Written Testimony of Patrick Spence

Chief Executive Officer, Sonos, Inc.

House Judiciary Committee
Antitrust, Commercial and Administrative Law Subcommittee
January 17, 2020

I'd like to thank Chairman Cicilline, Ranking Member Sensenbrenner, and distinguished members of the Committee for the opportunity to appear before you to address critically important issues around competition and innovation.

My name is Patrick Spence, and I am the Chief Executive Officer at Sonos. It is my privilege to lead a company that reflects a classic American success story. Sonos was founded in 2002 by a handful of entrepreneurs in Santa Barbara, California who imagined a better way of enjoying music throughout your home. At the time, playing music at home meant coils of wires snaking between bulky components inside your house. The founders of Sonos envisioned a better way: using new, emerging technologies to make it simple to play high fidelity music in any room of your home, and to do it all wirelessly. The critics said we would never succeed. But we placed a bet that the wireless internet and streaming music would be game changers. And we were right.

Today, Sonos has nearly 1,500 employees and our products have been welcomed into more than 9 million homes around the world. We bring in approximately $1.3 billion in revenue annually. Our revenue and profitability has been growing by double digits per year for several years running. In mid-2018, we enjoyed a successful initial public offering — another rite of passage for many up and coming American companies. Our products include smart speakers, soundbars, subwoofers, and amplifiers that work together as a system, providing a seamless customer experience. We have some of the finest hardware and software engineers in the world working out of our offices in Boston, Seattle, Santa Barbara and San Francisco. We focus on consumer choice. You can listen to over 100 different audio streaming services on Sonos, including Spotify, Tidal, and Apple Music. Recently, we launched successful partnerships with Ikea, Best Buy, Costco, and many other household names.

The scope and scale of Sonos's innovation is reflected in our portfolio of more than 750 patents, a number that continues to grow every year as our innovation never stops. Our technology underpins many innovations in what is now known as "the smart home." Smart speakers are a combination of hardware (such as chips, transducers, electronics) and software (that exists on the device and in the cloud). Sonos employs a world-class design team and we hire top-notch software developers, along with many other talented employees who help us bring our products to market.

Our business model is simple — we sell products which people pay for once, and we make them better over time with software updates. We've achieved success without trying to monetize the data of our customers. We live by the mantra that if we keep making great products, customers will recognize that, and come back and buy more over time. Nearly 40% of our typical customers buy a Sonos product and enjoy it so much they buy another one. We have been shipping products for 16 years, and an astounding 93% of our products are still in use. Keep in mind these are computers — how many of you are still able to use a computer or mobile phone you had 16 years ago? We're proud of this, as we've always tried to build products that last for a long time. This stands in stark contrast to "disposable" tech, where people are encouraged to buy a new product every few years. We are focused on doing one thing really well — providing great sound experiences for customers.

I welcomed this Committee's invitation to testify because I'm gravely concerned that the market conditions that allowed Sonos to innovate and thrive — and many smaller companies like us — are endangered by the rise of a small group of companies with unprecedented size, scale, and dominance. And although I appear with a bit of trepidation as it may impact the willingness of these companies to provide us access or to partner with us, Sonos is strong enough and successful enough to say what goes largely unspoken, but remains very much on the minds of countless tech entrepreneurs at smaller firms and people thinking about starting new businesses. One reason they do not speak up is that they're afraid of how dominant platforms could retaliate against their businesses. This is one of the many reasons we believe that this Committee needs to act urgently to support the next set of big ideas and to create a fair playing field for smaller technology companies. If we do nothing, America's leadership in innovation will suffer with inevitable negative long-term consequences for American consumers and the economy as a whole.

We need to preserve competition in technology

As your Committee has heard over the previous year, competition in many technology markets is being restricted by a few dominant players. But let me start by saluting those companies. They were born of exceptional innovation. They have built tremendous value for their shareholders and created jobs for thousands of employees. They offer some excellent products and services that have improved consumers' lives. At Sonos, we value our partnerships with them.

But we also know from hard experience that they have come to use the scope of their platforms and their overwhelming dominance in certain markets to unfairly disadvantage competitors and squelch potential competition.

