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(ENDORSED)  
**FILED**

MAR - 8 2012

DAVID H. YAMASAKI  
Chief Executive Officer/Clerk  
Superior Court of CA County of Santa Clara  
BY Felicia Samoy DEPUTY

SUPERIOR COURT OF THE STATE OF CALIFORNIA  
FOR THE COUNTY OF SANTA CLARA

DVD COPY CONTROL ASSOCIATION,  
INC., a Delaware corporation,

Plaintiff,

v.

KALEIDESCAPE, INC., a Delaware  
corporation,

Defendant.

Case No. 1:04-CV-031829

**STATEMENT OF DECISION**

Complaint Filed: December 7, 2004  
Trial Date: November 14, 2011  
Dept.: 16  
Judge: Hon. William J. Monahan

1           **This civil court trial came on for hearing before the Honorable William J. Monahan in Dept.**  
2 **16, beginning at 10:00 a.m. on November 14, 2011. Plaintiff DVD Copy Control Association, Inc., a**  
3 **Delaware corporation ("Plaintiff" or "DVDCCA" or "DVD CCA") appeared by counsel, including**  
4 **Steven Zager, Esq., Reginald Steer, Esq., Maria Ellinikos, Esq., Teresa Ghali, Esq., John Grantham,**  
5 **Esq., Mark Lambert, Esq. and Mark Weinstein, Esq. Defendant Kaleidescape, Inc. ("Defendant" or**  
6 **"Kaleidescape") appeared by counsel, including Allen Ruby, Esq., Steven Ellenberg, Esq., Nancy**  
7 **Tompkins, Esq. and Richard Weibe, Esq. Both sides waived a jury (and in any event, only equitable**  
8 **relief [an injunction] was sought), and the matter proceeded by court trial. At trial witnesses were**  
9 **sworn and testified, and documents were admitted into evidence. Closing arguments were heard on**  
10 **December 7, 2011.**

11           **The Court, having heard and considered the arguments, evidence and testimony presented, as**  
12 **well as Kaleidescape's Request For a Statement of Decision [and its objections, proposals and**  
13 **comments] with respect to the Court's Tentative [and the Plaintiff's Proposed] Statement of Decision,**  
14 **the Court's Tentative [and the Plaintiff's Proposed] Judgment, [and the Plaintiff's Proposed Permanent**  
15 **Injunction], including but not limited to all proposals, objections, comments and other documents**  
16 **submitted by either party regarding the tentative or proposed statement of decision, the tentative or**  
17 **proposed judgment and the proposed injunction, including but not limited to the revised and second**  
18 **revised proposed permanent injunction by each party, and the Court having held a hearing on February**  
19 **27, 2012, at Kaleidescape's request regarding any objections, proposals and comments before it issued**  
20 **its statement of decision, judgment and permanent injunction, the matters having been submitted, and**  
21 **good cause appearing, orders as its statement of decision as follows:**

22           **The Court notes that Plaintiff's Request for Judicial Notice of a Kaleidescape Patent**  
23 **Application was granted at the hearing on February 27, 2012; however, after review of the document,**  
24 **it did not find it useful. Accordingly, it did not affect this Court's decision.**

25           **The Court also finds that the Declaration of Michael A. Malcolm in Support of Kaleidescape,**  
26 **Inc.'s Proposed Alternative Injunction dated February 17, 2012, discussed at the hearing on February 27,**  
27 **2012, was unpersuasive. His self-serving declaration, as the Chief Executive Officer of Kaleidescape,**  
28 **is biased and argumentative that only his terms regarding the injunction should be allowed.**

1 **I. INTRODUCTION**

2 Plaintiff DVD Copy Control Association, Inc. ("DVDCCA") licenses the Content Scramble  
3 System ("CSS"). CSS is the security technology that protects against unauthorized consumer  
4 copying of copyrighted content on DVDs. DVDCCA licenses CSS to companies that make and sell  
5 products that allow consumers to watch DVDs. It is licensed through the uniform CSS License  
6 Agreement ("License Agreement"), which requires licensees to comply with CSS Specifications.  
7 DVDCCA interprets the License Agreement and CSS Specifications to require CSS-licensed  
8 products to play the CSS-protected content on DVDs from the physical DVD disc, not from a  
9 permanent copy of the DVD content stored on a server or hard drive; DVDCCA refers to this as the  
10 playback from disc requirement. DVDCCA brought this lawsuit in 2004, alleging that Defendant  
11 Kaleidescape, Inc., a CSS licensee, has breached the License Agreement and CSS Specifications by  
12 using CSS to build and sell a home entertainment system, the "Kaleidescape System," that copies  
13 DVD content to a server for unlimited future playback without the physical DVD disc.

14 Following an initial bench trial, the court (the Honorable Leslie Nichols) held that the  
15 General Specifications, on which DVDCCA based its breach of contract claim at the first trial, are  
16 not part of the License Agreement, and entered judgment for Kaleidescape. DVDCCA appealed, and  
17 the Court of Appeal reversed and remanded. It held that the General Specifications are CSS  
18 Specifications and thus are part of the License Agreement. (*DVD Copy Control Assn., Inc. v.*  
19 *Kaleidescape, Inc.* (2009) 176 Cal.App.4th 697, 718 [hereinafter "*App. Op.*"].) The Court of Appeal  
20 also held that Section 2.1.2 of the General Specifications requires that playback of DVDs on devices  
21 subject to that provision must "be performed utilizing the physical DVD." (*Id.* at p. 720.) Because  
22 the issue of breach was not before it, the Court of Appeal did not decide whether Kaleidescape has  
23 breached Section 2.1.2 of the General Specifications. It left it for this Court on remand to determine  
24 if the Kaleidescape System is subject to and breaches that provision. The Court of Appeal also  
25 instructed that if a breach is found on remand, this Court should determine "the nature and extent of  
26 the harm DVDCCA would suffer as a result of a continuing breach," and whether that harm can be  
27 "remedied in damages." (*Id.* at p. 727.) If monetary relief is inadequate, the Court of Appeal  
28 instructed, then the parties' contractual stipulation in Section 9.2 of the License Agreement that a

1 breach will cause irreparable harm to DVDCCA, for which the remedy of a permanent injunction is  
2 warranted, is controlling and must be enforced. (*Ibid.*)

3 On remand, the case was tried before this Court in a bench trial from November 14 through  
4 December 7, 2011. This Court has considered the Court of Appeal's rulings and instructions, the  
5 evidence that the parties have presented, and relevant judicial decisions, including the federal district  
6 court decision in *RealNetworks, Inc. v. DVD Copy Control Assn., Inc.* (N.D. Cal. 2009) 641 F.  
7 Supp.2d 913, which interpreted the CSS License Agreement and the same CSS Specifications at  
8 issue here to require CSS-licensed products to play back DVDs from the physical DVD disc, not  
9 from copies stored on a hard drive. Based on the law and the evidence, the Court concludes as  
10 follows:

- 11 • There was a contract between Kaleidescape and DVDCCA.
- 12 • DVDCCA did all or substantially all of the significant things the contract required it to do.
- 13 • The Kaleidescape System is subject to Section 2.1.2 of the General Specifications because it  
14 is a device that contains or incorporates a DVD Drive and CSS Decryption Module.
- 15 • The Court of Appeal's ruling that Section 2.1.2 of the General Specifications imposes a  
16 playback from disc requirement is the law of the case and thus is binding on this Court.
- 17 • Even if the Court of Appeal's reading of Section 2.1.2 of the General Specifications were not  
18 the law of the case, this Court's independent interpretation of the provision and the License  
19 Agreement as a whole, as informed by the evidence and expert testimony at trial and the  
20 reasoning of the federal district court in the *RealNetworks* case, is that it imposes a playback  
21 from disc requirement and forecloses copying of CSS-protected content from DVDs onto a  
22 hard drive or server for playback without the physical DVD disc.
- 23 • Kaleidescape has breached Section 2.1.2 of the General Specifications because it is  
24 undisputed that the Kaleidescape System uses CSS to create a permanent copy of CSS-  
25 protected DVD content on a server for playback without the physical DVD disc.
- 26 • For the same reason, Kaleidescape has breached other provisions of the CSS Specifications  
27 on which DVDCCA has based its claim for breach of contract on remand and which, like  
28 Section 2.1.2 of the General Specifications, impose a playback from disc requirement and

1 forecloses copying CSS-protected content from DVDs onto a hard drive or server for  
2 playback without the physical DVD disc.

- 3 • Additionally, Kaleidescape has breached provisions of the License Agreement and CSS  
4 Specifications that prohibit licensees from using CSS to circumvent the methods and  
5 obligations imposed by the CSS Specifications.
- 6 • The nature and extent of the harm that DVDCCA would suffer from a breach by  
7 Kaleidescape cannot be adequately remedied through money damages, and thus the parties'  
8 contractual stipulation in Section 9.2 of the License Agreement that a permanent injunction is  
9 warranted to remedy a breach is controlling and must be enforced.

10 In light of these holdings, the Court will enter judgment for DVDCCA and against  
11 Kaleidescape, and will enter an order for a permanent injunction.<sup>1</sup>

## 12 II. FACTUAL BACKGROUND

### 13 A. CSS.

14 When the DVD format was first developed, companies in the entertainment industry were  
15 reluctant to release copyrighted content on DVDs absent some means of protecting against the  
16 unauthorized copying of that content. (Deposition of Andrew Parsons, 8/31/11, 137:1-9; Deposition  
17 of Alan Bell, 2/23/07, 28:12-29:11.) This concern was well-founded because the digital format of  
18 DVDs means that any copy of the content on a DVD is a perfect digital copy that offers a high  
19 quality, premium viewing experience. (11/16/11 PM Tr. 66:15-24 [Testimony of Dr. John Kelly];  
20 *App. Op., supra*, 176 Cal.App.4th at p. 703.) For their part, companies in the consumer electronics  
21 and information technology industries that make devices that play back DVDs for viewing sought an  
22 effective copy protection system that would not add significantly to the price of their products or  
23 interfere unduly with the products' operation. (Parsons Dep., 8/31/11, 137:10-25.) The three  
24 industries recognized they shared a common interest in delivering digital content to consumers on  
25 DVDs, and so they worked together to address and accommodate their respective copy protection  
26  
27

28 <sup>1</sup> At trial, Kaleidescape failed to meet its burden of proof on its affirmative defenses that it advanced in its amended answer on remand.

1 concerns. The solution they agreed upon was CSS. (Parsons Dep., 8/31/11, 136:12-20, 138:11-22;  
2 Bell Dep., 2/23/07, 29:12-18.)

3 DVDDCA's technical expert, Dr. John Kelly, testified at trial on how the copy protection  
4 mechanisms of CSS work. Dr. Kelly explained that CSS "scrambles" movie content, referred to as  
5 Audio-Visual, or "A/V" data, that is recorded onto the DVD Disc. On the DVD Disc, the A/V data  
6 is then "locked" using a series of interconnected encryption keys. This process locks the DVD so  
7 that it will not play, unless and until the content is descrambled using the CSS keys and related  
8 processes. The keys used to unlock the scrambled A/V data are the Title Keys. CSS, in turn,  
9 encrypts the Title Keys and hides them in a special area of the DVD Disc known as the Sector  
10 Header. The encrypted Title Keys are unlocked using the Disc Key and the Title Key Recovery  
11 Algorithm. CSS then encrypts the Disc Key into a form called the Secured Disc Key Set (or Secured  
12 Disc Key Data) and hides it in a separate area of the DVD Disc known as the Lead-in Area. The  
13 Disc Key is decrypted by a Master Key that resides inside a CSS-enabled playback device, using a  
14 process called the Disc Key Recovery Logic. (11/17/11 AM Tr. 22:9-23:21, 36:16-37:15 [Kelly].)

15 CSS also imposes restrictions on the devices that are used to play back DVDs. When a  
16 playback system consists of a DVD Drive and a CSS Decryption Module, the DVD Drive and the  
17 CSS Decryption Module must "authenticate" one another to ensure that both devices are authorized  
18 to engage in playback of CSS-protected content. A CSS Decryption Module consists of two parts:  
19 (1) an Authenticator Module for CSS Decryption Module, and (2) a Descrambler; it is connected to a  
20 DVD Drive so that it can receive, decrypt, and descramble transmissions of data from the DVD  
21 Drive. (11/17/11 AM Tr. 24:20-25:2 [Kelly].) In order for playback to occur, the CSS Decryption  
22 Module must have access to the encrypted Disc Key (the Secured Disc Key Data) and the Encrypted  
23 Title Key, and to obtain that access, the keys must be sent by the DVD Drive to the CSS Decryption  
24 Module. The DVD Drive has its own Authenticator Module, which communicates with the  
25 Authenticator in the CSS Decryption Module through a specified exchange of data using an  
26 Authentication Control Code. This process is called "mutual authentication," and its purpose is to  
27 transmit the encrypted Disc and Title Keys to the Descrambler, which is the part of the CSS  
28 Decryption Module that decrypts those keys and uses them to descramble the A/V data for playback.

1 If authentication does not occur, data will not be transmitted from the DVD Drive to the CSS  
2 Decryption Module. (11/17/11 AM Tr. 25:3-22; 27:3-16; 28:3-29:19 [Kelly].)

3 After mutual authentication, the DVD Drive and CSS Decryption Module perform a process  
4 called "bus encryption" and "bus decryption." DVD Drives transmit data to other computing  
5 components over a collection of wires, referred to as a "bus." (11/17/11 AM Tr. 26:4-27:2 [Kelly].)  
6 Because busses are not secure, CSS requires that the Disc Key and the Title Key be encrypted with  
7 an additional layer of protection, beyond the encryption that protects them on the DVD Disc, when  
8 they are transmitted from the DVD Drive to the CSS Decryption Module over the bus. This layer of  
9 protection is called bus encryption. The process of bus encryption creates yet another key, known as  
10 the Bus Key, which is a "time variable" key that is generated by the Authenticator in the DVD Drive  
11 and the Authenticator portion of the CSS Decryption Module. (11/17/11 AM Tr. 29:13-30:4  
12 [Kelly].) The bus key is "time variable" because a new bus key is generated each time that a key is  
13 sent over the bus. (*Id.*)

14 After bus encryption, the bus encrypted Title Key and the bus encrypted Secured Disc Key  
15 Data are transmitted from the DVD Drive to the CSS Decryption Module. (11/17/11 AM Tr. 30:5-  
16 31:9 [Kelly].) The Authenticator Module in the CSS Decryption Module then performs bus  
17 decryption and connects to the Descrambler. Bus decryption is completed when the encrypted Title  
18 Keys and Secured Disc Key Data are transmitted to the Descrambler. (*Id.* 31:13-32:4, 46:6-47:2  
19 [Kelly].) The Descrambler then uses the Master Key and the Disc Key Recovery Logic to obtain the  
20 Disc Key; uses the Disc Key and the Title Key Recovery Algorithm to decrypt the Title Key; and  
21 uses the Title Key to unscramble the A/V data sector by sector from the DVD Disc. (*Id.* 31:13-33:20  
22 [Kelly].) This process will fail if a DVD Disc is removed from the DVD Drive. (*Id.* 35:1-6 [Kelly].)

23 Dr. Kelly testified that CSS uses these processes to provide "end-to-end" security of the CSS  
24 keys and A/V data during the playback process and protect them from interception and copying  
25 through utilization of the CSS-protected DVD for playback. (11/16/11 PM Tr. 67:24-69:17, 70:4-  
26 72:8 [Kelly].)

27 **B. The DVDCCA.**  
28

1 The DVDCCA was formed to serve as the licensor of CSS. (3/22/07 Tr. 142:16-143:4,  
2 157:24-26 [Testimony of Alfred Perry]; Deposition of Peter Biddle, 2/9/11, 54:17-54:23; Parsons  
3 Dep., 8/31/11, 136:5-10.) It is a not-for-profit corporation. (Defendant's Exhibit ["DRX"] 530 at  
4 KAL033069.) The DVDCCA is governed by a Board of Directors. (*Id.* at KAL033081.)

5 **C. The License Agreement.**

6 DVDCCA licenses CSS pursuant to the CSS License Agreement. (PRX-4 § 2.1(a).) The  
7 License Agreement is governed by California law. (PRX-4 § 10.4(a).) At present, there are nearly  
8 250 CSS licensees. (Defendant's Exhibit ["DRX"]-567.) As the Court of Appeal observed, CSS is  
9 licensed on a uniform basis. The right to use CSS thus is made available on the same terms and  
10 under the same conditions to all CSS licensees. (*App. Op., supra*, 176 Cal.App.4th at p. 703.)  
11 DVDCCA's primary purpose is to administer and enforce the License Agreement. (Parsons Dep.,  
12 8/31/11, 136:5-10; Deposition of John Hoy, 12/28/06, 49:17-20.) It also considers and approves  
13 amendments to the License Agreement. (Hoy Dep., 12/28/06, 49:21-50:23.)

14 1. The Documents That Make Up The License Agreement.

15 The Court of Appeal's decision in this case discusses in detail the documents that make up  
16 the License Agreement. The decision states that the License Agreement consists of the licensing  
17 document itself, which is captioned "CSS License Agreement" and is referred to hereinafter in this  
18 decision as "the License," as well as the documents that are referred to in the licensing document as  
19 "the CSS Specifications." (*App. Op., supra*, 176 Cal.App.4th at pp. 705-706.) In turn, the CSS  
20 Specifications are comprised of: (i) the Procedural Specifications and (ii) the Technical  
21 Specifications. (*Id.* at p. 705.) The Technical Specifications are themselves broken down into (i) the  
22 General Specifications and (ii) other "Titles" that are specific to the "membership category" that a  
23 licensee selects. (*Id.* at pp. 705, 713, 718.)

24 The category-specific Technical Specification Titles relevant to this case, corresponding to  
25 the membership categories that Kaleidescape selected when it executed the License Agreement, are  
26 the DVD-Video Descrambler and Authenticator Module for CSS Decryption Module, Titles 609 and  
27 809, respectively. (*App. Op., supra*, 176 Cal.App.4th at p. 703.) Accordingly, the contract between  
28 DVDCCA and Kaleidescape consists of the executed License (PRX- 4); the Procedural

1 Specifications (PRX-9);<sup>2</sup> the Technical Specifications entitled Authenticator Module for CSS  
2 Decryption Module (PRX-10); the Technical Specifications entitled DVD Video Descrambler (PRX-  
3 11), and the CSS General Specifications (PRX-12) (collectively, the "License Agreement").

4 As the Court of Appeal noted, the License and the Procedural Specifications are publicly  
5 available on DVDCCA's website; a prospective licensee can review them before executing the  
6 License Agreement. The Technical Specifications (*i.e.*, the General Specifications and the category-  
7 oriented Technical Specification Titles) are not publicly available; pursuant to the terms of the  
8 License, DVDCCA provides these documents to a licensee only after the licensee has executed the  
9 License Agreement. As the Court of Appeal noted, this method of distributing the CSS Technical  
10 Specifications is intended to protect the confidentiality of CSS. (*App. Op.*, *supra*, 176 Cal.App.4th  
11 at pp. 705-706, 715.)

## 12 2. The Requirements Of The License Agreement.

13 Recital A to the License states that the central objective of CSS, "together with the terms and  
14 conditions of [the] Agreement, [is] "to provide protection for" the content placed on DVDs "against  
15 unauthorized consumer copying." (PRX-4 at Recital A.) That same overarching anti-copying  
16 objective also is expressly stated in the CSS Specifications. (CSS General Specifications, PRX-12,  
17 § 1.5(1) ["CSS"] is intended to prevent casual users from the unauthorized copying of copyrighted  
18 materials recorded on DVD-Video/Audio Discs.]; Authenticator Module for CSS Decryption  
19 Module, PRX-10, § 1.1 ["The objectives of bus authentication and bus decryption are . . . [t]o prevent  
20 digital-to-digital copying in a personal computer environment [and] the unauthorized interception of  
21 data after mutual authentication"]; Procedural Specifications, PRX-9, § 6.2 [to promote "Copy  
22 Protection," CSS Licensees must adhere to "conditions . . . with respect to . . . playback of . . . CSS  
23 Data"].)

24 Section 4.2.1 of the License provides that licensees "*shall comply with the CSS*  
25 *Specifications. . .*" (PRX-4, § 4.2.1, emphasis added.) Section 4.2.1 further provides that "[*e*]*ach*  
26

27 <sup>2</sup> PRX- 9 is version 3.2 of the Procedural Specifications. Earlier versions of the Procedural  
28 Specifications were received into evidence as PRX-13 (version 2.2) and PRX- 3 (version 1.1). The  
text of the provisions of the Procedural Specifications cited in this decision are the same in each of  
those documents. Citations to the Procedural Specifications in this decision refer to PRX- 9.

