

“Hot Topics” in Intellectual Property

Presented by The Michelson 20MM Foundation & Intellectual Property Owners Education Foundation



How Can We Stop Chinese Theft of American Intellectual Property?

David Kline

The latest figures indicate that the total cost of patent infringement, pirated software, counterfeit goods, a theft of trade secrets costs the U.S. economy somewhere between \$225 billion to \$600 billion each and every year. And according to the official Commission on the Theft of American Intellectual Property, “China remains the world’s principal IP infringer.”

But a recent deal between two companies — one Chinese, one American — suggests that tariffs, sanctions, and even trade wars may not be the best way to stop Chinese IP theft.

Xiaomi (pronounced *shauw-me*) is one of the more successful companies to emerge from China’s entrepreneurial boom. Seven years ago, it didn’t even exist. Today Xiaomi is the 5th largest smartphone maker on the planet, selling more phones in China (70 million) than Apple. Until recently, it was the most valuable startup in the world, but Uber now has that title.

For Xiaomi, the biggest hurdle to its global expansion is the need to secure the IP rights to the components used in its products — including the patented wireless and digital audio components in smartphones. Without these IP rights, Xiaomi would find its future plans to sell phones in the U.S. stymied by patent infringement lawsuits, and its products even barred from the American market.

So although Xiaomi would like to secure IP rights, it is constrained by the very thin margins that make its phones so affordable — only \$285 for Xiaomi’s most popular phone, or less than half the cost of an iPhone.

That’s where Via Licensing, a subsidiary of American audio pioneer Dolby Laboratories, comes in. Via licenses the rights to the core digital audio technologies developed by 10 global technology leaders, including Dolby, who participate in its Advanced Audio Coding (AAC) patent pool. These audio rights had been licensed by 805 manufacturers worldwide — but until this year, not a single Chinese smartphone maker.

Now, during America’s early industrialization period, it too was a notorious IP pirate. Only after indigenous American authors and publishers began demanding stronger copyright protections to prevent their own creative work from being stolen did the U.S. finally comply with international copyright norms.

China is following a similar path from IP piracy to IP compliance. And it’s true — as Chinese industry has become more R&D intensive, Chinese businesses themselves have begun to demand stronger IP protections precisely to safeguard their own investments in R&D.

And in point of fact, Xiaomi was not trying to steal IP? They were simply looking for deal terms that fairly reflected the more challenging economic realities of emerging markets like China, where profit margins, product selling prices, and the value and enforceability of patents are all much lower than they are in advanced economies like the U.S.

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Yet oddly, Western rights holders had always assumed that licensing on a “fair, reasonable, and non-discriminatory” (FRAND) basis meant charging every product maker, whether Chinese or American, the same rates for patent rights — even though, again, product margins and patent values are much lower in China.

But is that really fair? The price of every other product, from autos to shoes, varies widely from region to region depending on component prices, the cost of labor, and other local factors. Why should patent rights somehow be exempt from local pricing influences?

So Via and Xiaomi came up with a more balanced definition of “fair, reasonable and non-discriminatory” that took into account China’s economic realities.

Here is what they negotiated: For Xiaomi products sold in emerging markets like China and India, Via offered an optional alternative royalty structure that yields up to a 35% discount compared to the standard royalty rate for products sold in developed markets like the U.S.

With this deal, Via became the first Western patent licensor to voluntarily adjust its rates to reflect local market realities. And Xiaomi became the first Chinese smartphone maker to license the entire pool of standards-essential audio patents. The two companies also established a migration path to further IP compliance in wireless and other technologies.

Is the Xiaomi-Via deal a model for resolving trade and IP tensions between the U.S. and China? The alternative is for our two nations to turn what is essentially just a *business* dispute into an ideological confrontation. And in confrontations, one or both sides always lose.

Better to follow Via’s and Xiaomi’s approach and practice “the art of the deal.”