I would like to focus on two phenomena in particular. First is the leveraging of dominance in one market to conquer or destroy adjacent markets, especially markets that may one day pose a threat to their dominance. Second is the exploitation of their role as essential business partners to tilt the playing field in favor of their own products and services.

Leveraging of dominance in one market to conquer or destroy adjacent markets, such as smart speakers

Take the smart speaker market in which Sonos participates. At one time, smart speakers were something of a niche product enjoyed mainly by audiophiles. But with the advent of voice technology, smart speakers have been transformed into the latest gateway to the internet. They connect you not merely to the music you love, but also to many of the most important services available on the internet, from search to e-commerce. And they also are used to connect and control a host of other smart home devices, such as lighting, thermostats, security, and even kitchen appliances.

For the dominant platforms, Google and Amazon specifically, technological development in smart speakers presents a potential threat and an enormous opportunity. The threat is that if someone else were to control the smart speaker market, they might stand between those companies and their customer base. The opportunity is to dominate yet another important consumer market and, even more critical, to use smart speakers to collect vast amounts of consumer data which can be monetized on their already dominant and enormously profitable existing platforms.

Google and Amazon have responded to the rise of the smart speaker market in similar fashion: they have flooded the market with dramatically price-subsidized products. Indeed, they make no pretense of the fact that the products themselves are money losers and they routinely give them away at steep discounts, even for free. It is difficult to predict the impact that voice assistants will have on search and e-commerce, but voice activated speakers have the potential to dramatically alter the way that consumers interact with the internet. We believe that Google and Amazon have been willing to forgo profits in smart speakers for this reason, in addition to their ability to monetize the valuable household data that these products vacuum up. And if voice purchasing and voice search do become the next big thing, they will own the market because their strategy is succeeding. Those two companies now control roughly 85% of the U.S. smart speaker market. Google just announced that it had sold 500,000,000 smart home products. Amazon is in the same league. It’s not because their hardware businesses are profitable in and of themselves.

That kind of market distortion — the leveraging of profits from one dominant platform to subsidize the conquest of another that poses a potential competitive threat in the future — may benefit consumers in the short-term through lower prices. But it’s terrible for the innovative dynamic created by robust and fair competition because it hamstrings those companies that have better products that cannot be sold at a loss. And what happens when dominant platforms have so poisoned this market through price subsidization that no one else is left? Long-term this could mean price increases and prevent new entrants. It also dries up the venture capital new companies need to develop the next great inventions and bring them to market. Venture capital firms are well aware of the kill zone that surrounds start ups that pass within striking distance of the dominant platforms — they stay away from those investments.

Separate and apart from the issue of price subsidies is the issue of platform dominance — the fact that a handful of very large companies are essential partners for pretty much every technology business — and because they are so essential to reach consumers these companies can, and sometimes do, engage in practices that again unfairly harm competitors, restrain innovation, and ultimately harm consumers.

Here, again, I'll focus on Sonos's business, though I have no doubt our experience is in many significant ways illustrative of broader truths.

Google operates an irreplaceable platform for advertising, controls one of the two dominant voice assistants (Google Assistant), controls one of the two dominant mobile operating systems our products operate on (Google Android) offers office productivity tools, and provides a popular music service (YouTube Music). Amazon is far and away the most important e-commerce channel, it runs one of the fewer and fewer viable, large scale cloud services platforms (AWS), it owns the other dominant general voice assistant (Amazon Alexa), and it too has a popular music service that it ties to other services (Amazon Prime Music). Given these companies' dominance in certain essential services, you have to do business with them. They are like platforms or basic infrastructure. In many respects, the relationships are productive and mutually beneficial, as these firms also value access to Sonos's large and growing customer base.

But dominance comes with its prerogatives. To gain access to their platforms and integrate with their services, these companies issue all manner of take-it-or-leave-it demands, from early and technically detailed access to our product roadmaps, to proprietary business data, including sales forecasts, to waivers of essential contractual rights.