1 *DVD Product shall comply with the . . . CSS Specifications . . .* (*Id.*, emphasis added.) (“DVD  
2 Products” is defined in Section 1.15 of the License to include Authenticators, Descramblers, and  
3 CSS Decryption Modules. (*Id.* § 1.15.)) Through Section 4.2.1 of the License, the CSS  
4 Specifications thus explicitly impose binding requirements on CSS licensees.

5 a. The Requirements of the CSS Specifications.

6 The CSS Specifications (the General Specifications, the Procedural Specifications, the  
7 Descrambler Specifications, and the Authenticator Specifications) prescribe how a licensee is to use  
8 CSS in DVD playback equipment.

9 • General Specifications (PRX-12)

10 Section 1.5 of the General Specifications is captioned “General Security Requirements.” It  
11 states that CSS is “intended to prevent casual users from unauthorized copying of copyrighted  
12 materials recorded on [DVDs].” (PRX-12, § 1.5.)

13 Section 2.1.1 is captioned “Encryption Keys.” It sets forth how the CSS encryption keys (the  
14 Title Key, Disc Key, and Master Key) are to be used in DVD playback equipment. The provision  
15 states that, in a “computer environment,” an “Authentication Control Code” is utilized in the  
16 authentication process during transmission of the keys from the DVD Drive to the Descrambler.  
17 (PRX-12, § 2.1.1.)

18 Section 2.1.2 is captioned “Encryption/Decryption Process.” It sets forth how the  
19 “encryption/decryption process” is to be accomplished during playback of a DVD. This provision  
20 begins with the playback requirements for “a DVD-Video Player (stand-alone device),” and  
21 prescribes the following three-step process:

- 22 (1) Disc Key Recovery logic in the DVD Video-Descrambler reads Secured Disc Key data  
23 from the hidden Lead-in Area and recovers the Video Disc Key.  
24 (2) The DVD-Video Descrambler then reads (decrypts) the Encrypted Video Title Key from  
25 the hidden Sector Header.  
26 (3) The DVD-Video Descrambler then descrambles the A/V data in real time for playback.

26 (PRX-12, § 2.1.2.)

27 Section 2.1.2 next sets forth the playback requirements for a product that “combin[es] . . . the  
28 DVD-Video DVD Drive and the DVD-Video CSS Decryption Module,” and states “the

1 decryption/descrambling process is the same as the stand-alone players except for an additional step  
2 prior to the actual descrambling." This additional step requires "the DVD-Video DVD Drive and the  
3 DVD-Video CSS Decryption Module [to] query each other in a bi-directional 'dialogue' to verify  
4 that both devices are authorized to transmit the keys and the scrambled data." Then, Section 2.1.2  
5 states that if this mutual authentication "query is successful and the devices recognize each other as  
6 authorized, the keys are encrypted and sent from the DVD-Video DVD Drive to the DVD-Video  
7 CSS Decryption Module." (PRX-12, § 2.1.2.)

8 As set forth below, the Court of Appeal interpreted Section 2.1.2 to require playback of  
9 DVDs on products that combine a DVD Drive with a CSS Decryption Module to "be performed  
10 utilizing the physical DVD" (*App. Op., supra*, 176 Cal.App.4th at p. 720), and this holding that  
11 Section 2.1.2 imposes a playback from disc requirement is the law of the case. However, setting  
12 aside whether the Court of Appeal's reading of Section 2.1.2 is the law of the case and therefore  
13 binding on this Court on remand, this Court interprets Section 2.1.2 in the same manner as the Court  
14 of Appeal and the federal district court did in *RealNetworks*. The court in *RealNetworks* held that  
15 Section 2.1.2 "require[s] that the keys and the DVD's video content be obtained directly from the  
16 physical DVD, at which time the keys are decrypted and the video data is descrambled and sent to  
17 the display device, without any opportunity for interception of the data and creation of a digital copy  
18 of the content." (*RealNetworks, supra*, 614 F.Supp.2d at p. 923.) In adopting this interpretation of  
19 Section 2.1.2, this Court has relied on and credited the testimony of DVDCCA's technical expert, Dr.  
20 John Kelly, regarding the meaning of Section 2.1.2. Dr. Kelly also testified as to the meaning of that  
21 provision in the *RealNetworks* case, which involved the same CSS Specifications at issue here and a  
22 CSS-licensed device with the same basic functionality as the Kaleidescape System. (11/17/11 AM  
23 Tr. 64:11-65:18; 11/17/11 PM Tr. 57:12-58:3.) In the Court's view, Dr. Kelly's testimony offers the  
24 only reasonable interpretation of Section 2.1.2 in light of the plain language of that provision, the  
25 License Agreement as a whole, and the overarching copy prevention purpose of the contract that is  
26 set forth, *inter alia*, in Recital A to the License and Section 1.5 of the General Specifications. The  
27 Court does not credit the testimony of Kaleidescape's proffered expert, Daniel Harkins, because,  
28 unlike Dr. Kelly, he is not an expert in DVD technologies or optical storage, and has no experience

1 with the design or building of DVD playback products. (11/30/11 PM Tr. 70:26-71:6, 72:26-73:20  
2 12/1/11 AM Tr. 32:20-23 [Testimony of Daniel Harkins]; see Civ. Code § 1645 ["Technical words  
3 are to be interpreted as usually understood by persons in the profession or business to which they  
4 relate, unless clearly used in a different sense."].)

5 This Court's interpretation of Section 2.1.2 is supported by provisions of the Procedural  
6 Specifications, Descrambler Specifications, and Authenticator Specifications, which together  
7 prescribe authentication and decryption/encryption processes that can only occur if playback of a  
8 DVD is from the physical DVD disc, not from a copy stored on a server or other medium. The  
9 relevant provisions of those Specifications are as follows:

10 • Procedural Specifications (PRX-9)

11 The definitional provisions of the Procedural Specifications make clear that CSS's process  
12 for decrypting scrambled DVD content for playback necessarily requires the use of a physical DVD  
13 disc in a DVD Drive. Section 1.23 defines the CSS Disc Key as "the cryptographic key required to  
14 decrypt one or more Title Keys resident on a DVD Disc." Likewise, Section 1.24 defines Disc Key  
15 Recovery Logic as the "logic required to extract the Disc Key from the Secured Disc Key set  
16 encoded on a DVD Disc." In the same vein is Section 1.32, which defines the Master Key as the  
17 "cryptographic key used in a DVD Player or CSS Decryption Module to decrypt the Disc Key of a  
18 DVD Disc." Section 1.44 continues this theme of use of the DVD Disc for playback, defining the  
19 Title Key as "the cryptographic key required to descramble a Title from a DVD Disc." And Section  
20 1.45 defines Title Key Recovery Algorithm as "the algorithm, employed in conjunction with the Disc  
21 Key of a DVD Disc, to decrypt one or more of the Title Keys resident therein." (PRX-9, §§ 1.23,  
22 1.24, 1.32, 1.44, and 1.45.)

23 Additional definitional provisions governing authentication make clear that the  
24 authentication required by CSS is between a DVD Drive and a CSS Decryption Module. Section 1.3  
25 defines "Authentication Key" as "the cryptographic key used in the process of a DVD Drive and  
26 CSS Decryption Module authenticating each other," while Section 1.10 defines "CSS Authentication  
27 Algorithm" as "the algorithm, employed in conjunction with the Authentication Key, for a DVD  
28 Drive and a CSS Decryption Module to authenticate each other." (PRX-9, §§ 1.3, 1.10.)

1           Section 6.2 of the Procedural Specifications is captioned "Copy Protection." It states that the  
2 requirements set forth in the subsections of Section 6.2 "must be observed by CSS Licensees with  
3 respect to access to, playback of and transmission of CSS Data and/or analog signals constituting the  
4 content converted from CSS Data." (PRX-9, § 6.2.) One of those subsections is Section 6.2.3,  
5 which imposes requirements on CSS Decryption Modules that perform the authentication process  
6 with a DVD Drive. Like Section 2.1.2 of the General Specifications, Section 6.2.3 of the Procedural  
7 Specifications provides that the Authenticator in the CSS Decryption Module must ensure that the  
8 Descrambler in the CSS Decryption Module receives the keys from the DVD Drive. (PRX-9,  
9 § 6.2.3.)

10           Section 6.2.2 of the Procedural Specifications imposes requirements on the use of DVD  
11 Drives, which engage in authentication with a CSS Decryption Module. Section 6.2.2.1, captioned  
12 "Digital Outputs," provides that a DVD Drive "shall include an Authenticator to engage in and  
13 complete the authentication process with the CSS Decryption Module and to ensure that the CSS  
14 Keys and CSS Data in scrambled form are passed to the CSS Decryption Module only if the  
15 authentication process is successful." (*Id.* § 6.2.2.1.) Section 6.2.2.1 provides that "[t]hese  
16 technologies [*i.e.*, DVD Drives, Authenticators, and CSS Decryption Modules] are designed to  
17 ensure that the destination product is a CSS Compliant Product and to ensure that the CSS Data  
18 transmitted from the DVD Drive to any such CSS Compliant Product remain in the scrambled form  
19 as on the DVD Disc and that the CSS Keys are further encrypted for transmission to such product."  
20 (*Id.*) Section 1.9 of the License defines "CSS Compliant Products" as "DVD Products which are  
21 compliant with the CSS Specifications in accordance with Section 4.2 of [the] License. . . ." (PRX-  
22 4, 1.9.)

23           • Authenticator Specifications (Title 809, PRX-10)

24           Section 1.1 of the Authenticator Module for CSS Decryption Module Specifications sets  
25 forth "[t]he objectives of bus authentication and bus decryption," and describes them as follows:

26           Bus authentication: To prevent digital-to-digital copying in a personal computer environment  
27 Bus Decryption: To prevent the unauthorized interception of data after mutual  
28 authentication.

1 (PRX 10, § 1.1.) Section 2 of the Authenticator Specifications prescribes how the algorithms for  
2 authentication and bus decryption are deployed. The last of these algorithms is performed "on  
3 insertion" of the DVD Disc in the DVD Drive, and "before playback" of the DVD Disc. Section 2  
4 further specifies that after the bus decryption of the data on the secured Disc Key and Title Key, the  
5 data is transmitted to the Descrambler without interference and without appearing on a user  
6 accessible bus.

7 • Descrambler Specifications (Title 609, PRX-11)

8 Section 3.2 of the Descrambler Specifications provides that the Disc Key recovery logic must  
9 be performed by the Descrambler upon insertion of the DVD Disc in the DVD Drive. (PRX-11, §  
10 3.2; 11/17/11 AM Tr. 48:17-49:17.)

11 b. The Anti-Circumvention Requirements.

12 In addition to the requirement in Section 4.2.1 of the License that CSS licensees comply with  
13 the CSS Specifications, Section 5.2 of the License prohibits licensees from using the CSS  
14 Specifications to circumvent the methods prescribed in those documents. (PRX-4, § 5.2.)

15 This anti-circumvention rule is reinforced by Section 6.2.12 of the Procedural Specifications,  
16 which precludes licensees from producing or selling devices or software "(a) under color of this  
17 Agreement, or (b) using CSS Confidential or Highly Confidential Information, where such devices  
18 or software are designed to circumvent the requirements of this Section 6.2." (PRX-9, § 6.2.12.)

19 The Kaleidescape System utilizes "CSS Confidential or Highly Confidential Information," and thus  
20 is subject to the anti-circumvention requirements of Section 6.2.12, because the CSS Specifications  
21 are "Confidential Information" within the meaning of the License (PRX-4, §§ 1.6, 1.21), and set  
22 forth the required authentication processes. "The requirements of . . . Section 6.2" referenced by  
23 Section 6.2.12 implicate Sections 6.2.2.1 and 6.2.3. As explained above, Section 6.2.2.1 requires  
24 that DVD Drives "engage in and complete the authentication process with the CSS Decryption  
25 Module and to ensure that the CSS Keys and CSS Data in scrambled form are passed to the CSS  
26 Decryption Module only if the authentication process is successful." (PRX-9, § 6.2.2.1.) Section  
27 6.2.2.1 also specifies that the DVD Drive, CSS Decryption Module and authentication technologies  
28 "are designed to ensure that the destination product is a CSS Compliant Product and to ensure that

1 CSS Data transmitted from the DVD Drive to any such CSS Compliant Product remain in the  
2 scrambled form as on the DVD Disc and that the CSS Keys are further encrypted for transmission to  
3 such product." Similarly, Section 6.2.3 of the Procedural Specifications, which applies to CSS  
4 Decryption Modules, provides that "[t]he Authenticator in a CSS Decryption Module shall correctly  
5 engage in and complete the authentication process with the DVD Drive and ensure that the CSS  
6 Keys are received by the Descrambler only if the authentication process is successful."

7  
8 **3. The Contractual Stipulation Of Irreparable Injury.**

9 Section 9.2 of the License is captioned "Equitable Relief." It stipulates that because any  
10 breach by Kaleidescape of Section 4.2 of the License, which, as indicated above, requires compliance  
11 with the CSS Specifications, and Section 5.2 of the License, which, as indicated above, bars  
12 circumvention of the CSS Specifications, would cause "lasting effect . . . and harm [such that] money  
13 damages alone will not adequately compensate an injured party . . . and th[e] injury . . . will be  
14 irreparable." (PRX-4, § 9.2.) Section 9.2 further stipulates that an "injured party . . . upon showing  
15 to the relevant court's satisfaction that applicable factors other than the fact that harm will be  
16 irreparable and that monetary damages are not sufficient to remedy the injury have been fulfilled, will  
17 be entitled to specific performance or other temporary, preliminary, or permanent injunctive relief . . .  
18 ." (*Id.*)

19 Kaleidescape itself insists on similar contractual stipulations of irreparable injury in uniform  
20 contracts it uses in certain of its business arrangements. As with Section 9.2 of the License,  
21 Kaleidescape's stipulations provide that injunctive relief is warranted for breaches of the applicable  
22 contractual rules. (PRX-138 at KAL091072-77 [Employment, Confidential Information and  
23 Invention Assignment Agreement]; PRX-138 at KAL091083-84 [Nondisclosure Agreement].)

24 **D. Kaleidescape.**

25 **1. The Development Of The Kaleidescape System.**

26 Kaleidescape was incorporated in February 2001. (11/29/11 AM Tr. 11:11-16 [Testimony of  
27 Dr. Michael Malcolm.] Early on, the company's founders considered developing a product that  
28 would deliver movies for home viewing over the internet. (*Id.* 7:23-8:24, 9:9-10:8 [Malcolm.]

1 Kaleidescape's plans soon shifted towards developing a home entertainment system for the  
2 playback of content from DVDs. (11/29/11 AM Tr. 13:22-17:6 [Malcolm].) Kaleidescape realized  
3 that it would need to use CSS in such a product, and that to use CSS, it would need to obtain a CSS  
4 license from DVDCCA. (Deposition of Dr. Michael Malcolm, 10/5/11, 20:8-15; Deposition of  
5 Daniel Collens, 9/21/2011, 13:3-6; PRX-144.) At that point, Kaleidescape charged David Bryant, a  
6 content protection analyst for the company, with determining how that product would need to  
7 operate in order to comply with the DVDCCA's licensing requirements. (Collens Dep., 9/21/2011,  
8 43:22-44:6, 45:3-17.) Based on his analysis, Bryant concluded that "strong . . . copy protection" of  
9 DVD content was of paramount concern for DVDCCA (PRX-52), and that because of that concern,  
10 DVD playback "[m]ethods that don't rely upon physical possession of the DVD are not going to cut  
11 it with the [DVD]CCA." (PRX-44). Bryant thus advised Kaleidescape that its "best approach  
12 [would be] one that . . . guarantees physical possession of the DVD media" (PRX-144), and that  
13 "retaining the DVD in some way is the best way to meet the [DVD]CCA's copy-control  
14 requirements." (PRX-72.) Dr. Michael Malcolm, Kaleidescape's Chief Executive Officer since the  
15 company's founding (11/28/11 PM Tr. 64:25-27 [Malcolm]; 11/29/11 AM Tr. 27:15-17 [Malcolm]),  
16 testified that Kaleidescape assumed at the time Bryant conducted his analysis that "there would be a  
17 prohibition against copying the DVDs," and that "the DVD would have to be resident at the time of  
18 playback." (11/29/11 AM Tr. 28:11-14.)

19 In light of Bryant's analysis, Kaleidescape considered several product options, including  
20 what it called the "carousel" and "DVD destruction" approaches. (PRX-52; PRX-75; PRX-78.)  
21 However, Kaleidescape rejected those options for marketing reasons, concluding that consumers  
22 would not be attracted to them. (Malcolm Dep., 10/5/11, 32:3-13, 35:1-6; Collens Dep., 9/21/2011,  
23 63:17-64:20, 64:21-65:2.) Having rejected the carousel and DVD destruction approaches,  
24 Kaleidescape proceeded to develop a DVD content playback device, the Kaleidescape System,  
25 which renders the physical DVD unnecessary for playback. (Malcolm Dep., 10/5/11, 56:4-8.)

26 In July 2002, Kaleidescape applied for a provisional patent application for a DVD playback  
27 device that would use CSS to copy CSS-protected DVD content onto a home entertainment server so  
28 that the user could play the content without the physical DVD. (PRX-85.) Kaleidescape filed its

1 patent application before it received the confidential CSS Specifications from DVDCCA, which did  
2 not occur until after Kaleidescape executed the License Agreement on September 3, 2002. (PRX-4  
3 at 0031.) At that point, DVDCCA sent Kaleidescape the General Specifications (PRX-12), along  
4 with the Technical Specifications corresponding to the product categories that Kaleidescape selected  
5 – the DVD-Video Descrambler Specifications (PRX-11) and the Authenticator Module for  
6 Decryption Module Specifications (PRX-10). (PRX-15 [DVD010060].)

7 2. The Characteristics And Functionality Of The Kaleidescape System.

8 Kaleidescape began selling the Kaleidescape System to the public in August 2003. (Malcolm  
9 Dep., 10/5/11, 72:16-18.) Over the years, Kaleidescape has introduced different versions of the  
10 Kaleidescape System. (12/1/11 PM Tr. 26:25-27:27:3 [Testimony of Dr. Stephen Watson]; 11/16/11  
11 PM Tr. 53:6-55:11, 57:6-23 [Kelly].) However, each version contains the following components:

- 12 • A “reader” that includes a DVD Drive for reading the CSS-protected content from the  
13 physical DVD discs.
- 14 • A “server” that stores the content of the DVD discs for future playback without the DVD  
15 disc.
- 16 • And a “player” that retrieves the DVD content from the server, then decrypts and  
17 descrambles the content for playback on a display screen.

18 In the initial version, there were three separate components for these functions. The current versions  
19 of Kaleidescape Players combine the reader and player functions in a single component, which  
20 operates with a server, and another current version combines the reader, player, and server in a single  
21 component, called Cinema One. (11/16/11 PM Tr. 53:6-55:11, 57:6-23 [Kelly].) Despite some  
22 differences in the way they operate, each version of the Kaleidescape System has the same basic  
23 functionality with respect to CSS. (11/17/11 AM Tr. 60:5-22 [Kelly].)

24 Section 1.13 of the Procedural Specifications defines CSS Decryption Module as “a product  
25 capable of receiving, decrypting and descrambling transmissions from a DVD Drive and that  
26 incorporates the CSS Authentication Algorithm, the Disc Key Recovery Logic, the Title Key  
27 Recovery Algorithm and the Content Scrambling Algorithm . . . in Hardware and/or Software.”  
28 (PRX-9, § 1.13.) In essence, a CSS Decryption Module is a combination of an Authenticator and a

1 Descrambler. (11/17/11 AM Tr. 24:20-23 [Kelly].) DVDCCA's technical expert, Dr. Kelly, testified  
2 that the Kaleidescape System meets the Section 1.13 definition of a CSS Decryption Module. (*Id.*  
3 54:25-55:3 [Kelly].) So too did one of Kaleidescape's co-founders, Daniel Collens. (Deposition of  
4 Daniel Collens, 6/27/06, 95:21-96:10.) Kaleidescape's proffered expert, Daniel Harkins, also  
5 acknowledged that the Kaleidescape System meets all of the elements of the Procedural  
6 Specifications' definition of a CSS Decryption Module. (12/1/11 AM Tr. 36:15-37:8, 38:23-39:1.)

7 Dr. Kelly testified, and Mr. Harkins did not dispute, that the Kaleidescape System operates in  
8 a personal computing environment within the meaning of the CSS Specifications. This is because a  
9 personal computer environment, for purposes of CSS, is an implementation of CSS through the  
10 combination of a DVD Drive and CSS Decryption Module, which are the type of devices in which  
11 the Kaleidescape System implements CSS. Under the CSS Specifications, it is not necessary for a  
12 device to be a general purpose personal computer in order to be subject to the requirements that are  
13 applicable to a DVD Drive plus CSS Decryption Module. (11/17/11 PM Tr. 25:26-26:6 [Kelly].)  
14 The Kaleidescape System has numerous characteristics of a computing device and operates in a  
15 personal computing environment. The Kaleidescape System's server operates as a computer server  
16 would operate in a typical computing network, and its internal components are typical of the kind of  
17 components that are found in a personal computer. (11/16/11 PM Tr. 57:15-20, 57:24-58:7 [Kelly].)  
18 Moreover, DVD content cannot be deleted from the server except through a personal computer  
19 interface. (*Id.* 58:14-21 [Kelly].) Even though the Kaleidescape System is not itself a personal  
20 computer as such, Kaleidescape's own installation guide has an illustration that displays the  
21 Kaleidescape System configured in a home personal computer network environment. (PRX-18.)  
22 And as the guide states, a personal computer is necessary to set up the Kaleidescape System. (*Ibid.*;  
23 11/16/11 PM Tr. 58:5-7 [Kelly].)

