It is well-recognized under antitrust law that IP rights are evaluated the same as other types of property. Since the antitrust laws condemn unlawful efforts by monopolists to artificially depress product input costs (e.g., monopsony power), the same should hold true with respect to monopolist efforts to artificially suppress the cost of necessary IP inputs.

When a company uses its dominant (or otherwise essential trading partner) status to gain valuable, competitively-sensitive data that it: (a) otherwise would not have access to, and (b) uses to compete against its partners/suppliers. This scenario is different than simply creating a product that infringes (either innocently or willfully) a competitor's patents because, in that scenario, the infringement is not the result of the improper use of market power. (Although it still is a legal misappropriation redressable by patent law.) But when the act of infringement would not occur "but for" the exercise of market power (i.e., getting access to non-public, competitively-sensitive data through "must have" business partnerships), it is a legal wrong that distorts lawful competition in addition to violating patent law.

The above provisions are necessary not only to prevent the distortion of competition, but to preserve the purpose of the constitutionally-mandated patent laws. Patents grant their owners the right to exclude the practice of covered inventions for a limited period, to encourage incentives to innovate. But the practices described above turn that system upside down. Instead of enabling patent owners to exclusively practice their inventions, the use of market power to artificially deflate IP input costs creates something akin to a compulsory licensing regime.