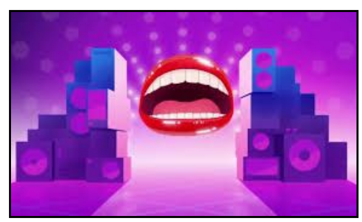
New ideas are being suppressed and we're losing innovation

Google has gone so far as to dictate what features we can have in our products. To take a particularly egregious and anti-consumer example, Sonos has developed the technical ability to host multiple voice assistants on its smart speakers simultaneously, which we call voice concurrency. In a product using this technology, you can call upon whichever voice assistant you want (including more than just the two dominant assistants) and the system will channel you into your chosen service automatically. This is a feature that customers told us they wanted and which requires complex engineering, and we worked hard to invent it. But Google demanded as a condition of having Google Assistant in our products that we never allow concurrency with another general voice assistant. As a result, today a Sonos customer must open an application and manually choose which single voice assistant will be configured on their device. This restriction is bad for consumers. (To its credit, Amazon embraced this choice-promoting "concurrency" concept and has even helped create a coalition to promote the idea.) And the fact that Google has the power to impose this restriction on others is bad for the structure of the economy.

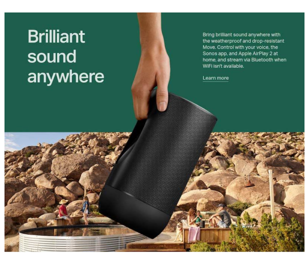
Using their role as essential services to tilt the playing field in favor of their own products

All this would be bad enough, but the issue is dramatically compounded when these companies then decide to use what they've learned about your business to produce remarkably similar products and to use those products to compete with you. Dominant platforms are able to develop copycat products by analyzing sales metrics on their platforms and combining them with rich data profiles of their customers. These copycat products are then sold at cost or lower, with no intent to reap a profit. They also can use remarkably similar trade dress and marketing campaigns.

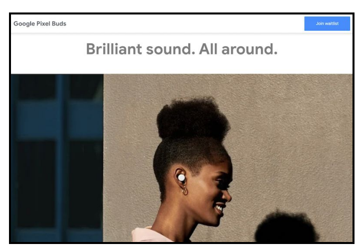
Sonos ad (2017)



Amazon ad (2018)



Sonos ad (2019)



Google ad (2019)

Our recently filed patent infringement case against Google makes the point. In 2013-14, we gave access to our technology to Google as part of a partnership to provide Google's music service to our customers. Then, in 2015 Google started producing more and more products that copy our key functionalities and infringe on our foundational intellectual property.

Sonos Play 5 (2015)

Google Home Max (2017)

We debated long and hard about whether to file suit and we spent years trying to reach a fair accommodation with Google precisely because they are such an important partner. We enjoy working with their teams and using their products, and we've built relationships with their employees. At some point, though, we just couldn't keep turning a blind eye, even at some risk of retaliation that would hurt our business. A lot of companies can't take such risks and are left to suffer silently.

Solutions

As CEO at Sonos, I'm a big believer in self-reliance, and I think that companies can take proactive measures to insulate themselves from dominant platforms. I've outlined steps such as focusing on doing one thing better than everyone else; winning through innovation, maintaining tight financial discipline; accepting money only from investors with a long-term vision; protecting your intellectual property; and maintaining focus when dominant firms enter your market.

There are moments, however, when a re-evaluation of existing law and policy is necessary. In that spirit, we welcome this Committee's work. Independent companies have never been more vital to the future we want to live in. Because people deserve choices. And because fair competition breeds creativity and progress.

Right now, many markets have not yet reached a tipping point beyond which government action would be rendered ineffective. At the same time, action is required before the "network effects" intrinsic to the digital age fully insulate dominant firms from future competition. There is no doubt that technology quickly evolves — but that does not mean responsible scrutiny and enforcement is not possible.

I am not a lawyer of any kind, much less an expert in antitrust. But my experience as a tech executive suggests some important areas for your exploration.

Do the rules around predatory pricing make sense in today's economy?

How do we limit the power of dominant players to leverage their business insights to create copycat private label products?

How do we protect smaller firms from retaliation by dominant players for the assertion of legal rights?

Should there be stronger firewalls between different business segments of the dominant platform players?

How can we encourage interoperability and greater access to dominant platforms, so that consumers, and businesses, can choose what's best for them?

A lot is at stake in finding smart answers to these and similar questions. Indeed, the future of American innovation depends on it. Thank you for your attention and I look forward to answering your questions.