24 The key feature of the Kaleidescape System is that it allows a user to make a permanent  
25 digital copy of CSS-protected DVD content for playback without the physical DVD disc. (11/16/11  
26 PM Tr. 61:6-20 [Kelly]; Malcolm Dep., 10/5/11, 53:24-54:2.) After the content of the DVD has been  
27 copied, or "imported" onto the Kaleidescape System's server, which is where the permanent copies  
28 of DVD content are stored for unlimited playback without the physical DVD disc, the user has no

1 further need for the disc. (Malcolm Dep., 10/5/11, 56:4-12.) Instead, the Kaleidescape System plays  
2 the DVD content directly from the copy on the server using copied CSS Keys. (*Id.*) (The initial  
3 version of the Kaleidescape System was not capable of playing a physical DVD from the DVD  
4 Drive. (*Id.* 74:19-22.)) Playback from a copy of the DVD content stored on the server can occur at  
5 any time, even years after the content has been copied to it and even if the user no longer has the  
6 physical DVD disc. (12/2/11 Tr. 94:9-12 [Watson].) Accordingly, with the Kaleidescape System, a  
7 user can return, sell, or give away the physical DVD disc after the DVD content is copied to the  
8 server. (Collens Dep., 9/21/11, 77:2-3, 5-8, 78:16-79:5, 79:14-23.) As the Court of Appeal  
9 observed, “[t]his feature of the system . . . allows users to make permanent copies of borrowed or  
10 rented DVDs so that a user could amass a sizeable DVD library without purchasing a single DVD.”  
11 (*App. Op., supra*, 176 Cal.App.4th at pp. 701-702.)

12 Because the DVD disc is eliminated from the playback process, authentication (including bus  
13 encryption and bus decryption) does not occur during playback. The CSS security keys and A/V  
14 data are not transmitted from the DVD Drive to the Descrambler through the Authenticator. Instead,  
15 they are intercepted and diverted to the Kaleidescape System’s server. (11/17/11 AM Tr. 57:14-  
16 58:14, 62:15-27 [Kelly].) Kaleidescape’s Chief Technology Officer, Dr. Stephen Watson, testified  
17 (12/2/11 Tr. 78:3-4 [Watson]) that the Kaleidescape System’s server is not a DVD Product within the  
18 meaning of Section 1.15 of the License, which lists the products that meet that definition, and is not  
19 a CSS Compliant Product, which, as indicated above, Section 1.9 of the License defines as a DVD  
20 Product that complies with the CSS Specifications in accordance with Section 4.2 of the License.  
21 (PRX-4, § 1.9.)

22 Kaleidescape contends that the Kaleidescape System can detect that an imported DVD is  
23 rented when the DVD has been marked as a rental DVD and that some rental DVDs are so marked.  
24 (11/29/11 PM Tr. 26:18-27:2 [Malcolm].) However, the Kaleidescape System cannot detect if an  
25 imported DVD is a DVD that the user has borrowed. (*Id.* 28:13-16 [Malcolm].) After the  
26 Kaleidescape System copies the DVD content to the server, it displays a message that states that it is  
27 illegal for a user to import a DVD that the user does not own and that the user must delete the copy if  
28 the DVD is not owned. The message further states that the user must click “Agree” to signify that

1 the user either owns the imported DVD or that the user will delete it. (11/29/11 AM Tr. 42:26-43:4  
2 [Malcolm]; 11/17/11 AM Tr. 61:5-13 [Kelly].) The Kaleidescape System does not, however, provide  
3 any mechanism for confirming that a user actually owns an imported DVD. (11/29/11 PM Tr. 27:3-  
4 20 [Malcolm]; 11/17/11 Tr. AM 62:1-5 [Kelly].) Furthermore, the Kaleidescape System itself cannot  
5 delete the imported DVD -- the user has to delete it using a personal computer. (11/17/11/AM Tr.  
6 61:14-21 [Kelly].)

### 7 III. PROCEDURAL HISTORY.

#### 8 A. The Ombudsman Process.

9 After DVDCCA became aware of how the Kaleidescape System operates, it sent a letter to  
10 Kaleidescape in December 2003. DVDCCA asserted in the letter that the Kaleidescape System  
11 violates the License Agreement and demanded that Kaleidescape cease manufacturing and selling it.  
12 (DRX-536.) The parties then met in January 2004 to discuss the matter; at that meeting,  
13 Kaleidescape demonstrated to DVDCCA how the Kaleidescape System operated. (12/2/11 Tr. 30:3-  
14 31:4 [Watson]; Deposition of Wade Hannibal, 12/8/06, 42:17-43:21.) Communications between the  
15 parties continued in the months after the meeting. (DRX-533; DRX-542; DRX-559.)

16 With the parties at an impasse over whether the Kaleidescape System complies with the  
17 License Agreement, in June 2004, DVDCCA invoked the "Ombudsman" procedures of Section 6.6  
18 of the DVDCCA Bylaws. (DRX-543.) Under those procedures, DVDCCA can appoint an  
19 Ombudsman to attempt to negotiate a resolution of a dispute between DVDCCA and a CSS licensee  
20 over compliance with the License Agreement. (DRX-530, § 6.6.) Section 6.6 states that if the  
21 negotiations conducted by the Ombudsman fail to produce a resolution, then the Ombudsman "shall  
22 be permitted to recommend to the Board of Directors that [DVDCCA] initiate enforcement action or  
23 that the [licensee] is in compliance and no further action need be taken." (*Ibid.*) Section 6.6 further  
24 states that "submission of a dispute to the Ombudsman shall be a precondition to the institution of  
25 enforcement action by the [DVDCCA]." (*Ibid.*) Pursuant to Section 6.6, DVDCCA appointed  
26 Geoffrey Tully in June 2004 as Ombudsman and submitted its dispute with Kaleidescape to him in  
27 an attempt to achieve a resolution. (DRX-543.) Six months later, when it did not appear that the  
28 Ombudsman process would lead to a resolution, DVDCCA sued Kaleidescape for breach of the

1 License Agreement. (*App. Op., supra*, 176 Cal.App.4th at p. 704.) The undisputed evidence is that  
2 the DVDCCA Board voted unanimously to sue Kaleidescape. (Deposition of Andrew Parsons,  
3 12/18/06, 18:2-6.)

4 **B. The Initial Trial Court Decision.**

5 At the first trial, DVDCCA confined its breach of contract claim against Kaleidescape to  
6 alleged violations of Sections 1.5 and 2.1.2 of the General Specifications, and sought only specific  
7 performance or a permanent injunction, not damages. (*App. Op., supra*, 176 Cal.App.4th at pp. 704,  
8 718.) Shortly before the trial started, Kaleidescape claimed for the first time that it did not have to  
9 comply with the General Specifications on the grounds that they are not part of the License  
10 Agreement. And because DVDCCA's breach of contract claim was confined to the General  
11 Specifications, Kaleidescape argued, DVDCCA's breach of contract claim failed. (*Id.* at p. 705.)  
12 The trial court agreed with Kaleidescape's argument. (*Id.* at pp. 710, 712.) The trial court did not  
13 reach the breach issue. But it also ruled that even if the General Specifications are part of the  
14 License Agreement, the court could not order specific performance for a breach of Sections 1.5 and  
15 2.1.2 on the grounds that those provisions are not "sufficiently definite for the court to know what  
16 to enforce." (*Id.* at p. 718.) Additionally, the trial court ruled that DVDCCA was not entitled to a  
17 permanent injunction because the parties' contractual stipulation in Section 9.2 of the License  
18 Agreement that a breach would cause irreparable harm to DVDCCA was not entitled to any weight  
19 and DVDCCA had not separately demonstrated that it would be irreparably harmed. (*Id.* at pp. 721,  
20 724.)

21 The trial court entered judgment for DVDCCA on Kaleidescape's cross-complaint. (*App.*  
22 *Op., supra*, 176 Cal.App.4th at p. 711 n.4.)

23 **C. The Court of Appeal's Decision And Instructions For Remand.**

24 DVDCCA appealed, and the Court of Appeal reversed the judgment for Kaleidescape and  
25 remanded.

26 First, the Court of Appeal held that the General Specifications are CSS Specifications, just  
27 like the other Technical Specification titles sent to Kaleidescape after they executed the license, and  
28 thus are part of the License Agreement between DVDCCA and Kaleidescape. (*App. Op., supra*, 176

1 Cal.App.4th at pp. 712-718.) In reaching that conclusion, the Court of Appeal relied on the language  
2 of the License stating that Kaleidescape would be bound by the confidential CSS Specifications that  
3 DVDDCA would provide to it after Kaleidescape executed the License Agreement. The Court of  
4 Appeal also relied on the undisputed extrinsic evidence showing that (i) after Kaleidescape executed  
5 the License Agreement, the package of confidential CSS Specifications that DVDDCA provided to  
6 Kaleidescape contained the two Technical Specifications that Kaleidescape selected when it  
7 executed the License Agreement (the Authenticator Specifications and the Descrambler  
8 Specifications) and the General Specifications, and (ii) Kaleidescape had treated all of those  
9 documents the same and as part of the License Agreement for almost four years until the start of the  
10 trial. (*Ibid.*) The Court of Appeal did not decide whether Kaleidescape had breached the General  
11 Specifications, remanding to this Court to decide that issue. (*Id.* at p. 718.)

12 Second, the Court of Appeal reversed the trial court's ruling that specific performance was  
13 unavailable for lack of certainty of Sections 1.5 and 2.1.2 of the General Specifications. As to  
14 Section 1.5, the Court of Appeal held that "[i]n stating the intent of the CSS technology, section 1.5  
15 sets forth a standard by which Kaleidescape's performance under the agreement can be measured."  
16 (*App. Op.*, *supra*, 176 Cal.App.4th at p. 719.) As to Section 2.1.2, the Court of Appeal held that "it  
17 is not so vague that the court cannot tell what it requires – it requires that playback of DVD content  
18 by a Drive plus Decryption device be performed utilizing the physical DVD." (*Id.* at p. 720.) The  
19 Court of Appeal thus held that Section 2.1.2 imposes a playback from disc requirement on playback  
20 devices that consist of a DVD Drive and CSS Decryption Module. It remanded to this Court to  
21 determine whether the Kaleidescape System is a "Drive plus Decryption Module," and if so, whether  
22 it violates the playback from disc requirement. (*Id.* at pp. 720, 727.)

23 Third, the Court of Appeal reversed the trial court's ruling declining to give any effect to the  
24 stipulated injunctive relief provision in Section 9.2 of the License. It described Section 9.2 as "an  
25 unambiguous recitation of the parties' intent pertaining to the remedy for a breach." (*App. Op.*,  
26 *supra*, 176 Cal.App.4th at p. 725.) While the Court of Appeal declined to treat Section 9.2 as  
27 dispositive regarding the appropriate remedy for a breach of the License Agreement, it stated that  
28 because "the parties have stipulated to the nature or amount of a remedy, it is proper for the trial

1 court to honor the parties' agreement unless it finds that to do so would be contrary to a rule of law  
2 or public policy." (*Ibid.*) The Court of Appeal instructed that it would not be contrary to any rule of  
3 law or public policy to honor the Section 9.2 stipulation for injunctive relief if the evidence on  
4 remand shows that monetary relief resulting from a breach cannot be quantified and thus would not  
5 adequately compensate DVDCCA. (*Id.* at pp. 725-726.) In that event, the Court of Appeal held, this  
6 Court must "enforce the stipulation." (*Id.* at p. 726.) The Court of Appeal thus remanded to this  
7 Court to "determine the nature and extent of the harm DVDCCA would suffer as a result of a  
8 continuing breach and . . . the appropriate remedy." (*Id.* at p. 727.) The Court of Appeal described  
9 that harm as harm to the integrity of the License Agreement that would arise from an unaddressed  
10 breach of the License Agreement by a CSS licensee. (*Id.* at pp. 726-727.) It instructed that the  
11 existence of unlicensed copying devices is irrelevant to the inquiry on remand into the nature and  
12 extent of that harm because the makers of such devices are not CSS licensees. (*Ibid.*)

#### 13 **IV. KALEIDESCAPE HAS BREACHED THE LICENSE AGREEMENT.**

14 The elements of a claim for breach of contract are (1) the existence of a contract; (2)  
15 plaintiff's performance of the contract or excuse for nonperformance; (3) the defendant's breach of  
16 the contract; and (4) damage to the plaintiff arising from the defendant's breach. (*Abdelhamid v.*  
17 *Fire Ins. Exchange* (2010) 182 Cal.App.4th 990, 999.) It is undisputed that the parties entered into a  
18 contract (the CSS License Agreement). As set forth in this portion of the Statement of Decision, the  
19 Court concludes that plaintiff DVDCCA performed its obligations under the contract and that  
20 defendant Kaleidescape has breached the contract. As set forth in Part V, below, Kaleidescape's  
21 breach has damaged DVDCCA irreparably, so that injunctive relief is warranted.

#### 22 **A. Breach Of Section 2.1.2 Of The General Specifications.**

##### 23 1. The Kaleidescape System Is Subject To Section 2.1.2 Of The General 24 Specifications Because It is A DVD Drive Plus Decryption Module.

25 By its unambiguous terms, the playback requirements in Section 2.1.2 of the CSS General  
26 Specifications apply to devices that use CSS in a combination of a DVD Drive and CSS Decryption  
27 Module. (PRX-12 § 2.1.2 ["For playback by a combination of the DVD-Video DVD Drive and the  
28

1 DVD-Video CSS Decryption Module, the decryption/descrambling process [of the provision  
2 applies].") The Kaleidescape System is such a device.

3 There is no dispute that every Kaleidescape System includes a DVD Drive. (11/16/11 PM Tr.  
4 57:6-8 [Kelly]; 12/01/11 PM Tr. 44:14-45:7 [Watson].) Section 1.13 of the Procedural Specifications  
5 defines CSS Decryption Module as "a product capable of receiving, decrypting, and descrambling  
6 transmissions from a DVD Drive and that incorporates the CSS Authentication Algorithm, the Disc  
7 Key Recovery Logic, the Title Key Recovery Algorithm and the Content Scrambling Algorithm . . .  
8 in Hardware and/or Software." (PRX-9, § 1.13.) DVCCA's technical expert, Dr. Kelly, testified  
9 that the Kaleidescape System is a CSS Decryption Module within the meaning of Section 1.13.

10 (11/17/11 AM Tr. 54:25-55:3 [Kelly].) One of Kaleidescape's own documents shows that the  
11 company recognized as far back as 2003 that the Kaleidescape System contains a CSS Decryption  
12 Module. (PRX-47.) The author of that document, Daniel Collens, one of Kaleidescape's co-  
13 founders, subsequently testified that it would be a "valid interpretation" to conclude that the  
14 Kaleidescape System contains a CSS Decryption Module. (Deposition of Daniel Collens, 6/27/06,  
15 95:21-96:10.) Kaleidescape's proffered expert, Daniel Harkins, testified that "there was no aspect of  
16 the definition" of CSS Decryption Module that the Kaleidescape System does not meet. (12/1/11  
17 AM Tr. 36:15-37:8, 38:23-39:1 [Harkins].) And Kaleidescape's Chief Technology Officer, Dr.  
18 Steven Watson, testified that a number of Kaleidescape's products meet the definition of CSS  
19 Decryption Module. (Deposition of Stephen Watson, 6/23/11, 284:13-16, 284:19-285:20.) Based on  
20 that testimony, the Court concludes that the Kaleidescape System is a DVD Drive plus CSS  
21 Decryption Module and therefore is subject to the playback requirements of Section 2.1.2 of the  
22 General Specifications.

23 Kaleidescape's characterization of the Kaleidescape System as an "Integrated Product"  
24 (12/1/11 PM Tr. 29:21-24 [Watson]) does not defeat application of Section 2.1.2 to the Kaleidescape  
25 System. This is because Section 1.31 of the Procedural Specifications states that the "use of the term  
26 'Integrated Product' does not affect the obligations or provisions pertaining to *any separately defined*  
27 *DVD Product.*" (PRX-9 § 1.31 (emphasis added).) A CSS Decryption Module is one of the DVD  
28 Products listed in Section 1.15 of the License, and, as indicated above, it is "separately defined" as a

1 CSS Decryption Module under Section 1.13 of the Procedural Specifications. Thus, while the  
2 Kaleidescape System is an Integrated Product, it also meets the definitional elements of a CSS  
3 Decryption Module under Section 1.13 of the Procedural Specifications (as Kaleidescape concedes)  
4 and therefore is subject to the "obligations or provisions pertaining" to CSS Decryption Modules,  
5 including the obligations in Section 2.1.2 of the General Specifications. In addition, Kaleidescape's  
6 Chief Technology Officer, Dr. Watson, conceded that the Kaleidescape System, as an Integrated  
7 Product, must satisfy all of the requirements of Section 6.2 of the Procedural Specifications that  
8 apply to the DVD Products that are incorporated into its systems, including a DVD Drive. (12/01/11  
9 PM Tr. 44:14-45:7 [Watson].)

10 2. The Court of Appeal's Ruling That Section 2.1.2 Of The General  
11 Specifications Imposes A Playback From Disc Requirement Is The Law Of The  
12 Case.

13 The California Supreme Court has stated that "[u]nder the law of the case doctrine, when an  
14 appellate court states in its opinion a principle or rule of law necessary to the decision, that principle  
15 or rule becomes the law of the case and must be adhered to throughout the case's subsequent  
16 progress, both in the lower court and upon subsequent appeal." (*People v. Barragan* (2004) 32  
17 Cal.4th 236, 246, internal quotations omitted; *see also Yu v. Signet Bank/Virginia* (2002) 103  
18 Cal.App.4th 298, 309 ["[T]he decision of an appellate court, stating a rule of law necessary to the  
19 decision of the case, conclusively establishes that rule and makes it determinative of the rights of the  
20 same parties in any subsequent retrial or appeal in the same case."], internal quotations and citation  
21 omitted.) The law of the case doctrine encompasses appellate rulings regarding the validity and  
22 "proper construction" of contracts. (9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 466, p. 524.)

23 The Court of Appeal construed Section 2.1.2 of the General Specifications to impose a  
24 playback from disc requirement on devices to which that provision applies. That construction is the  
25 law of the case because it states a rule of law that was necessary to the Court of Appeal's decision.  
26 The Kaleidescape System does not comply with that requirement and thus Kaleidescape has  
27 breached Section 2.1.2 of the General Specifications.

28 a. The Court of Appeal Stated What Section 2.1.2 Requires.

1 As the Court of Appeal stated in describing what happened at the first trial, the trial court  
2 ruled that equitable relief, in the form of specific performance, for breach of the General  
3 Specifications was precluded because the General Specifications are not sufficiently definite for the  
4 court to know what to enforce. (*App. Op. supra*, 176 Cal.App.4th at p. 718.) The Court of Appeal  
5 reversed the trial court on this question in a portion of the opinion with the heading "Equitable Relief  
6 Is Not Precluded." (*Ibid.*) The Court of Appeal then proceeded to explain why equitable relief in the  
7 form of specific performance is not precluded. The Court stated:

8 [I]f section 2.1.2 applies to the Kaleidescape system, a question that is  
9 not before us and upon which the trial court did not rule, then section  
10 2.1.2, as clarified by the undisputed extrinsic evidence, is not so vague  
11 that the court cannot tell what it requires—it requires that playback of  
12 DVD content by a Drive plus Decryption device be performed utilizing  
13 the physical DVD.

14 (*Id.* at p. 720, emphasis added.) This Court concludes that this statement of the Court of Appeal is  
15 an unequivocal statement regarding what Section 2.1.2 requires.

16 In arguing that the law of the case doctrine is inapplicable to the Court of Appeal's statement  
17 on what Section 2.1.2 requires, Kaleidescape has pointed to a statement that the Court of Appeal  
18 made earlier in its opinion that its "holding should not be read as interpreting the precise  
19 requirements of [the] General Specifications or whether they actually apply to the Kaleidescape  
20 system. That is part of the breach analysis upon which we express no opinion." (*App. Op., supra*,  
21 176 Cal.App.4th at p. 718.) This passage appears in the portion of the opinion that addresses  
22 whether the General Specifications are part of the License Agreement, but that does not interpret the  
23 General Specifications. The "holding" to which the Court of Appeal thus referred in that passage  
24 was its holding, just a few sentences earlier, that the General Specifications are part of the License  
25 Agreement. That holding did not address what the General Specifications require. That issue was  
26 addressed in the next portion of the opinion that specifically reversed the trial court's ruling that the  
27 requirements of Section 2.1.2 are insufficiently definite to be enforceable through an equitable order.  
28 That determination was an interpretation of Section 2.1.2.

Kaleidescape also has pointed to the paragraph near the end of the Court of Appeal's opinion  
with the heading "Conclusion" as showing that the Court of Appeal did not decide what Section

1 2.1.2 means. That paragraph states that Kaleidescape is "bound by the terms contained in [the]  
2 General Specifications," and that "the trial court must decide what those terms require." (*App. Op.*,  
3 *supra*, 176 Cal.App.4th at p. 727.) This Court believes that Kaleidescape has read too much into that  
4 paragraph. The Court of Appeal had held in the specific performance section of its opinion that it  
5 was not deciding whether the requirements of Section 2.1.2 apply to the Kaleidescape System. (*Id.*  
6 at p. 720.) This Court concludes that this was all that the Court of Appeal was referring to when it  
7 mentioned in the Conclusion what it was leaving for the trial court to decide regarding Section 2.1.2.  
8 This Court declines to read the Conclusion as stating that the Court of Appeal was offering no  
9 holding on the meaning of Section 2.1.2. Such a construction of the Court of Appeal's opinion  
10 would render the analysis of Section 2.1.2 a nullity. The Court of Appeal would not have stated  
11 explicitly what Section 2.1.2 requires and held that those requirements can be enforced through an  
12 equitable order of specific performance, only to negate that determination a few pages later in the  
13 Conclusion.

14 b. The Court of Appeal's Statement On Section 2.1.2 Was A Rule Of Law.

15 The Court of Appeal's statement of what Section 2.1.2 requires sets forth a rule of law to  
16 which the law of the case doctrine applies. Contract interpretation is a question of law when  
17 undisputed extrinsic evidence is considered to ascertain the contract's meaning. (*See City of Hope*  
18 *National Medical Center v. Genentech* (2008) 43 Cal.4th 375, 395.) As the Court of Appeal noted in  
19 its opinion in this case, it is only when there is a dispute in the extrinsic evidence that contract  
20 interpretation becomes a factual question. (*App. Op., supra*, 176 Cal.App.4th at p. 713.) In  
21 interpreting Section 2.1.2 of the General Specifications, the Court of Appeal analyzed the language  
22 of the provision and considered the extrinsic evidence that was introduced on the provision's  
23 meaning. As the Court of Appeal stressed, that extrinsic evidence was "undisputed." (*Id.* at p. 720.)  
24 DVDCCA's technical expert at the first trial, Brian Berg, testified that, based on his reading of  
25 Section 2.1.2, that provision requires playback from the physical DVD disc. (*Ibid*; 3/22/07 Tr.  
26 200:19-23.)

27 Kaleidescape's proffered expert on remand, Daniel Harkins, also testified for Kaleidescape  
28 at the first trial. In a deposition prior to the first trial, Mr. Harkins testified that Section 2.1.2 was a

1 "normative" provision and that he would "implement it as written." (12/1/11 AM Tr. 5:4-10, 5:16-  
2 19, 6:5-12.) At the first trial itself, "[a]s to section 2.1.2, Harkins explained that its requirements  
3 were inapplicable to the Kaleidescape system because the system did not fit either category of DVD  
4 device described by that section." (*App. Op., supra*, 176 Cal.App.4<sup>th</sup> at p. 717.) In sum, because it  
5 was based on the language of the provision and undisputed extrinsic evidence, the Court of Appeal's  
6 interpretation of Section 2.1.2 was a pure legal ruling to which the law of the case doctrine applies.  
7 (*See* 9 Witkin, *supra*, Appeal, § 466, p. 524 [law of the case doctrine applies to appellate rulings  
8 interpreting contracts].)

9 Kaleidescape has argued that the law of the case doctrine is inapplicable because the extrinsic  
10 evidence on the meaning of Section 2.1.2 is different and disputed at the trial on remand. But  
11 Kaleidescape did not present any new extrinsic evidence on what Kaleidescape itself thought Section  
12 2.1.2 means when it obtained and reviewed the General Specifications. The only new extrinsic  
13 evidence that Kaleidescape presented at the trial on remand is Mr. Harkins's contradiction of his  
14 opinion from 2007. Specifically, Mr. Harkins testified that his testimony on remand is exactly the  
15 same as it was in 2007, except that he has changed his mind about whether Section 2.1.2 is  
16 "normative" or "informative." In 2007, Mr. Harkins testified that Section 2.1.2 is normative and that  
17 he "would implement it as written." (12/1/11 AM Tr. 5:4-10, 5:16-19, 6:5-12.) Mr. Harkins now  
18 takes the view, nine years after Kaleidescape received the General Specifications and five years after  
19 his deposition testimony in connection with the first trial, that Section 2.1.2 is "informative," not  
20 "normative." (11/30/11 AM Tr. 33:1-20 [Harkins].) Mr. Harkins's shift of positions, cannot,  
21 however, retroactively convert the Court of Appeal's interpretation of Section 2.1.2 from a legal  
22 ruling subject to the law of the case doctrine into a factual ruling to which the law of the case  
23 doctrine is inapplicable. Under the law of the case doctrine, "[l]itigants are not free to continually  
24 reinvent their position on legal issues that have been resolved against them by an appellate court."  
25 (*Yu, supra*, 103 Cal.App.4<sup>th</sup> at p. 312.) Otherwise, the finality that the law of the case doctrine  
26 promotes (*id.* at p. 309) would be lost. DVDCCA presented different technical experts at the two  
27 trials -- Mr. Berg at the first trial, Dr. Kelly at the second trial. But their testimony was identical on  
28 the meaning of Section 2.1.2 and consistent with the Court of Appeal's interpretation. Both testified

1 that Section 2.1.2 imposes a playback from disc requirement. (*App. Op., supra*, 176 Cal.App.4th at  
2 p. 720 [Berg]; 11/17/11 AM Tr. 35:13-21, 39:7-45:20 [Kelly].)

3 Kaleidescape also argued that a contract interpretation that relies on undisputed extrinsic  
4 evidence is an application of law to fact, and thus is not subject to the law of the case doctrine. But  
5 the only case that Kaleidescape cited for this proposition is *Barragan*, which was not a case about  
6 contract interpretation and lends no support to Kaleidescape's argument. If Kaleidescape's argument  
7 were correct, it would mean that the Court of Appeal's holding that the General Specifications are  
8 part of the License Agreement is not subject to the law of the case doctrine either, because the Court  
9 of Appeal arrived at that holding, too, based on its interpretation of the relevant contractual language,  
10 as well as on undisputed extrinsic evidence. (*App. Op., supra*, 176 Cal.App.4th at pp. 716-717.)  
11 Kaleidescape has acknowledged, however, that this holding is the law of the case. So, too, is the  
12 holding that Section 2.1.2 of the General Specifications imposes a playback from disc requirement.

13 c. The Court of Appeal's Statement On Section 2.1.2 Was Necessary.

14 The trial court held that equitable relief was precluded because Section 2.1.2 of the General  
15 Specifications is too indefinite to be equitably enforced through an order of specific performance.  
16 The Court of Appeal's ruling on the meaning of Section 2.1.2 was necessary to its decision reversing  
17 the trial court's opinion that equitable relief was precluded. Put another way, the Court of Appeal  
18 had to interpret Section 2.1.2 and determine what it requires in order to decide whether the trial court  
19 was right or wrong in holding that the provision's requirements are insufficiently definite to support  
20 equitable relief.

21 Kaleidescape has argued that the Court of Appeal's ruling on the meaning of Section 2.1.2 of  
22 the General Specifications was unnecessary to its reversal of the trial court's ruling that the General  
23 Specifications are not part of the License Agreement, and that the Court could have left it at that and  
24 remanded for a determination on what Section 2.1.2 requires. But the trial court had ruled that the  
25 requirements of Section 2.1.2 could not be ascertained, and in its appeal, DVDCCA sought reversal  
26 of that ruling. The Court of Appeal's holding that the requirements of Section 2.1.2 can be  
27 ascertained thus provided an additional ground for its reversal of the trial court, and, as such, is the  
28 law of the case. (9 Witkin, *supra*, Appeal, § 475, at p. 533 [appellate court's additional grounds for

1 reversal are not dicta but rather, are the law of the case.) Had the Court of Appeal agreed with the  
2 trial court's ruling that Section 2.1.2 was too uncertain to be enforced through specific performance,  
3 it would have obviated the need for a remand: the judgment for Kaleidescape would have been  
4 affirmed on that ground. The Court of Appeal's holding regarding the requirements of Section 2.1.2  
5 also furnished instructions to this Court's determination on remand whether Kaleidescape has  
6 breached Section 2.1.2, and the holding is the law of that case for that reason as well. (*Id.* [law of  
7 the case doctrine applies to "a matter properly presented to the court for decision and one whose  
8 decision was proper as a guide to the court below on a new trial."], internal quotation omitted).

9 d. Appellate Decisions Involving Unqualified Remands Are Inapposite.

10 Finally, Kaleidescape argues that the law of the case doctrine is inapplicable on the grounds  
11 that an appellate court's reversal of a judgment with a remand to the trial court puts the parties in the  
12 same place as if the matter had never been heard by the trial court. But the cases on which  
13 Kaleidescape has relied for that proposition are inapposite: in each of them, the appellate court's  
14 reversal was *unqualified*, which allowed the parties to present any and all evidence on remand.  
15 (*Barragan, supra*, 32 Cal.4th 236; *Barron v. Superior Court* (2009) 173 Cal.App.4th 298;  
16 *Weightman v. Hadley* (1956) 138 Cal.App.2d 831; *Erlin v. National Union Fire Ins. Co.* (1936) 7  
17 Cal.2d 547.) By contrast here, the Court of Appeal's reversal was *qualified*. It held that Section  
18 2.1.2 imposes a playback from disc requirement, and instructed this Court to decide whether Section  
19 2.1.2 applies to the Kaleidescape System and, if so, whether the Kaleidescape System violates the  
20 playback from disc requirement. Unlike in the cases Kaleidescape cites, the Court of Appeal's ruling  
21 did not place the parties in the same position as if the first trial had not taken place.

22  
23 3. Even If The Court of Appeal's Reading Of Section 2.1.2 Were Not The Law Of The  
Case, This Court Interprets The Provision To Require Playback From A Disc.

24 If the Court of Appeal's ruling on what Section 2.1.2 requires is not the law of the case, then  
25 this Court must decide that issue for itself. Based on the Court's own independent construction of  
26 the provision and the License Agreement as a whole, and the evidence presented including the  
27 testimony of DVDFCA's expert, Dr. Kelly, it concludes that Section 2.1.2 imposes a playback from  
28

1 disc requirement, which the Kaleidescape System breaches. In this Court's view, this interpretation  
2 of Section 2.1.2 is the only reasonable one.

3 a. The Language of Section 2.1.2 And The Relevant Extrinsic Evidence.

4 Under California law, contracts are interpreted to reflect the mutual intent of the parties.  
5 (*Cedars-Sinai Medical Ctr. v. Shewry* (2006) 137 Cal.App.4th 964, 979.) The starting point for  
6 ascertaining the parties' intent is the language of the contract. (*Crawford v. Weather Shield Mfg., Inc.*  
7 (2008) 44 Cal.4th 541, 552; Civ. Code, § 1639.) The language of the contract must be interpreted as  
8 a whole to give effect to each provision. (Civ. Code, § 1641.) "Particular clauses of a contract are  
9 subordinate to its general intent." (*Id.*, § 1650.) Extrinsic evidence is admissible to show the parties'  
10 intent if the language of the contract is reasonably susceptible of being construed according to either  
11 party's interpretation. (*Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.* (1968) 69  
12 Cal.2d 33, 40.) These principles apply equally to uniform, non-negotiated contracts, like the CSS  
13 License Agreement. (*Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 819 & fn. 16.) Uniform  
14 contracts are construed against the party that drafts and prescribes them only as a last resort when the  
15 contract's meaning cannot be ascertained through ordinary principles of interpretation. (*Rainier*  
16 *Credit Co. v. Western Alliance Corp.* (1985) 171 Cal.App.3d 255, 263.)

17 Applying these principles, the Court concludes that the unambiguous language of Section  
18 2.1.2, as informed by the extrinsic evidence, precludes CSS licensees from using CSS to build and  
19 market devices that play back DVD content from permanent copies of the content stored on a server.  
20 Because of the lack of ambiguity in Section 2.1.2, the principle that uniform contracts are construed  
21 against the party that drafts and prescribes them is inapplicable here, as the federal court in  
22 *RealNetworks* similarly concluded in holding, under California's interpretive rules, that Section 2.1.2  
23 imposes a playback from disc requirement. (*RealNetworks, supra*, 641 F.Supp.2d at p. 949.)

24 First, the language of Section 2.1.2 plainly specifies playback from the DVD disc. Section  
25 2.1.2 initially sets forth a three-step set of descrambling requirements for playback of DVDs on a  
26 DVD Player. Kaleidescape's Chief Technology Officer, Dr. Steven Watson, acknowledged that a  
27 DVD Player plays back DVD content using the physical DVD disc. (12/2/11 Tr. 86:18-87:3  
28 [Watson].) Section 2.1.2 then sets forth the playback requirements for DVD Drive plus Decryption

1 Module, and states that the steps "are the same" as for a DVD Player, except for the "additional  
2 step" of a mutual authentication process between the DVD Drive and the CSS Decryption Module,  
3 prior to the three-enumerated descrambling steps for DVD Players. Because the three steps for  
4 playback by a DVD Player necessarily utilize the physical DVD disc for playback, and the steps for  
5 playback by a DVD Drive plus Decryption Module are the same as for a DVD Player, then playback  
6 by a DVD Drive plus Decryption Module must also necessarily utilize the physical DVD disc. By  
7 rendering the physical DVD disc unnecessary for playback, and allowing users to playback DVD  
8 content from a permanent copy on the server, the Kaleidescape System breaches the playback from  
9 disc requirement.

10 Second, the "additional step" of authentication between the DVD Drive and the CSS  
11 Decryption Module, referenced in the second sentence of Section 2.1.2's statement regarding  
12 playback by a DVD Drive plus Decryption Module (PRX-12, § 2.1.2), reinforces the concept of  
13 playback from the DVD disc. Authentication is "for playback" under the terms of Section 2.1.2. As  
14 Dr. Kelly testified, in this authentication process, the Disc Key must be transmitted from the DVD  
15 disc in the DVD Drive to the Descrambler. (11/17/11 AM Tr. 43:25-44:27 [Kelly].) That is  
16 confirmed by Section 2 of the Authenticator Module for CSS Decryption Module Specifications and  
17 by Section 6.2.3 of the Procedural Specifications. The last sentence of Section 2.1.2 (PRX-12, §  
18 2.1.2) reflects that the keys are bus encrypted when authentication is successful and sent "from the  
19 DVD-Video DVD Drive to the DVD-Video CSS Decryption Module." Kaleidescape argues that  
20 Section 2.1.2 is silent on what happens at that point. Sections 2.1.1 and 2.5 of the General  
21 Specifications, Section 2 of the Authenticator Module for CSS Decryption Module Specifications,  
22 and Sections 6.2.3 and 6.2.2.1 of the Procedural Specifications make clear, however, that the CSS  
23 Decryption Module performs bus decryption on the keys within the Authenticator Module and then  
24 causes the bus decrypted Encrypted Title Key and the bus decrypted Secured Disc Key data to be  
25 passed to the Descrambler. (PRX-12 §§ 2.1.1, 2.5; PRX-10 § 2, PRX-9 §§ 6.2.3, 6.2.2.1;  
26 11/17/2011 AM Tr. 46:1-47:26; 11/17/2011 PM Tr. 55:18-56:19 [Kelly].) Kaleidescape's  
27 interpretation omits those provisions from the License Agreement. Minus those provisions,  
28 Kaleidescape reads the License Agreement to allow the DVD Drive to pass the bus encrypted keys

1 only to an Authenticator Module for CSS Decryption -- not a CSS Decryption Module (i.e. an  
2 Authenticator and a Descrambler) -- from which the keys are then sent to the Kaleidescape server,  
3 which, by Kaleidescape's own admission, is not a CSS Compliant Product, (12/2/11 Tr. 77:15-79:4  
4 [Watson]), instead of a CSS-Compliant Descrambler, as required by the CSS Specifications. In  
5 addition, each time the Kaleidescape System does play back the copied movie using the copied CSS  
6 Keys, there is no authentication, no bus encryption and no bus decryption. (11/17/2011 AM Tr.  
7 62:12-63:26 [Kelly].) DVDCCA's interpretation of Section 2.1.2 is the only interpretation to which  
8 the provision is reasonably susceptible, and it is consistent with the interpretation of the Court of  
9 Appeal and the federal court in the *RealNetworks* case.

10 Third, the Court credits the testimony of Dr. Kelly regarding the meaning of Section 2.1.2  
11 over the testimony of Mr. Harkins. The Court finds that CSS is a complex technology that draws  
12 from a number of specialized disciplines, including DVD technology, digital cryptography and  
13 optical storage (11/16/11 PM Tr. 49:3-50:14, 66:15-67:7 [Kelly]) and that the License Agreement,  
14 which sets forth the requirements for the use of CSS, is thus likewise necessarily complex. Dr. Kelly  
15 is an expert in DVD technologies, computer cryptography, and optical storage. (11/16/11 PM Tr.  
16 47:26-50:28 [Kelly].) Accordingly, the Court may and does rely on Dr. Kelly's expert testimony in  
17 interpreting the License Agreement, including Section 2.1.2 of the General Specifications. (Civ.  
18 Code, § 1645 ["Technical words are to be interpreted as usually understood by persons in the  
19 profession or business to which they relate, unless clearly used in a different sense."]; *Beverly Hills*  
20 *Oil Co. v. Beverly Hills Unified Sch. Dist.* (1968) 264 Cal.App.2d 603, 607 [trial court properly  
21 admitted and relied on testimony of expert witness to interpret oil and gas leases on grounds that  
22 leases were "of a highly specialized character" and their meaning could "be answered only by  
23 knowledge of technical terms"]; *Bailey v. Breetwor* (1962) 206 Cal.App.2d 287, 291 ["There was no  
24 error in permitting expert testimony as to the proper interpretation of technical words used in . . .  
25 construction contracts."].) Additionally, the Court finds it significant that Dr. Kelly applied his  
26 technical expertise to explain the requirements of Section 2.1.2 in light of the complex language of  
27 the License Agreement as a whole, including all of the CSS Specifications. And he analyzed how  
28 other provisions of the Specifications address common subject matter to what is specified in Section

1 2.1.2 – including Sections 1.5, 2.1.1, 2.4 and 2.5 of the General Specifications; Sections 1.1, 1.3,  
2 1.10, 1.13, 1.23, 1.24, 1.32, 1.44, 1.45, and 6.2.3 of the Procedural Specifications; Sections 1.1 and 2  
3 of the Authenticator Module for CSS Decryption Module Specifications; Sections 1.2, 2, 3.2, and 3.4  
4 of the Descrambler Specifications; and Recital A and Section 4.2.1 in the License. (11/17/2011 AM  
5 Tr. 32:5-33:20, 34:21-35:9, 51:1-7; 11/17/2011 PM Tr. 55:18-56:19 [Kelly].) Dr. Kelly testified that  
6 the interpretation of Section 2.1.2 advanced by Kaleidescape would render superfluous express terms  
7 in Section 2.1.2 itself and in numerous other provisions of the CSS Specifications. (11/17/11 AM Tr.  
8 47:3-49:17 [Kelly].) It is elemental that “[a]n interpretation which renders part of the instrument to  
9 be surplusage should be avoided.” (*Ticor Title Ins. Co. v. Rancho Santa Fe Assn.* (1986) 177  
10 Cal.App.3d 726, 730.)<sup>3</sup>

11 By contrast, Mr. Harkins, who testified on behalf of Kaleidescape, testified that he is not an  
12 expert in DVD technologies (or in the broader area optical storage technology); lacks experience  
13 with specifications pertaining to DVD technologies; has never reviewed any code for performing  
14 DVD playback; and has never been involved in the design or building of a DVD playback product.  
15 (11/30/11 PM Tr. 49:12-50:4, 70:26-71:6, 72:26-74:8; 12/1/11 AM Tr. 32:20-23 [Harkins].)  
16 Furthermore, Mr. Harkins testified that he did not read the CSS Specifications as a whole, and that  
17 he views the general intent of the License and CSS Specifications to be subordinate to particular  
18 provisions. (12/1/2011 AM Tr. 7:10-16; 39:2-18 [Harkins]. That approach is contrary to  
19 fundamental rules of contract interpretation under California law. (Civ. Code, §1641 [“The whole of  
20 a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each  
21 clause helping to interpret the other”]; *id.*, §1650 [“Particular clauses of a contract are subordinate to  
22 its general intent.”].) In addition, Mr. Harkins’s shift from his 2007 testimony in connection with the  
23 first trial that Section 2.1.2 is “normative” and that he “would implement it as written” (12/1/11 AM  
24 Tr. 5:4-10, 5:16-19, 6:5-12), to the opposite in his 2011 testimony that Section 2.1.2 is informative  
25 and cannot be implemented as written diminishes his credibility and the reliability of his testimony.

26  
27 <sup>3</sup> Dr. Kelly did not opine on the parties’ state of mind when they entered the Agreement. Nor  
28 could he. But under Civil Code Section 1639, the mutual intent of the parties is generally  
ascertained from the terms of a written contract, and under Section 1645, the Court can and does rely  
on Dr. Kelly’s interpretation of the technical terms of that contract in ascertaining the parties’ intent  
for purposes of contract interpretation.

1 Finally, as set forth above, Mr. Harkins does not possess the requisite experience to provide  
2 competent and credible testimony pertaining to the technical meaning of a contract that addresses the  
3 operation of DVD playback devices, especially when compared to the qualifications of Dr. Kelly.  
4 (Civ. Code, §§ 1641, 1645.)

5 Fourth, this Court is persuaded by the reasoning of the federal district court in *RealNetworks*.  
6 That case involved a CSS licensee's use of CSS in a home entertainment device (and in a related  
7 software product) called RealDVD that made permanent digital copies of DVD content for playback  
8 without the physical DVD disc. (*RealNetworks, supra*, 641 F.Supp.2d at pp. 924-927.) Dr. Kelly,  
9 who testified as an expert in the *RealNetworks* case, testified here that the RealDVD home  
10 entertainment device had the same basic functionality and implemented CSS in the same way as the  
11 Kaleidescape System. (11/17/11 AM Tr. 64:11-66:11.) RealNetworks considered the Kaleidescape  
12 System to be the "blueprint" for RealDVD. (*RealNetworks, supra*, 641 F.Supp.2d at p. 925.)  
13 Following an evidentiary hearing, the *RealNetworks* court applied the same California contract  
14 interpretation principles on which this Court has relied and held that Section 2.1.2 unambiguously  
15 "prevent[s] unauthorized interception and the creation of a copy of the [CSS] keys and DVD video  
16 content on a storage device for future playback without the DVD, such as a computer hard drive."  
17 (*Id.* at pp. 923-924; *see also id.* at p. 949.) In interpreting the language of Section 2.1.2, the  
18 *RealNetworks* court also relied on Recital A in the License Agreement and Section 1.5 of the General  
19 Specifications, which set forth the copy protection objective of CSS and the License Agreement.  
20 The court admonished that a contract intended to protect against copying of DVD content cannot be  
21 read to authorize the building of "DVD copiers." (*Id.* at pp. 949, 951.) Such an interpretation, the  
22 court stated, "would lead to a very unreasonable result." (*Id.* at p. 951.) In reaching that conclusion,  
23 the court in *RealNetworks* was correct to rely on the copy protection objective in Recital A of the  
24 License because, as indicated above, California law requires that the contract must be read as a  
25 whole (Civ. Code, § 1641). The Court of Appeal in its decision in this case noted that the statement  
26 of contractual intent in Section 1.5 of the General Specifications, which, like Recital A, states the  
27 copy protection objective of CSS and the License Agreement, "can be used to interpret some of the  
28 more 'normative' language in the agreement." (*App. Op., supra*, 176 Cal.App.4th at p. 717.)

1 Fifth, the relevant extrinsic evidence confirms that the parties understood that the License  
2 Agreement imposes a playback from disc requirement and that the contract is not "reasonably  
3 susceptible of the [contrary] meaning Kaleidescape urges." (*App. Op., supra*, 176 Cal.App.4th at p.  
4 714.) That evidence shows that Kaleidescape was aware before it executed the License Agreement  
5 that DVDCCA would likely require that Kaleidescape use CSS in a device that plays back DVD  
6 content from the physical DVD disc. (PRX-44; PRX-52; PRX-72; 11/29/11 AM Tr. 28:11-14  
7 [Malcolm].) The evidence also shows that Kaleidescape rejected proposed alternative products that  
8 would have played back DVDs from the physical DVD disc, not because it concluded that the  
9 License Agreement would allow the play back of DVDs from permanent copies stored on a server,  
10 but rather, because of marketing considerations. (PRX-52; PRX-75; PRX-78; Malcolm Dep.,  
11 10/5/11, 32:3-13, 34:23-35:6; Collens Dep., 9/21/2011, 63:17-64:20, 64:21-65:2.)

12 Kaleidescape's Chief Technology Officer, Dr. Watson, testified that after Kaleidescape  
13 received the CSS Specifications from the DVDCCA, he was charged by the company's CEO, Dr.  
14 Malcolm, with reviewing them, and that he prepared a report in 2003 based on his review, which  
15 concluded that the CSS Specifications did not bar Kaleidescape from using CSS in a device that  
16 plays back DVDs from permanent copies of DVD content stored on a server. (12/1/11 PM Tr. 19:16-  
17 28, 21:21-23:13, 24:16-25:21; DRX-546.) But there is no evidence that Kaleidescape ever  
18 communicated this reading of the CSS Specifications to the DVDCCA before the Kaleidescape  
19 System was marketed. Under basic contract interpretation principles, if the extrinsic evidence shows  
20 that one party (here, Kaleidescape) understood that the other party (DVDCCA) likely interpreted the  
21 contract in a particular way and never communicated a contrary interpretation, then the other party's  
22 (DVDCCA's) interpretation controls. (Civ. Code, § 1649; *Beck v. American Health Group Int'l, Inc.*  
23 (1989) 211 Cal.App.3d 1555, 1562; *Merced County Sheriff's Employee's Assn. v. County of Merced*  
24 (1987) 188 Cal.App.3d 662, 673.)

25 b. Kaleidescape's Counter-Arguments.

26 Kaleidescape has advanced several arguments to counter the proposition that Section 2.1.2 of  
27 the General Specifications imposes a playback from disc requirement. Having considered each of  
28 those counter-arguments, the Court rejects them.

1           (1)    The Lack Of Literal Language

2           Kaleidescape's principal argument is that Section 2.1.2 does not literally state that "the  
3 creation of a permanent digital copy of DVD content" is prohibited, and therefore, the provision  
4 imposes no such prohibition. This argument is at odds with the basic principle that a contract may  
5 be interpreted to impose a requirement even if it does not expressly state the requirement. (*Foley v.*  
6 *Interactive Data Corp.* (1988) 47 Cal.3d 654, 677-678; *Okun v. Morton* (1988) 203 Cal.App.3d 805,  
7 818.) Here, based on the mandate in the License that a licensee "shall comply with the CSS  
8 Specifications" (PRX-4, § 4.2.1), the affirmative statement of processes set forth in Section 2.1.2  
9 itself, the overarching intent of the License Agreement as reflected in Recital A of the License and  
10 Section 1.5 of the General Specifications, Dr. Kelly's expert testimony on the technical meaning of  
11 Section 2.1.2 and substantively-related provisions in the CSS Specifications, and the extrinsic  
12 evidence of the parties' understanding, it is clear that Section 2.1.2 imposes a playback from disc  
13 requirement. In the Court's view, Section 2.1.2 is not reasonably susceptible to a contrary  
14 interpretation.

15           (2)    The Normative/Informative Distinction

16           Kaleidescape also argues that Section 2.1.2 cannot impose a playback from disc requirement  
17 because the language of the provision is merely "informative." (11/30/11 AM Tr. 33:1-20 [Harkins].)  
18 Relying on Mr. Harkins's testimony, it contends that Section 2.1.2 does not impose "normative,"  
19 binding requirements on licensees because it does not use words like "shall," which, Mr. Harkins  
20 states, are necessary for a technically-oriented specification to impose such requirements. (*Id.*  
21 38:24-39:22 [Harkins].) The Court of Appeal rejected the "normative/informative" distinction,  
22 however. It stated that the supposedly "'informative' character" of the language of a contract does  
23 not mean that the language imposes no requirements. Rather, to determine if the language imposes  
24 requirements and, if so, what those requirements may be, a court must employ traditional  
25 interpretive principles. (*App. Op. supra*, 176 Cal.App.4th at p. 719.)

26           The basis of Mr. Harkins's normative/informative distinction is subject to question as well.  
27 Mr. Harkins testified that his opinion that words like "shall" and "must" are necessary for a technical  
28

1 specification to impose binding, normative requirements is premised on certain international  
2 specification guidelines. (11/29/11 PM Tr. 70:2-79:26)

3 Kalsidescape has cited no decision, however, in which a court has interpreted a contract  
4 based on those guidelines, and this Court is unaware of any such decision. In any event, Mr. Harkins  
5 admitted that the guidelines have no bearing on DVD technologies (11/30/11 PM Tr. 74:13-75:4  
6 [Harkins]), and that the provisions of the guidelines that demarcate their scope make clear that the  
7 guidelines do not apply to the CSS Specifications. (12/1/11 AM Tr: 8:26-28, 10:9-11:1, 11:5-12,  
8 13:6-19, 15:4-7 [Harkins].) Therefore, the guidelines on which Mr. Harkins relied do not constitute  
9 evidence of trade usage, custom, and practice in the DVD industry that can aid in the interpretation  
10 of the CSS Specifications. (*Southern Pacific Transp. Co. v. Santa Fe Pacific Pipelines, Inc.* (1999)  
11 74 Cal.App.4th 1232, 1244 ["Contract terms must be interpreted according to any special meaning  
12 given to them by usage, and technical terms are interpreted as generally understood in the  
13 industry."], citing Civ. Code, §§ 1644, 1645.) For all of these reasons, the Court does not credit Mr.  
14 Harkins's testimony that, under the guidelines on which he relied, Section 5 of the Descrambler  
15 Specifications and Section 6 of the Authenticator Specifications are the only binding provisions of  
16 the Technical Specification Titles because they are the only provisions of those documents that use  
17 the terms "shall" or "must." (11/30/11 AM Tr. 20:18-25:6 [Harkins].)

18 Further, Mr. Harkins did not address the fact that Section 4.2.1 of the License expressly states  
19 that CSS licensees "shall comply with the CSS Specifications," and that their "DVD Product[s] shall  
20 comply with the . . . CSS Specifications." (PRX-4, § 4.2.1, emphasis added.) Even assuming that  
21 Mr. Harkins is correct that a contractual provision in a technical specification can never impose  
22 requirements unless it uses words like "shall," Section 2.1.2 of the General Specifications satisfies  
23 that test. Section 2.1.2 imposes requirements by virtue of its plain statement of the processes for  
24 playback and by the explicit command in Section 4.2.1 of the License that CSS licensees and the  
25 DVD Products they make that use CSS "shall comply with the . . . CSS Specifications." Mr. Harkins  
26 apparently did not consider Section 4.2.1. He testified that he has no opinion on whether the General  
27 Specifications are part of a larger agreement, including the License; that he had no recollection of  
28 whether he had ever seen the License; and that he thus he has no opinion on whether the General

1 Specifications are encompassed by Section 4.2.1 of the License. (11/30/11 PM Tr. 53:27-56:20  
2 [Harkins].) Mr. Harkins's interpretation of Section 2.1.2 in isolation from the License Agreement as  
3 a whole is inconsistent with California law.

4 The Court notes that Kaleidescape itself did not subscribe to Mr. Harkins's interpretive  
5 approach when it reviewed the General Specifications and the other CSS Specifications after  
6 receiving them from the DVDCCA in 2002. Dr. Watson's 2003 compliance report (DRX-546), which  
7 Dr. Watson said he prepared based on a lengthy review of the CSS Specifications, acknowledged that  
8 those documents impose binding requirements, but erroneously concluded that the Kaleidescape  
9 System complies with them. If Kaleidescape had believed that the CSS Specifications were just  
10 informative and nonbinding, Dr. Watson's report presumably would have said that. (As discussed,  
11 above, however, such an interpretation, even if honestly believed by Dr. Watson at the time in 2003,  
12 would have been irrelevant as the undisclosed subjective intent of one party.)

13 (3) Proposed Amendments To The Procedural Specifications.

14 Kaleidescape argues that amendments proposed by some DVDCCA directors in May and  
15 November 2007, which would have inserted an express playback from disc requirement into the  
16 Procedural Specifications, demonstrate that the General Specifications do not contain any such  
17 requirement. (DRX-551, DRX-599.) According to Kaleidescape, there would have been no need to  
18 add an explicit playback from disc requirement in the Procedural Specifications if the General  
19 Specifications already contained that requirement. However, the evidence regarding the timing of  
20 the amendments shows that they were proposed after the trial court ruled that the General  
21 Specifications are not part of the License Agreement, and before the Court of Appeal reversed that  
22 decision and held that the General Specifications are part of the License Agreement and impose a  
23 playback from disc requirement. (Deposition of John Hoy, 8/4/11, 179:15-23.) Thus, the inference  
24 from the timing is that the directors who proposed the amendments were concerned, in light of the  
25 trial court's ruling, that licensees might not be bound by the requirements of the General  
26 Specifications, and so they sought, in an abundance of caution, to include the playback from disc  
27 requirement elsewhere in the License Agreement.

28

1           The evidence further indicates that the DVDOCA Board never voted on the proposed  
2 Amendments. (Parsons Dep., 8/31/11, 110:14-111-6; Hoy Dep., 8/4/11, 179:21-23.) Kaleidescape  
3 has presented no evidence to support its argument that the failure of the Board to vote on the  
4 proposed amendments demonstrates that the License Agreement was never intended to preclude  
5 playback of DVD content from a permanent digital copy stored on a server. It is at least equally  
6 likely that the amendments were not voted on because they were deemed unnecessary. Courts have  
7 long drawn a similar lesson in rejecting the argument that the meaning of a statute can be gleaned  
8 from the failure of a legislature to modify the statute. (E.g., *Central Bank of Denver, N. A. v. First*  
9 *Interstate Bank of Denver, N. A.* (1994) 511 U.S. 164, 187 [“Congressional inaction lacks persuasive  
10 significance because several equally tenable inferences may be drawn from such inaction, including  
11 the inference that the existing legislation already incorporated the offered change.”], internal  
12 quotation omitted.) It also can be inferred from the evidence that support for the amendments was  
13 diluted as a result of Kaleidescape’s June 2007 letter threatening to sue anyone who voted for the  
14 first amendment. (PRX-180; Parsons Dep., 8/31/11, 110:14-111:6.) And in the end, the Court of  
15 Appeal’s ruling that Section 2.1.2 of the General Specifications imposes a playback from disc  
16 requirement renders evidence about the proposed amendments academic.

17                           (4)    The Biddle Testimony.

18           The deposition testimony of Peter Biddle, which Kaleidescape relies upon, does not support  
19 the proposition that the License Agreement permits licensees to use CSS to make and sell devices  
20 that play back DVD content from permanent digital copies of the content stored on a server.  
21 Mr. Biddle testified that he was Microsoft’s representative in the working group that negotiated the  
22 License Agreement. He further testified that, on Microsoft’s behalf, he sought in the working group  
23 to ensure that there would be no blanket prohibition in the License Agreement on the copying of  
24 DVD content, and that the License Agreement that emerged from the working group and that was  
25 approved does not contain any such prohibition. (Biddle Dep., 2/9/11, 13:1-14:8, 14:10-12, 14:14-  
26 17, 14:19-15:4, 15:6-25, 16:2-9, 16:12-17:4, 17:6-8, 17:11-18:25, 19:3-7, 19:9-11, 20:3-6, 20:8-10,  
27 20:12-15, 20:17-21:6, 21:8-11, 21:13.) It is clear from Mr. Biddle’s testimony, however, that his  
28 concern in the working group was to ensure that the License Agreement did not prohibit the

1 temporary copying of DVD content in a computer's memory, a concept known as "buffering." (*Id.*  
2 40:3-9, 40:11-43:25, 44:2-6, 44:8-16, 44:18-45:15.) Temporary copying of scrambled A/V data in a  
3 buffer in a CSS Decryption Module is necessary for playback to occur. (11/17/11 AM Tr. 34:21-28,  
4 11/17/11 PM Tr. 52:21-28 [Kelly].) The court in the *RealNetworks* case interpreted the CSS  
5 Specifications to authorize this form of copying in the same opinion in which it interpreted Section  
6 2.1.2 of the General Specifications to prohibit use of CSS to make a permanent copy of CSS  
7 protected DVD content to a hard drive for playback without the physical DVD disc. (*RealNetworks*,  
8 *supra*, 641 F.Supp.2d at p. 923.) Authorized, temporary copying of DVD content in a buffer is very  
9 different from the permanent copying of DVD content to a server for unlimited playback at any time  
10 without the physical DVD disc, which is not authorized. Mr. Biddle acknowledged this distinction  
11 himself. He testified that the type of copying that the License Agreement does not authorize is the  
12 copying that occurs when one person copies rented or borrowed DVDs and thus can return the  
13 physical DVD disc to a DVD rental store or to the person from whom he borrowed the DVD because  
14 he can play the DVD content from the persistent copy that has been created. (Biddle Dep., 2/9/11,  
15 55:25-57:3, 57:6-58:5.)

16 The notion that Mr. Biddle sought to ensure on Microsoft's behalf that the License  
17 Agreement would allow licensees to use CSS to build devices that play back DVD content from  
18 persistent digital copies stored on a server is undercut by the lack of any evidence showing that  
19 Microsoft, which is a CSS licensee (DRX-567), has ever marketed any such device. (12/1/11 AM  
20 Tr. 25:3-11 [Harkins]; 11/29/11 PM Tr. 55:10-12 [Testimony of Geoffrey Franklin].) Microsoft is  
21 not alone in this regard. There is no evidence that any of the other leading information technology  
22 and consumer electronics companies that are CSS licensees (DRX-567), such as Apple, Pioneer,  
23 Toshiba, Sony, and Hewlett-Packard, use CSS to make and sell devices that play back DVD content  
24 from persistent digital copies stored on a server. (12/1/11 AM Tr. 26:20-27:8 [Harkins]; 11/29/11  
25 PM Tr. 54:18-55:9 [Franklin].) In fact, Mr. Harkins testified that he could not identify any CSS  
26 licensee that currently uses CSS in that manner. (12/1/11 AM Tr. 24:14-22 [Harkins].) The evidence  
27 is that Kaleidescape is the only one of the nearly 250 current CSS licensees (DRX-567) that does. If  
28 the License Agreement allows CSS to be used the way Kaleidescape uses it, surely other licensees,

1 which include some of the most innovative technology companies in the world, would have  
2 manufactured and sold devices that play back DVD content from persistent digital copies stored on a  
3 server. That they have not done so is further evidence of the unreasonableness of Kaleidescape's  
4 position that the License Agreement authorizes such a product.

5 **B. Breach Of The Procedural, Authenticator, and Descrambler Specifications.**

6 On remand, DVDCCA is allowed to assert additional breach theories, beyond the claim of  
7 breach of the General Specifications on which DVDCCA predicated its case at the first trial. (*Wood v.*  
8 *Lowe* (1974) 39 Cal.App.3d 296, 302.) At the trial on remand, DVDCCA submitted evidence that  
9 Kaleidescape has breached the Procedural, Authenticator, and Descrambler Specifications, all of  
10 which address the same CSS processes that are addressed by Section 2.1.2 of the General  
11 Specifications. The Court concludes that the evidence shows that Kaleidescape has violated these  
12 Specifications as well.

13 1. The Procedural Specifications.

14 Section 6.2.3 of the Procedural Specifications requires that a CSS Decryption Module must  
15 function in a way so that its Authenticator engages in and completes the authentication process with  
16 the DVD Drive in order to ensure that the CSS keys are transmitted to the Descrambler. (PRX-9, §  
17 6.2.3.) In short, authentication is supposed to be between a DVD Drive and the CSS Decryption  
18 Module, and the CSS keys must be obtained by the Authenticator in the CSS Decryption Module  
19 from the DVD Drive and then passed by the Authenticator to the Descrambler. That does not happen  
20 with the Kaleidescape System. Instead, the Authenticator Module for CSS Decryption Module in the  
21 Kaleidescape System diverts the CSS keys to the server. (11/17/2011 AM Tr. 57:14-58:14 [Kelly];  
22 11/17/11 PM Tr. 41:18-43:3 [Kelly].) Thus, Kaleidescape has breached Section 6.2.3.

23 Section 6.2.2.1 of the Procedural Specifications reinforces the requirement that the CSS  
24 Decryption Module must ensure delivery of the CSS Keys to the Descrambler directly from its  
25 Authenticator Module. It provides that the DVD Drive must "engage in and complete the  
26 authentication process with the CSS Decryption Module" and "to ensure that the CSS Keys and CSS  
27 data" (A/V data) are passed to the CSS Decryption Module, underscoring these requirements with a  
28 statement that "[t]hese technologies are designed to ensure that the destination product is a CSS

1 Compliant Product . . . .” (PRX-9, §6.2.2.1.) Dr. Watson testified that the Kaleidescape System’s  
2 server, the destination of the CSS Keys and CSS data after authentication, is not a CSS Compliant  
3 Product. (12/2/11 Tr. 77:15-79:4 [Watson].) Kaleidescape has breached Section 6.2.2.1.<sup>4</sup>

4                   2.     The Authenticator Specifications.

5             The Authenticator Specifications state that the authentication process is intended to “prevent  
6 digital-to-digital copying in a personal computer environment.” (PRX-10, § 1.1.) As Dr. Kelly  
7 testified, and Mr. Harkins did not dispute, the Kaleidescape System operates in a personal computing  
8 environment. (11/16/11 PM Tr. 58:5-59:28, 67:8-69:9; 11/17/11 AM Tr. 16:11-18 [Kelly].) The  
9 Authenticator Specifications require that the Authenticator Module for CSS Decryption Module  
10 must connect to the Descrambler when completing the bus decryption process. Kaleidescape has  
11 breached that requirement of the Authenticator Specifications because bus encryption, and bus  
12 decryption are processes for playback that do not occur when a Kaleidescape System plays back  
13 copied A/V data using copied keys from the server. The federal district court in *RealNetworks*  
14 reached the same conclusion about RealDVD, holding that it did not comply with the Authenticator  
15 Specifications’ requirements “concerning authentication and bus encryption.” (*RealNetworks, supra*,  
16 641 F.Supp.2d at p. 949.)<sup>5</sup> Additionally, Section 2 of the Authenticator Specifications prescribes  
17 how the algorithms for authentication and bus decryption are deployed. (PRX-10, § 2; 11/17/11 AM  
18 Tr. 46:6-47:1, 52:1-53:2 [Kelly].) By the terms of Section 2, the last of these algorithms for bus  
19 decryption – “Bus-Decrypt” – must be performed “[o]n [i]nsertion of disc,” and “[b]efore playback,”  
20 and specifies that the Authenticator in the CSS Decryption Module must connect “to Descrambler  
21 without appearing on a user-accessible bus.” (*Id.*) The Kaleidescape System performs neither of  
22

23             <sup>4</sup> Contrary to Kaleidescape’s contention, Kaleidescape’s breach of Section 6.2.2.1 of the  
24 Procedural Specifications was properly before the Court. Kaleidescape itself opened the door to this  
25 issue through Dr. Watson’s testimony in his direct examination that the Kaleidescape System  
26 complies with Section 6.2 of the Procedural Specifications (12/1/11 PM Tr. 43:24-60:4), with  
27 specific reference to Section 6.2.2 (*id.* 45:4-5), of which Section 6.2.2.1 is a part. In his cross-  
28 examination, Dr. Watson conceded that Kaleidescape must comply with Section 6.2.2 (12/2/11 Tr.  
71:16-19), but that it does not comply with Section 6.2.2.1’s authentication requirement. (*Id.* 78:6-  
79:4.)

<sup>5</sup> The Authenticator Specifications and Descrambler Specifications were part of the License  
Agreement between DVCCA and RealNetworks because, when it executed the License  
Agreement, RealNetworks selected the membership categories corresponding to those  
Specifications. (*RealNetworks, supra*, 641 F.Supp.2d at p. 922.)

1 these requirements, (11/17/11 AM Tr. at 47:3-6 [Kelly]), and thus Kaleidescape has breached Section  
2 2 of the Authenticator Specifications.

3 Kaleidescape offered little evidence to the contrary. Its proffered expert, Mr. Harkins,  
4 testified that bus decryption is a "missing step" in Section 2.1.2 of the General Specifications, but he  
5 acknowledged that bus decryption is reflected in the other CSS Specifications. (12/1/11 AM Tr. 6:3-  
6 17 [Harkins].)

7 **3. The Descrambler Specifications.**

8 The critical provision of the Descrambler Specifications is Section 3.2. (PRX-11.) Dr. Kelly  
9 testified that it requires that the Disc Key recovery logic be performed by the Descrambler upon  
10 insertion of the physical DVD disc in the DVD Drive. (11/17/11 AM Tr. 48:23-49:7, 62:12-63:14  
11 [Kelly].) The Kaleidescape System does not do this either. (*Id.*) Kaleidescape thus has breached the  
12 Descrambler Specifications.

13 **C. Breach Of The Anti-Circumvention Requirements.**

14 The Kaleidescape System also breaches the anti-circumvention rules of the CSS License  
15 Agreement. Section 5.2 of the License prohibits licensees from using the confidential CSS  
16 Specifications to circumvent the methodology disclosed in those confidential documents. (PRX-4 §  
17 5.2 [CSS License Agreement].) The evidence shows that Kaleidescape used the confidential CSS  
18 Specifications to circumvent the playback methods set forth therein in violation of Section 5.2.  
19 (Watson Dep., 6/23/2011, 317:18-22, 318:3-18.)

20 Additionally, Kaleidescape breaches the separate anti-circumvention requirement of Section  
21 6.2.12 of the Procedural Specifications, which states that "Licensees shall not produce or sell devices  
22 or software (a) under color of th[e] Agreement or (b) using CSS Confidential or Highly Confidential  
23 Information, where such devices or software are designed to circumvent the requirements of . . .  
24 Section 6.2." (PRX-9, § 6.2.12.) As indicated above, the Kaleidescape System is subject to Section  
25 6.2.12 because it uses Confidential Information within the meaning of the License. "The  
26 requirements of Section 6.2" to which Section 6.2.12 refers are thus implicated here.

27 Section 6.2, which is captioned "Copy Protection," sets forth "conditions [that] must be  
28 observed by CSS Licensees with respect to access to, playback of and transmission of CSS Data

1 and/or analog signals constituting the content converted from CSS Data.” (PRX-9, § 6.2.) Among  
 2 those “conditions” are the requirements of Sections 6.2.3 and 6.2.2.1 of the Procedural  
 3 Specifications, which set forth an authentication process between the DVD Drive and CSS  
 4 Decryption Module, and require that a Descrambler that is a CSS Compliant Product receive the  
 5 encrypted keys and the scrambled A/V data from the Authenticator Module in the CSS Decryption  
 6 Module. The Kaleidescape System circumvents those processes by causing the Authenticator to  
 7 copy the CSS Keys and A/V data to a Kaleidescape Server, which is not a CSS Compliant Product,  
 8 as opposed to a Descrambler that is a CSS Compliant Product (i.e. a Descrambler that complies with  
 9 the CSS Specifications). (12/2/11 Tr. 77:15-79:4 [Watson].) Therefore, the Kaleidescape System’s  
 10 use of CSS circumvents the required processes of Section 6.2 and breaches the anti-circumvention  
 11 requirement of Section 6.2.12.

12 **D. DVCCA Did Not Breach An Obligation Regarding The Ombudsman Process.**

13 DVCCA performed all, or substantially all, of the significant things that the contract  
 14 required it to do. After Kaleidescape executed the License Agreement and paid the administrative  
 15 fee, and requested the technical specifications for Descramblers and Authenticators, DVCCA then  
 16 sent Kaleidescape a master key, specifications for Descramblers (Title 609), specifications for  
 17 Authenticators (Title 809) and the General Specifications. Utilizing the specifications DVCCA had  
 18 provided, Kaleidescape completed development of its system and shipped it to dealers in August  
 19 2003.

20 Kaleidescape argues that DVCCA has failed to satisfy the elements of a breach of contract  
 21 claim because it breached an alleged obligation owed to Kaleidescape under Section 6.6 of the  
 22 DVCCA Bylaws, which provides that the “submission of a dispute to the Ombudsman shall be a  
 23 pre-condition to the institution of enforcement action by the [DVCCA].” (DRX-530.)

24 Kaleidescape does not deny that the parties’ dispute was submitted to an Ombudsman, Mr. Tully  
 25 (DRX-543), but argues that DVCCA violated Section 6.6 by filing suit in the Superior Court  
 26 before the Ombudsman reached a decision and issued a recommendation regarding the dispute. This  
 27 argument, which Kaleidescape unsuccessfully advanced at the first trial (*App. Op., supra*, 176  
 28 Cal.App.4th at p. 711, fn. 4), fails again.

1 First, the plain language of Section 6.6 of the DVDCCA Bylaws does not require that the  
 2 DVDCCA wait for a recommendation from the Ombudsman regarding a resolution of a dispute with  
 3 a licensee before it can file suit against the licensee. Section 6.6 simply states that, if an  
 4 Ombudsman is appointed, the DVDCCA must submit the dispute to the Ombudsman before a suit is  
 5 filed. DVDCCA complied with these procedures. DVDCCA appointed Mr. Tully as Ombudsman in  
 6 June 2004, submitted its dispute with Kaleidescape to him at that time (DRX-543), and did not sue  
 7 Kaleidescape until six months later.

8 Second, the Declaration of John Hoy submitted into evidence by Kaleidescape confirms  
 9 DVDCCA's compliance with the Ombudsman procedure before filing suit and states in paragraph 9  
 10 that:

11 DVD CCA and Kaleidescape submitted the dispute to the Ombudsman . . . Despite the  
 12 efforts of the parties and the Ombudsman, the process did not result in a resolution of the  
 13 dispute. The Ombudsman did not make a recommendation for resolution of the dispute to  
 the Board. (DRX- 593.)

14 Third, even assuming that DVDCCA was obligated by Section 6.6 to wait for a  
 15 recommendation from Mr. Tully before filing suit, Kaleidescape fails to show that its own obligation  
 16 to comply with the License Agreement was excused as a result. Any obligation that DVDCCA owes  
 17 under the Bylaws is not a condition precedent to Kaleidescape's compliance obligation.  
 18 Kaleidescape's compliance obligation is tied instead to DVDCCA's obligation in the License to  
 19 provide Kaleidescape with the CSS keys and transmit the confidential CSS Specifications (PRX-4,  
 20 §§ 4.1, 4.2), a condition precedent that DVDCCA indisputably fulfilled. (*App. Op., supra*, 176  
 21 Cal.App.4th at p. 715.) Thus, this is not a case in which a defendant's obligation to perform on a  
 22 contract is excused as a result of the plaintiff's failure to carry out a condition precedent. (Civ. Code,  
 23 § 1436 ["A condition precedent is one which is to be performed before some right dependent thereon  
 24 accrues, or some act dependent thereon is performed."]; *id.* § 1439 ["Before any party to an  
 25 obligation can require another party to perform any act under it, he must fulfill all conditions  
 26 precedent thereto imposed upon himself; and must be able and offer to fulfill all conditions  
 27 concurrent so imposed upon him on the like fulfillment by the other party . . ."].)

1 Fourth, in order to evaluate properly Kaleidescape's argument, the Court would need to  
2 consider evidence related to Mr. Tully's communications with the parties following his appointment  
3 as Ombudsman and the submission of the dispute to him. But any such evidence is subject to the  
4 mediation privilege and therefore inadmissible. (Evid. Code, § 1119, subd. (a) ["No evidence of  
5 anything said or any admission made for the purpose of, in the course of, or pursuant to, a mediation  
6 or a mediation consultation is admissible or subject to discovery."].)

7 **V. THE ENTRY OF PERMANENT INJUNCTIVE RELIEF UNDER THE**  
8 **PARTIES' CONTRACTUAL STIPULATION IS WARRANTED TO REMEDY**  
9 **KALEIDESCAPE'S BREACH.**

10 The Court of Appeal held that if this Court on remand finds that Kaleidescape has breached  
11 the License Agreement, it must "determine the nature and extent of the harm DVDCCA would suffer  
12 as a result of a continuing breach," and whether that harm can be "remedied in damages." (*App. Op.*  
13 *supra*, 176 Cal.App.4th at p. 727.) The Court of Appeal also held that if that harm cannot be  
14 remedied in damages, then the parties' contractual stipulation in Section 9.2 of the License that an  
15 injured party will suffer irreparable harm from certain breaches of the Agreement such that  
16 injunctive relief is warranted is controlling on remand. (*Ibid.*) Based on the Court of Appeal's  
17 decision and the evidence presented on remand, this Court concludes that DVDCCA is an "injured  
18 party" within the meaning of Section 9.2 and that the nature and extent of the harm that DVDCCA  
19 would suffer if Kaleidescape's breach is not enjoined cannot be adequately remedied in damages.  
20 Accordingly, DVDCCA is entitled to permanent injunctive relief under the parties' stipulation in  
21 Section 9.2 of the License.

22 Kaleidescape argues that Section 9.2 is inapplicable because the provision requires  
23 DVDCCA to prove that a breach of the License Agreement will lead to "widespread unauthorized  
24 copying of copyrighted content intended to be protected using CSS . . ." (PRX-4, § 9.2, emphasis  
25 added.) That is not what Section 9.2 says. Section 9.2's reference to "widespread unauthorized  
26 copying of copyrighted content intended to be protected using CSS . . ." is just an illustration of a  
27 type of harm that could result from a breach.<sup>6</sup> Contrary to Kaleidescape's argument, Section 9.2

28 <sup>6</sup> In pertinent part, Section 9.2 states: "Licensee and Licensor recognize and agree that due to the unique nature of certain provisions hereof and the lasting effect of and harm from a breach of

1 does not require that DVDCCA prove that particular form of harm in order for the provision to  
2 apply. The Court of Appeal did not read Section 9.2 in the way that Kaleidescape does. It described  
3 Section 9.2 as "an unambiguous recitation of the parties' intent pertaining to the remedy for a  
4 breach" that must be enforced if money damages cannot compensate DVDCCA for the breach.  
5 (*App. Op., supra*, 176 Cal.App.4th at p. 725.) The Court of Appeal did not state that, for Section 9.2  
6 to apply, the breach must entail "widespread unauthorized copying of copyrighted content intended  
7 to be protected using CSS. . . ."

8 Even if Kaleidescape's argument that Section 9.2 requires proof that a breach entails  
9 widespread unauthorized copying were correct, the record contains that proof. The evidence is that  
10 approximately 10,000 Kaleidescape Systems have been sold to date. (Malcolm Dep., 10/5/11,  
11 72:10-12.) With that number of systems in users' hands, if each user made as few as 10  
12 unauthorized copies of borrowed or rental DVDs, that would mean that there are 100,000  
13 unauthorized copies of copyrighted content stored on Kaleidescape Systems. Indeed, Kaleidescape's  
14 own evidence shows that the Kaleidescape System is designed to store large numbers of copies of  
15 DVDs, ranging from the hundreds to the thousands of copies. (PRX-17, at 17-0010; PRX-18, at 18-  
16 0008; 11/29/11 PM Tr. 47:8-27, 48:23-49:2 [Franklin].) Kaleidescape dealer Geoffrey Franklin  
17 testified that he has imported over 1,000 DVDs for a client. (11/29/11 PM Tr. 47:8-27, 48:23-49:2  
18 [Franklin].) Dr. Malcolm also testified he was aware of clients with thousands of them.

19 **A. The Nature And Extent Of DVDCCA's Harm.**

20 Kaleidescape argues that DVDCCA suffered no harm by first pointing to its stipulation filed  
21 Nov. 14, 2011 with the DVDCCA, that states:

22 DVDCCA does not possess knowledge of evidence of any harm that any movie studio, content  
23 provider, or other person or entity has suffered or may suffer from the manufacture, sale, or  
24 use of the Kaleidescape System, or knowledge of evidence of any adverse effect the  
25 manufacture, sale, or use of the Kaleidescape System has caused or may cause in the future on  
the release or distribution of movies or other content on DVDs, including the timing of DVD  
title releases or the number of titles released.

26 DVDCCA therefore stipulates that DVDCCA will not seek at trial to prove its claim of  
27 irreparable injury based on such evidence. Except for this limitation of DVDCCA, this  
stipulation does not preclude the presentation of evidence of alleged harm to DVD CCA,

28 such provisions, *including* making available the means for widespread unauthorized copying of  
copyrighted content intended to be protected using CSS. . . ." (PRX-4, § 9.2, emphasis added.)

1 including under Section 9.2 of the CSS License Agreement, or any other evidence by either  
2 party.

3 The November 14, 2011 stipulation does not support Kaleidescape's argument. Consistent  
4 with that stipulation, the evidence of harm that DVDCCA presented at the trial on remand was not  
5 predicated on, or derivative of, any harm to movie studios or content providers. DVDCCA did not  
6 offer evidence that movie studios or content providers have lost sales or would limit or delay the  
7 release of content on DVDs or release fewer movies on DVDs. The movie studios and content  
8 providers are not parties to this case, and so whether or not the Kaleidescape System has harmed them  
9 does not resolve whether DVDCCA has suffered harm. (11/18/11 AM Tr. 18:20-19:3 [Gilbert]  
10 (studios' lost DVD sales not an appropriate measure of DVDCCA's damage).)

11 As was the case at the first trial, the evidence of the nature of the harm that DVDCCA  
12 presented at the trial on remand related to harm to the integrity to the License Agreement, and thus  
13 harm to the DVDCCA's purpose of ensuring the License Agreement's integrity, that would arise from  
14 an unaddressed breach of the License Agreement by a CSS licensee. (*App. Op., supra*, 176  
15 Cal.App.4th at p. 722 [first trial]; 11/18/11 AM Tr. 19:6-14 [Testimony of Richard Gilbert].)

16 The Court of Appeal explained that the DVDCCA's unaddressed breach theory of harm is  
17 rooted in the development of CSS and the negotiation of the uniform License Agreement under which  
18 CSS would be licensed. As the Court noted, it is "undisputed that the movie studios insisted upon  
19 some method for preventing unauthorized copying before they would release their movies in the DVD  
20 format," and that the consumer electronics industry and the computer industry worked with the  
21 entertainment industry in developing an "answer to that concern," which was "[t]he CSS technology,  
22 combined with the License Agreement. . . ." (*App. Op., supra*, 176 Cal.App.4th at p. 727.) The  
23 evidence presented at the trial on remand demonstrates that trust in the integrity of the License  
24 Agreement was the basis around which these disparate industries coalesced. (Parsons Dep., 8/31/11,  
25 90:1-6, 136:5-25.) The evidence shows that this trust would erode if a CSS licensee that broke the  
26 rules preventing unauthorized copying of DVDs nevertheless were permitted to keep breaking them,  
27 *i.e.* if the breach were unaddressed. (*Id.* 55:24-56:25, 136:5-138:22.) In that event, the intended  
28 uniformity of the rules "becomes relatively moot" (*Id.* 55:13), because other licensees then would

1 have little compunction about following in the footsteps of the initial rule-breaker and breaking the  
2 rules too and the uniform, level playing field the License Agreement established would be upset. (*Id.*  
3 54:25-55:9, 125:22-126:7; *see also* Deposition of Wade Hanniball, 12/8/06, 77:4-10; Hoy Dep.,  
4 12/28/06, 89:23-90:3; 3/22/07 Tr. 145:5-11 [Perry].) This noneconomic harm that these witnesses  
5 described, both at the first trial and the trial on remand, is not harm to the entertainment, consumer  
6 electronics, or information technology industries. Rather, the harm is to DVDCCA itself from the  
7 undermining of those industries' trust and confidence in the License Agreement, and thus in  
8 DVDCCA, if a breach by a licensee were to go unaddressed.

9 The evidence DVDCCA presented regarding the extent of that harm shows that because an  
10 unaddressed breach of the License Agreement would likely beget follow-on breaches, "the very  
11 reason" for DVDCCA's existence, which is to ensure that every CSS licensee plays by uniform rules,  
12 would be compromised. (Parsons Dep., 8/31/2011, 56:22-57:6, 59:13-18, 59:21-60:5; 136:5-10.)  
13 DVDCCA's remedies expert, Richard Gilbert, a University of California at Berkeley economist who  
14 has been qualified as an expert in other cases involving the economics of intellectual property  
15 licensing (11/18/2011 AM Tr. 11:11-12:2 [Gilbert]), testified that an unaddressed breach will establish  
16 a rule-breaking precedent, thus compromising DVDCCA's authority to enforce the rules going  
17 forward and causing noneconomic harm to DVDCCA. (*Id.* 19:8-14, 23:21-24:2, 26:14-20.) Other  
18 CSS licensees, concluding that they can get away with making DVD copiers, will make them,  
19 frustrating the ability of DVDCCA to carry out its goal of ensuring the uniformity of the CSS  
20 licensing system. (*Id.* 21:10-15.)<sup>7</sup>

21 Kaleidescape argues that DVDCCA has not presented evidence that it has suffered or will  
22 suffer any economic harm from the manufacture, sale or use of the Kaleidescape System. However,  
23 economic harm is not a precondition to obtaining injunctive relief. (*See, e.g. Clear Lake Riviera*  
24 *Community Ass'n v. Cramer* (2010) 182 Cal.App.4th 459, 473 [enjoining homeowner from violating  
25 community association's height guidelines where harm was not only economic, but also included  
26

27 <sup>7</sup>The loss of current or potential CSS licensees, evidence on which was not adduced at trial, is  
28 one possible manifestation of harm to DVDCCA. However, the sustainability of DVDCCA as a  
consensus-based consortium dedicated to preserving uniform rules, abundant evidence on which was  
adduced at trial and is cited in this section of the Statement of the Decision, is another manifestation  
of harm to DVDCCA.

1 causing "Association [to] effectively lose the ability to enforce any of its guidelines"; *High Sierra*  
 2 *Hikers Assoc. v. Blackwell* (9th Cir. 2004) 390 F.3d 630, 642-643 [nonprofit organizations were  
 3 entitled to injunction to prevent environmental injury to wilderness areas].)

4 Kaleidescape fares no better with its argument that the only evidence of harm from an  
 5 unaddressed breach that DVDCCA has presented is "future" harm and that such harm cannot be the  
 6 basis for an injunction (11/28/11 PM Tr. 42:21-43:2, 43:27-44:1.) That argument is wrong on the facts  
 7 and the law.

8 As to the facts, DVDCCA presented evidence of the noneconomic harm to the integrity of the  
 9 License Agreement that it previously suffered as a result of the first trial in the case, which allowed  
 10 Kaleidescape to continue selling the Kaleidescape System and led to the introduction by  
 11 RealNetworks, a CSS licensee, of its RealDVD product. Indeed, the court in *RealNetworks* found that  
 12 RealNetworks relied on the initial trial court decision here in concluding that it could go ahead and  
 13 launch its RealDVD product. (*RealNetworks, supra*, 641 F.Supp.2d at p. 925.)<sup>8</sup> That action of  
 14 RealNetworks is an actual manifestation of the theory of harm to the integrity of the License  
 15 Agreement and to DVDCCA's mission from an unaddressed breach.<sup>9</sup> The uncontroverted testimony  
 16 at trial is that a RealNetworks-type experience likely will recur in the future if Kaleidescape is found  
 17 in breach of the License Agreement but is not enjoined because an unaddressed breach of the rules is  
 18 likely to lead to another breach. Based on his analysis of RealNetworks' DVD copier, DVDCCA's

19 <sup>8</sup> This Court may take judicial notice of the existence of the factual finding of the federal  
 20 district court in the *RealNetworks* case regarding the impact of the initial trial court decision in this  
 21 case on the actions of RealNetworks, without taking judicial notice of the truth of those findings.  
 (*Sosinsky v. Grant* (1992) 6 Cal.App.4th 1548, 1563 [court may take judicial notice that previous  
 court made certain findings without taking judicial notice of the truth of those findings].)

22 <sup>9</sup> Kaleidescape argued that the RealNetworks experience does not reflect proof that an  
 23 unaddressed breach harms DVDCCA because at the time RealNetworks introduced its RealDVD  
 24 product, there was a final judgment in this case that Kaleidescape was not in breach of the License  
 25 Agreement. Kaleidescape's argument is wrong for multiple reasons. First, because DVDCCA  
 26 appealed from it, the initial trial court ruling was not a final judgment. (*Franklin & Franklin v. 7-*  
 27 *Eleven Owners for Fair Franchising* (2000) 85 Cal.App.4th 1168, 1174.) Second, the initial court  
 28 ruling did not hold that Kaleidescape was not in breach of the License Agreement. It declined to  
 reach the breach issue in holding that the General Specifications were not part of the License  
 Agreement. Third, and most importantly, the unaddressed breach theory does not depend on a  
 finding of breach. It is premised on the inability of DVDCCA to "enforce the License Agreement"  
 to prevent unauthorized copying of CSS-protected content (*App. Op., supra*, 176 Cal.App.4th at p.  
 727), whether that inability stems from a finding that a particular Specification is not part of the  
 Agreement, a finding that a licensee that made a DVD copier is nonetheless not in breach, or a  
 finding that injunctive relief is not warranted to remedy a breach of the Agreement.

1 technical expert, Dr. Kelly, testified in this case that a DVD copier that uses and CSS and that has the  
2 same basic DVD copying functionality as the Kaleidescape System could be sold to consumers for a  
3 relatively inexpensive price. (11/17/2011 AM Tr. 65:2-66:11, 66:16-24 [Kelly].) As Dr. Kelly  
4 testified, RealNetworks sold a software product with similar CSS functionality for less than \$30,  
5 which was a fraction of the cost of the Kaleidescape System. (*Id.* 66:16-24; 11/17/2011 PM Tr. 45:21-  
6 46:21 [Kelly].)

7 As to the law, Kaleidescape's argument is contrary to the fundamental remedial principle that  
8 an injunction may be entered to prevent the prospect of future harm from occurring. (*See, e.g., In re*  
9 *Tobacco II Cases* (2009) 46 Cal.4th 298, 320; *Scripps Health v. Marin* (1999) 72 Cal.App.4th 324,  
10 333; *People v. Toomey* (1984) 157 Cal.App.3d 1, 20.) If Kaleidescape were right, then a party to a  
11 contract could not secure an injunction to remedy an anticipatory breach of the contract because the  
12 harm from such a breach often will not occur until the breach occurs, which is sometime in the future.  
13 That is not the law, however. (*See Southern Christian Leadership Conference v. Al Malaikah*  
14 *Auditorium Co.* (1991) 230 Cal.App.3d 207, 224 [injunctive relief may be granted to enjoin an  
15 anticipatory breach of a contract that can be specifically enforced].)

16 **B. Monetary Relief Cannot Adequately Remedy The Harm To The DVDCCA.**

17 Professor Gilbert testified that a monetary award cannot adequately compensate DVDCCA for  
18 the harms arising from an unaddressed breach of the License Agreement. (11/18/11 AM Tr. 13:25-  
19 14:2 [Gilbert].) Professor Gilbert provided three bases for that opinion.

20 First, Professor Gilbert testified that any monetary damages to DVDCCA would be hard to  
21 predict because of the lack of experience with unaddressed breaches of the License Agreement.  
22 (11/18/11 AM Tr. 16:7-9, 17:25-18:10 [Gilbert].) This lack of experience with unaddressed breaches  
23 stems from the fact that the DVDCCA has been successful in maintaining uniformity of the License  
24 Agreement. As the Court of Appeal pointed out, "[a]t the time of [the first] trial, there was no  
25 unaddressed breach," and DVDCCA sued Kaleidescape precisely to address the breach. (*App. Op.*,  
26 *supra*, 176 Cal.App.4th at p. 726.) Professor Gilbert noted that it was only in the two-year period  
27 between the initial trial court decision and the Court of Appeal decision reversing the judgment for  
28 Kaleidescape and remanding that there has been an unaddressed breach. (11/18/11 AM Tr. 18:4-10

1 [Gilbert].) Professor Gilbert opined that a calculation of the amount of lost DVD sales from DVD  
2 "piracy" would not be an accurate measure of the harm arising from an unaddressed breach of the  
3 License Agreement by a CSS licensee. (*Id.* 18:11-19:3.) For this reason, Professor Gilbert also  
4 opined that the impact on the DVDCCA from the use of DeCSS technology for copying DVDs is  
5 irrelevant to the remedial question in this case because DeCSS was not licensed by DVDCCA.  
6 (11/18/11 PM Tr. 26:24-27:27 [Gilbert]. Professor Gilbert's opinion on the irrelevance of DeCSS was  
7 consistent with the Court of Appeal's ruling in this case, which stated that evidence about the  
8 availability of unlicensed DVD copying technology that does not use CSS is irrelevant to the asserted  
9 harm to DVDCCA caused when a CSS licensee uses CSS in DVD copying technology. (*App. Op.*,  
10 *supra*, 176 Cal.App.4th at pp. 726-727.)

11 Second, Professor Gilbert testified that an unaddressed breach of the License Agreement  
12 would cause "non-monetary" harm to DVDCCA. (11/18/11 AM Tr. 16:10-18, 19:4-19 [Gilbert].)  
13 Professor Gilbert observed that DVDCCA is a not-for-profit organization with one mission:  
14 administering and enforcing the License Agreement. (*Id.* 19:6-11.) Professor Gilbert further  
15 explained that an unaddressed breach, by definition, would significantly impair DVDCCA's ability to  
16 carry out that mission and thus cause harm to DVDCCA. (*Id.* 23:21-24:2.) Professor Gilbert opined  
17 that "it's hard to put a dollar term" on that type of harm, which implicates the organization's very  
18 existence. (*Id.* 19:6-19.)

19 Third, Professor Gilbert testified that an unaddressed breach of the License Agreement has  
20 "spillover effects" that are difficult to quantify monetarily. (11/18/11 AM Tr. 16:20-23, 20-23:21:1  
21 [Gilbert].) Professor Gilbert explained that the "spillover effect" from Kaleidescape's unaddressed  
22 breach after the first trial in the case was the creation of a DVD copier by another CSS licensee,  
23 RealNetworks. (*Id.* 21:2-15.) Additionally, Professor Gilbert explained this spillover harm would  
24 likely recur in the future if a breach by Kaleidescape went unaddressed: like RealNetworks, he said,  
25 other CSS licensees might be emboldened to make a DVD copier. This future spillover harm,  
26 Professor Gilbert opined, cannot be addressed in monetary terms, and thus it does not make economic  
27 sense to wait for that future copycat breach to occur before addressing Kaleidescape's breach through  
28 injunctive relief. (*Id.* 25:8-26:3.)

1 Professor Gilbert testified that each of these three problems with respect to the adequacy of  
2 monetary relief -- the difficulty of predicting harm, the existence of non-monetary harms, and likely  
3 spillover effects -- have "one unified theme." And that theme is that it is difficult to quantify the  
4 amount of harm to DVDCCA arising from a breach of the License Agreement. (11/18/11 AM Tr.  
5 17:11-22 [Gilbert].) Summing up his conclusions, Professor Gilbert stated: "I've thought about it. I  
6 don't see how to perform a reliable calculation." (11/18/11 PM Tr. 28:23-26 [Gilbert].)

7 Professor Gilbert's opinion that money damages cannot adequately compensate DVDCCA was  
8 unrefuted. Indeed, it was confirmed by Kaleidescape. The evidence shows that Kaleidescape  
9 recognized early on that the harm to DVDCCA arising from a breach of the License Agreement would  
10 be very hard to quantify. In 2003, for example, Kaleidescape's Chief Technology Officer, Dr. Watson,  
11 predicted in an email to company CEO Dr. Malcolm that: "It may not be easy for DVD-CCA to  
12 terminate [the License Agreement] without being able to show some kind of damages (*and they won't*  
13 *be able to do that.*)" (PRX-49 (emphasis added) [KAL038184-KAL038185].) In the same vein, Dr.  
14 Malcolm forecast in a 2006 email about this lawsuit that: "[t]he court could also require that  
15 Kaleidescape pay damages to DVDCCA, *but the DVDCCA would have difficulty proving any real*  
16 *damages.*" (PRX-136 (emphasis added) [KAL82779-KAL82780].)

17 Kaleidescape's two remedies experts at trial, Dr. Roger Noll and Mr. Paul Regan, did not  
18 testify to the contrary. Neither of them quantified the harm to DVDCCA. Mr. Regan asserted that a  
19 lost profits calculation for non-profit entities such as DVDCCA could be made. (12/1/11 PM Tr.  
20 6:21-26 [Regan]) However, he conceded that he had not done a lost profits calculation in this case  
21 (*Id.* 6:13-15), and that no such calculation could be made given "the facts and circumstances" of the  
22 case. (*Id.* 6:18-20.) Mr. Regan also admitted that he could not quantify economic damage to  
23 DVDCCA arising from a breach by a licensee of the licensing rules. (*Id.* 9:1-13.)

24 Instead of attempting to quantify the harm to DVDCCA, Dr. Noll and Mr. Regan disputed  
25 whether DVDCCA would suffer any harm from a breach of the License Agreement in the first  
26 place--a position that contradicts Kaleidescape's contractual stipulation that DVDCCA would be  
27 irreparably harmed and the Court of Appeal's holding that the sole inquiry on remand is whether that  
28 harm, which the Court of Appeal described as harm to the integrity of the License Agreement arising

1 from an unaddressed breach, can be adequately remedied through monetary relief. (*App. Op., supra*,  
2 176 Cal.App.4th at pp. 726-727.)

3 In any event, Dr. Noll's testimony on harm served to support DVDCCA's argument that a  
4 breach of the uniform rules of the License Agreement would cause it to suffer irreparable injury from  
5 an erosion of trust and confidence in the integrity of the License Agreement. Dr. Noll conceded that  
6 DVDCCA's claim of irreparable injury relates to the sustainability of the organization, and that this, in  
7 turn, depends on its ability to forge a consensus around a common standard of encryption of DVD  
8 content and to enforce that standard. (12/2/11 Tr. 114:20-26.) Dr. Noll testified, however, that he did  
9 not analyze the consequences for a consensus organization like DVDCCA if a member does not  
10 follow the standard, and that he would not know how to conduct such an analysis anyway. (*Id.*, 115:2-  
11 12.)

12 Additionally, Dr. Noll's opinion that DVDCCA has not suffered harm was based on a  
13 misunderstanding of the facts of the *RealNetworks* case. Dr. Noll testified that he did not disagree  
14 with the court's decision to enjoin *RealNetworks*. (12/2/11 Tr. 123:21-26.) This indicates that Dr.  
15 Noll was familiar with that case. But Dr. Noll's testimony revealed that he was unaware that, as the  
16 *RealNetworks* experience showed, devices that play back DVD content from permanent digital  
17 copies of the content can be sold to consumers at a relatively low price, (*RealNetworks, supra*, 641  
18 F.Supp.2d at p. 925; 11/17/2011 AM Tr. 65:2-25, 66:16-24 [Kelly]), not for the tens of thousands of  
19 dollars that Dr. Noll thought that such products would cost. (12/2/11 Tr. 113:10-114:11 [Noll].)  
20 Thus, Dr. Noll was unaware of the nature and extent of the harm posed to the DVDCCA by the  
21 ability of CSS licensees to market inexpensive DVD copiers, which is one of the central lessons of  
22 the *RealNetworks* case.

23 Mr. Regan acknowledged that Kaleidescape had stipulated in the License Agreement that  
24 DVDCCA would suffer irreparable harm from a breach of the License Agreement and that a  
25 permanent injunction would be warranted to remedy that harm. Mr. Regan opined that such  
26 stipulations are a common feature of agreements for the licensing of intellectual property. (12/1/11  
27 PM Tr. 10:5-15 [Regan].)  
28

1 Finally, neither Mr. Regan nor Dr. Noll took into account the Court of Appeal's statement that  
2 evidence of irreparable harm is the flip side of the same coin as evidence of the inadequacy of, or  
3 difficulty in, quantifying monetary compensation. As the Court put it, "to say that the harm is  
4 irreparable is simply another way of saying that pecuniary compensation would not afford adequate  
5 relief or that it would be extremely difficult to ascertain the amount that would afford adequate relief."  
6 (*App. Op., supra*, 176 Cal.App.4th at p. 722; *see also* Civ. Code, § 3422; 11/18/11 PM Tr. 28:27-30:24  
7 [Gilbert].) The evidence presented at trial demonstrates that the harm to DVDCCA's mission of  
8 maintaining the integrity and uniformity of the License Agreement that would arise from an  
9 unaddressed breach of the License Agreement cannot be adequately remedied through monetary relief  
10 and thus that harm is irreparable. Accordingly, under the Court of Appeal's decision, the parties'  
11 contractual stipulation in Section 9.2 of the License controls and this Court must enter a permanent  
12 injunction to remedy Kaleidescape's breach.

13 **C. The Equities Weigh Against Kaleidescape.**

14 Kaleidescape's argument that it will be greatly burdened if a permanent injunction is entered  
15 against it such that the equities tip in its favor is not supported by the evidence.

16 First, Kaleidescape's CEO Dr. Malcolm has stated that Kaleidescape will survive no matter  
17 the outcome of this lawsuit because of its substantial business that is "unrelated" to the suit. (PRX-  
18 135 [KAL037032-KAL037034].) That unrelated" business includes Kaleidescape's manufacture  
19 and sale of Blu-ray players and equipment that provides support for music. (Malcolm Dep., 10/5/11,  
20 113:6-11.) Dr. Malcolm has testified that none of the company's employees (most of whom were  
21 hired after DVDCCA sued Kaleidescape) has duties that are exclusively related to DVDs. (11/29/11  
22 PM Tr. 14:15-15:17 [Malcolm].) Second, Dr. Malcolm testified that Kaleidescape likely can come  
23 into compliance with the License Agreement within four to twelve months in the event of a ruling  
24 against it in this lawsuit. And the evidence suggests that Kaleidescape has the funds to support itself  
25 while it seeks to come into compliance. (Malcolm Dep., 10/5/11, 15:22-24.) Third, as a CSS  
26 licensee, Kaleidescape could have sought to propose amendments to the License Agreement that  
27 would allow a device that functions like the Kaleidescape System. (DRX-530 §§ 6.2, 6.3.) But it  
28 never proposed any such amendment, and never sought the cooperation of other licensees in the

1 development of an amendment. (Malcolm Dep., 10/5/11, 83:23-84:22; Parsons Dep., 8/31/11,  
2 30:11-24, 139:15-140:2, 140:8-18, 141:4-142:8; 12/2/11 Tr. 68:15-20 [Watson].) Fourth, Dr. Noll  
3 testified that, had it pursued the amendment option, Kaleidescape might have been required to reveal  
4 its innovation to competitors. (12/2/11 Tr. 121:12-24 [Noll].) But Kaleidescape did not want to do  
5 that. The evidence shows that such an approach would have been contrary to the company's strategy  
6 to operate in a "stealth mode," which it did for two years from 2001-2003 as a means of erecting  
7 barriers to competition. (PRX-186; Malcolm Dep., 10/5/11, 94:4-22; 11/29/11 PM Tr. 23:6-24:16.)  
8 Finally, Kaleidescape admitted that, when it embarked on its business plan, it took the risk that the  
9 License Agreement might be interpreted to preclude the Kaleidescape System. (Deposition of  
10 Stephen Watson, 6/27/06, 23:5-6 ["We chose to risk the possibility that the full CSS License would  
11 turn out to be unacceptable to us."]) Indeed, before it executed the License Agreement,  
12 Kaleidescape was aware that DVDCCA likely would require a CSS-licensed device to play back  
13 DVD content from the physical DVD disc (PRX-44; PRX-72; PRX-144), but it proceeded anyway,  
14 and filed a provisional patent application several months prior to receiving the CSS Specifications  
15 (PRX-85), and has touted the Kaleidescape System as CSS-compliant from the time that it first  
16 marketed that product. (11/29/11 PM Tr. 12:3-7.) In the Court's view, Kaleidescape cannot be heard  
17 now to complain about the hardships arising from the fact that the risk that the Kaleidescape System  
18 would be found not to be CSS-complaint has materialized. (See *City of San Marino v. Roman*  
19 *Catholic Archbishop of Los Angeles* (1960) 180 Cal.App.2d 657, 673 ["One who purchases property  
20 in anticipation of procuring a variance to enable him to use it for a purpose forbidden at the time of  
21 sale cannot complain of hardship ensuing from the denial of the desired variance."], internal  
22 quotations and citation omitted.)

23 In addition, Kaleidescape has been on notice that DVDCCA objected to its products since it  
24 received its December 22, 2003 letter (within about four months of when it first began selling its  
25 systems.) (DRX-536.) Its April 24, 2003 email exchange entitled "Thinking Out Loud," suggests  
26 that Kaleidescape took a calculated risk, knowing it might be sued, to release their product without  
27 any carousel, and Dr. Malcolm noted that "[t]hings move very, very slowly in the litigation world."  
28 (PRX- 133.) At the time DVDCCA filed its lawsuit on December 7, 2004, Kaleidescape only had

1 close to 300 systems installed in the field. (PRX-51.) Ironically, the closing arguments on this trial  
 2 were seven years later on December 7, 2011, and by that time Kaleidescape had sold over 10,000  
 3 systems. Dr. Malcolm's prediction in his April 23, 2003 email that "[t]hings move very, very slowly  
 4 in the litigation world," was correct. (PRX-133.)

5 In sum, the balance of the equities do not weigh in Kaleidescape's favor. Any burden that it  
 6 will incur does not outweigh the harm to DVDCCA for which a permanent injunction is warranted as  
 7 a remedy.

8 **VI. KALEIDESCAPE'S AFFIRMATIVE DEFENSES AND PUBLIC POLICY**  
 9 **ARGUMENTS.**

10 On remand, Kaleidescape filed an amended answer that contains a laundry list of affirmative  
 11 defenses. The Court has considered all the arguments Kaleidescape made regarding its affirmative  
 12 defenses in its trial brief, even though none were argued in its closing arguments. The affirmative  
 13 defenses are meritless. Kaleidescape has not met its burden of proof by a preponderance of the  
 14 evidence with respect to any of its affirmative defenses.

15 Kaleidescape's affirmative defenses are failure to state a cause of action (first affirmative  
 16 defense); unclean hands (second affirmative defense); no equitable relief (fifth affirmative defense);  
 17 consent (sixth affirmative defense); unconscionable conduct (seventh affirmative defense); no  
 18 equitable relief (eighth affirmative defense); unenforceability (ninth affirmative defense); and  
 19 reformation (tenth affirmative defense). DVDCCA's demurrer to Kaleidescape's third and fourth  
 20 affirmative defenses, waiver and estoppel, respectively, was sustained. Its demurrer to the remaining  
 21 affirmative defenses was overruled. (Dec. 17, 2010 Order on Pl.'s Demurrer to First Am. Ans.)

22 The first amended complaint states a cause of action for breach of contract. As indicated  
 23 above, the elements of a claim for breach of contract are (1) the existence of a contract; (2) plaintiff's  
 24 performance of the contract or excuse for nonperformance; (3) the defendant's breach of the  
 25 contract; and (4) damage to the plaintiff arising from the defendant's breach. (*Abdelhamid, supra*,  
 26 182 Cal.App.4th at p. 999.)<sup>10</sup>

27 <sup>10</sup> Plaintiff's second cause of action for breach of the covenant of good faith and fair dealing is  
 28 dismissed with prejudice as Plaintiff's counsel indicated in closing arguments that breach of contract  
 was the only claim the Court needed to address in its tentative decision. (12/7/2011, Tr. 56:2-17 [Mr.  
 Zager].) (See Wegner, Fairbank & Epstein, Cal. Prac. Guide: Civil Trials and Evid. (The Rutter Group

1 Kaleidescape's consent defense was not disputed in its trial brief, and there was no evidence  
2 that DVDFCA consented to Kaleidescape's breach of its License Agreement.

3 Kaleidescape's affirmative defenses that DVDFCA has unclean hands, is not entitled to  
4 equitable relief, and engaged in unconscionable conduct, and that the CSS License Agreement  
5 should be reformed are all contingent on the notion that CSS Specifications were "secret documents"  
6 that DVDFCA refused to disclose to Kaleidescape until after it executed the Agreement. According  
7 to Kaleidescape, DVDFCA had no "reason, necessity, or business or commercial justification" for  
8 keeping those documents "secret." But that statement defies the law of the case established by the  
9 Court of Appeal, which held that maintaining the confidentiality of the CSS Specifications prior to  
10 execution of the CSS License Agreement was central to the "overarching and undisputed intent of  
11 the License Agreement," and that Kaleidescape knew well that it would not receive the confidential  
12 CSS Specifications until after it executed the Agreement. (*App. Op., supra*, 176 Cal.App.4th at p.  
13 715.) There was nothing secret about this fact.

14 The district court in *RealNetworks* rejected an identical "secret documents" defense.  
15 (*RealNetworks, supra*, 641 F.Supp.2d at pp. 947-952.) It held that notwithstanding the fact that  
16 RealNetworks "had no opportunity to negotiate any of the provisions [of the License Agreement],  
17 including the confidential technical specifications only given to Real after the execution of the  
18 [License] Agreement," the Agreement was enforceable according to its terms. (*Id.* at p. 947.) The  
19 district court recognized the "understandable benefit of leaving the terms non-negotiable and  
20 granting all subscribing parties, across all industries, a level playing field for this basic ability."  
21 (*Ibid.*)

22 As the Court of Appeal in the present case stated at 176 Cal. App.4th at pages 713-714:

23 Having independently reviewed the plain language of the License Agreement, we find that it  
24 unambiguously grants Kaleidescape a license to use CSS to develop a DVD device in  
25 exchange for a number of promises, including Kaleidescape's promise that it would maintain  
26 the confidentiality of the CSS technology and that it would comply with the CSS  
specifications that DVDFCA would provide after Kaleidescape selected a membership  
category and paid the associated fees.

27  
28 2011) ¶12:390, pp.12-77 to 12-78 ["Plaintiff retains the right to dismiss any cause of action ... even  
during trial. However, any dismissal during trial must be with prejudice ... unless all parties consent to  
dismissal without prejudice or the court so orders on a showing of good cause. [CCP §581(e)"].

1  
2 In this case, the agreement plainly requires Kaleidescape to comply with technical  
3 specifications that would not be disclosed until after the agreement was executed .....

4 As the Court of Appeal in this case has stated at 176 Cal.App.4th, page 715:

5 The overarching and undisputed intent of the License Agreement was to allow Kaleidescape  
6 to produce a DVD device utilizing CSS to access DVD content while maintaining the  
7 confidentiality of the CSS technology. DVDCCA could not distribute confidential  
8 information pertaining to CSS absent Kaleidescape's promise to maintain its confidentiality.  
9 Thus, the agreement was made under circumstances that required DVDCCA to withhold the  
10 confidential specifications until after Kaleidescape signed the confidentiality provisions  
11 contained in the License Agreement. Both parties understood that technical specifications  
12 would be provided after the License Agreement was executed. Kaleidescape knew that it  
13 was taking a risk that the undisclosed specifications might preclude the type of device it  
14 planned to make. All three sets of specifications, identically formatted, were delivered  
15 together, along with the master key, promptly after the agreement was executed, indicating  
16 that General Specifications was one set of CSS specifications that DVDCCA was providing  
17 pursuant to the License Agreement.

18 The underlying concern in many of Kaleidescape's affirmative defenses was that  
19 Kaleidescape should not be bound by terms contained in a "secret" document. However, the License  
20 Agreement was not unfair to Kaleidescape.

21 As the Court of Appeal in this case stated at 176 Cal.App.4th, pages 715-716 [fn. 5 omitted]:

22 The License Agreement is a contract of adhesion in that it is "a standardized contract, which,  
23 imposed and drafted by the party of superior bargaining strength, relegates to the subscribing  
24 party only the opportunity to adhere to the contract or reject it." (*Neal v. State Farm Ins. Cos.*  
25 (1961) 188 Cal.App.2d 690, 694, 10 Cal.Rptr. 781.) But such a contract is fully enforceable  
26 according to its terms "unless certain other factors are present which, under established legal  
27 rules—legislative or judicial—operate to render it otherwise." (*Graham v. Scissor-Tail, Inc.*  
28 (1981) 28 Cal.3d 807, 820, 171 Cal.Rptr. 604, 623 P.2d 165, fn. omitted.) To be sure,  
standardized licenses offered on a take-it-or-leave-it basis are not at all uncommon and have  
numerous commercial benefits. (*See, e.g., Pro CD, Inc. v. Zeidenberg* (7th Cir. 1996) 86 F.3d  
1447, 1450-1452 [for Judge Easterbrook's discussion of why shrink-wrap software licenses  
are enforceable].)

Kaleidescape's argument that it ought not be bound by secret terms is akin to arguing that the  
terms were not consistent with its reasonable expectations, one of the judicial limitations  
upon enforcing contracts of adhesion. (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal.3d at p.  
820.) But Kaleidescape actually anticipated the requirements of sections 1.5 and 2.1.2 in its  
prelicensing discussions. Watson admitted that Kaleidescape understood that the undisclosed  
specifications might prohibit the type of system the founders had in mind. One adviser even  
warned that the license would probably include a disk-in-tray requirement. Furthermore, the  
requirements of General Specification were no more secret than were the requirements of  
Titles 609 and 809, by which Kaleidescape is admittedly bound. Thus, although the contract  
was adhesive in that Kaleidescape had to agree to its terms if it wanted to license CSS, the  
requirements contained in General Specifications did not fall outside Kaleidescape's  
reasonable expectations.

1 One reason the trial court might have been concerned with whether the license was unfairly  
2 adhesive would have been to decide how forcefully to apply the doctrine of *contra*  
3 *proferentem*—the rule that unresolved ambiguities in a contract are to be interpreted against  
4 the drafter. (Civ. Code, § 1654; *Badie v. Bank of America* (1998) 67 Cal.App.4th 779, 801, 79  
5 Cal.Rptr.2d 273.) Since we find the extrinsic evidence resolves any ambiguity in the contract  
6 language, application of that rule is beside the point.

7 In any event, Kaleidescape never complained to DVDCCA about the supposedly secret  
8 documents or secret terms. (Watson 6/23/2011 Dep. 320:5-14, PRX 226.) Furthermore,  
9 Kaleidescape could have terminated its license after it received and reviewed the secret documents  
10 and terms. But it did not do that. And as a CSS licensee and participating member in the DVDCCA,  
11 Kaleidescape could, at any time, have sought to propose an amendment to the CSS Specifications.  
12 (DRX-530 §§ 6.2, 6.3.) But Kaleidescape did not avail itself of that right either: it never proposed  
13 any amendments, and never sought the cooperation of other licensees to develop an amendment.  
14 (Malcolm Dep., 10/5/11, 83:23-84:22; Parsons Dep., 8/31/11, 30:12-24, 139:15-140:2, 140:8-18,  
15 141:4-142:8;; 12/2/11 Tr. 68:15-20 [Watson].)

16 In its trial brief regarding its unclean hands defense, Kaleidescape claims, among other things,  
17 that DVDCCA breached an obligation to provide a content marking system (Kaleidescape's Trial  
18 Brief at 29:23 to 30:17) and DVDCCA's breach of fiduciary duties (Kaleidescape's trial brief at  
19 30:18 to 31:5.) However, Kaleidescape failed to prove any affirmative defense at trial by a  
20 preponderance of the evidence.

21 In any event, Section 6.2.13.2 of the Procedural Specifications, which Kaleidescape invoked  
22 in its trial brief as support for this affirmative defense, imposes no obligation on DVDCCA to adopt  
23 a content marking system. That provision states that work on a content marking system "will be  
24 pursued vigorously and expeditiously." (PRX-9, Section 6.2.13.2.) At most, this reflects a  
25 commitment that DVDCCA will use good faith efforts to develop a content marking system.  
26 Kaleidescape presented no evidence at trial that DVDCCA did not do so, or that there were any  
27 damages related thereto. Nothing in Section 6.2.13.2 requires that a content marking system actually  
28

1 be adopted. Nor does anything in Section 6.2.13.2 provide any assurance to Kaleidescape that a  
2 content marking system, if adopted, would alter the requirements of the CSS Specifications in such a  
3 way as to absolve Kaleidescape of its breach.  
4

5 Kaleidescape failed to prove any breach of fiduciary duties by a preponderance of the  
6 evidence. DVDCCA's acts concerning the content marking system were not shown to be a breach  
7 of fiduciary duty. It was not a breach of fiduciary duty for DVDCCA to keep some of the terms of  
8 its License Agreement confidential. It was not a breach of fiduciary duty for DVDCCA's Board to  
9 decide to sue Kaleidescape. Indeed, as discussed above, this Court finds that Kaleidescape has  
10 breached its License Agreement with DVDCCA.  
11

12 Kaleidescape's reformation defense also rests on the separate supposition that the DVDCCA  
13 negligently misrepresented the requirements of the CSS License Agreement, when, prior to execution,  
14 it disclosed to Kaleidescape the publicly available Procedural Specifications, which Kaleidescape  
15 says does not contain the prohibition on persistent digital copies and playback-from-disc rule. There  
16 was no evidence that DVDCCA made any oral misrepresentations about what the Agreement  
17 requires. Furthermore, the Procedural Specifications do not state that permanent digital copies or  
18 playback from DVD copies is permissible. Thus Kaleidescape's misrepresentation-based tack for  
19 reformation necessarily rests on the idea that the Procedural Specifications contain an indirect  
20 misrepresentation. But there is no such thing as an implied negligent misrepresentation under  
21 California law: instead a negligent misrepresentation must be explicit to be legally cognizable.  
22 (*Byrum v. Brand* (1990) 219 Cal.App.3d 926, 941-942 [representation by omission cannot amount to  
23 negligent misrepresentation]; *Wilson v. Century 21 Great Western Realty* (1993) 15 Cal.App.4th 298,  
24 306 [same].)  
25

26 Kaleidescape further claims that the CSS License Agreement should be reformed on account  
27 of a "mistake" that Kaleidescape made in the interpretation of the CSS License Agreement. To the  
28

1 extent that Kaleidescape is claiming a unilateral mistake of its own, that defense fails because it  
2 requires the mistake to have been "known or suspected by the other party at the time of execution of  
3 the document." (*Cedars-Sinai Medical Ctr. v. Shewry* (2006) 137 Cal.App.4th 964, 985.) There is no  
4 evidence that DVCCA knew or suspected at the time of execution of the CSS License Agreement  
5 that Kaleidescape intended to use a CSS license to build a device that plays back DVDs without the  
6 presence of the physical DVD disc. To the extent that Kaleidescape is claiming that the contract  
7 should be reformed on account of mutual mistake, that defense fails because reformation is  
8 unavailable where the reformed contract would not express the common intention of both parties, but  
9 rather would create a new contract that reflects the supposed intent on just one party. (*Paterson v.*  
10 *Board of Trustees* (1958) 157 Cal.App.2d 811, 816-817; 1 Witkin, Summary of Cal. Law (10th ed.  
11 2008) Contracts, § 278, p. 308.) The remedy in such situations is to rescind the contract, not to  
12 rewrite it to suit one party's desires. (*Lemoge Elec. v. County of San Mateo* (1956) 46 Cal.2d 659,  
13 665.) But refashioning the CSS License Agreement to memorialize Kaleidescape's singular view of it  
14 is precisely what Kaleidescape seeks in asking this Court, under the guise of a "mistake," to allow  
15 Kaleidescape to make a DVD copier that plays back DVDs without the presence of the physical DVD  
16 disc.  
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19  
20 Next, Kaleidescape's affirmative defense that the CSS License Agreement is "unenforceable"  
21 because it violates a supposed "fair use" right of consumers (*see* 17 U.S.C. §§ 107, 117) to copy  
22 DVDs has no business in this case. As Kaleidescape has conceded, fair use is a defense to copyright  
23 violations, not breaches of contractual rules. This is a breach of contract case, not a copyright case,  
24 and so fair use is simply not applicable here. (Malcolm 10/5/2011 Dep. 109:22-23, PRX-201; PRX-  
25 148.) Furthermore, this fair use defense was discussed and rejected in the RealNetworks case. (*See*  
26 *RealNetworks, supra*, 641 F.Supp.2d at pp. 940-944.) Kaleidescape relies on *Sony Corp. of Am. v.*  
27 *Universal City Studio* (1984) 464 U.S. 417, which is superseded by the Digital Millennium Copyright  
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Act ("DMCA") (17 U.S.C. 1201 *et. seq.*). (*Real Networks, supra*, 641 F.Supp.2d p. 941.)

Kaleidescape is not entitled to the same fair use protections the Supreme Court afforded to video-cassette recorders used for "time-shifting" in *Sony*. (*Id.*)

There is no public policy that is advanced by allowing Kaleidescape to continue in its breach of the License Agreement. If it is not enjoined, Kaleidescape's breach of the Agreement will result in permanent harm to the DVDCCA, thus injunctive relief is warranted. The permanent injunction seeks to put an end to that breach, but it does so without requiring Kaleidescape to recall its noncompliant products.

In its trial brief, Kaleidescape claims that any provisions in the CSS licensing contract prohibiting all persistent digital copies or requiring the presence of the DVD disc during playback would be contrary to public policy. (Kaleidescape's Trial Brief 31:6-32:23.) However, DVDCCA's License Agreement is with Kaleidescape, not with consumers. Kaleidescape can't ignore the terms of its License Agreement and unlock CSS protection of DVDs for its customers. (*See, e.g., Realnetworks, supra*, 641 F. Supp. 2d at p. 932; *see also, e.g., 321 Studios v. Metro Goldwyn Mayer Studios, Inc.* (N.D. Cal. 2004) 307 F. Supp.2d 1085, 1095.)

Kaleidescape also argues in its trial brief that the movie studios sought to control the marketplace through the threat of withholding their movies from DVD release. (Kaleidescape's Trial Brief 31:13-19.) Kaleidescape further argues that this course of action would amount to copyright misuse, citing *Lasercomb American Inc. v. Reynolds* (4th Cir. 1990) 911 F.2d 970. (*Id.*) However, Kaleidescape has not met its burden of proof by a preponderance of the evidence in regards to these allegations. In enacting the DMCA, Congress specifically banned the trafficking in and marketing of devices primarily designed to circumvent the use restriction protective technologies. (*321 Studios, supra*, 307 F.Supp.2d at p. 1097.)

1 Kaleidescape's trial brief cites a variety of code sections on "pro-competitive, pro-innovative,  
2 pro-consumer policies embodied in state and federal antitrust law." (Kaleidescape's Trial Brief 31:22-  
3 32:4.) While it may be accurate in its statement of the law, no violation of any of these provisions  
4 was shown by a preponderance of the evidence.

5  
6 A reading of the DMCA makes it clear that its prohibition applies to the trafficking in and  
7 marketing of devices that would circumvent encryption technology, not to the users of such  
8 technology. (See *321 Studios, supra*, 307 F.Supp.2d at p. 1097.) While it may be fair use for an  
9 individual consumer to store a backup copy of a personally owned DVD on that individual's  
10 computer, a federal law has nonetheless made it illegal to manufacture or traffic in a device or tool  
11 that permits a consumer to make such copies. (*Realnetworks, supra*, 641 F.Supp.2d at p. 942.)

12  
13 In any event, the downstream uses of the Kaleidescape system by its customers, whether legal  
14 or illegal, are not relevant to determining whether Kaleidescape itself is violating its License  
15 Agreement. (See e.g., *321 Studios, supra*, 307 F.Supp.2d 1085, 1097 ["[T]he downstream uses of the  
16 software by the customers of 321, whether legal or illegal, are not relevant to determining whether  
17 321 itself is violating the [DMCA] statute."].)

## 18 19 VII. CONCLUSION

20 Consistent with this Statement of Decision, the Court enters judgment in favor of Plaintiff  
21 against Kaleidescape on DVDCCA's claim for breach of contract.

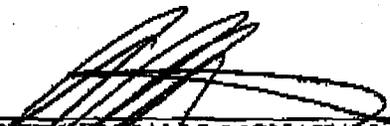
22  
23 As reflected in the judgment, Plaintiff is entitled to a permanent injunction against  
24 Defendant. The Court adopts the language of Plaintiff's [Second Revised Proposed] Permanent  
25 Injunction Order; however, paragraph 3 (d) was changed to the following language: "directly or  
26 indirectly providing any support services that include Prohibited Technology to third parties,  
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**[Emphasis added.] This Court retains continuing jurisdiction over the Parties for the purposes of enforcing this Permanent Injunction.**

Plaintiff is the prevailing party and entitled to costs against Kaleidescape in the amount of \$ \_\_\_\_\_.

Dated: April 8, 2012

  
JUDGE WILLIAM J. MONAHAN  
SANTA CLARA COUNTY SUPERIOR COURT

SUPERIOR COURT OF CALIFORNIA, COUNTY OF SANTA CLARA  
191 N. First Street  
San Jose, CA 95113-1090

**FILED**

MAR - 8 2012

DAVID H. YAMASAKI  
Chief Executive Officer/Clerk  
Superior Court of CA, County of Santa Clara  
BY Felicia Samoy DEPUTY

TO: FILE COPY

RE: DVD Copy Vs Kaleidescape  
Case Nbr: 1-04-CV-031829

**PROOF OF SERVICE**

Statement of Decision

was delivered to the parties listed below in the above entitled case as set forth in the sworn declaration below.

Parties/Attorneys of Record:

- CC: Reginald David Steer , Akin Gump Strauss Hauer Et Al  
580 California Street, Suite 1500, San Francisco, CA 94104  
White & Case LLP  
3000 El Camino Real, 10th Floor, Palo Alto, CA 94306
- Steven A. Ellenberg , Steven A. Ellenberg Law Office  
4 North Second Street, Suite 1240, San Jose, CA 95113-1308
- Thomas E. Moore III, Moore Law Group  
228 Hamilton Avenue, Third Floor, Palo Alto, CA 94301
- Richard R. Wiebe , Richard R. Wiebe Law Office  
One California St., Suite 900, San Francisco, CA 94111
- Allen J. Ruby , Skadden Arps Slate Meagher Et Al  
525 University Avenue, Suite 1100, Palo Alto, CA 94301

If you, a party represented by you, or a witness to be called on behalf of that party need an accommodation under the American with Disabilities Act, please contact the Court Administrator's office at (408)862-2700, or use the Court's TDD line, (408)862-2690 or the Voice/TDD California Relay Service, (800)735-2922.

DECLARATION OF SERVICE BY MAIL: I declare that I served this notice by enclosing a true copy in a sealed envelope, addressed to each person whose name is shown above, and by depositing the envelope with postage fully prepaid, in the United States Mail at San Jose, CA on 030812. DAVID H. YAMASAKI, Chief Executive Officer/Clerk by Felicia P Samoy, Deputy