

H031631

**IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
SIXTH APPELLATE DISTRICT**

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

Plaintiff and Appellant,

v.

KALEIDESCAPE, INC., a Delaware corporation,

Defendant and Appellee.

APPEAL FROM THE SUPERIOR COURT FOR THE COUNTY OF SANTA CLARA
HON. LESLIE C. NICHOLS, JUDGE
CASE No. 1:04 CV 031829

APPELLANT'S OPENING BRIEF

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CERTIFICATE OF INTERESTED ENTITIES OR PARTIES

[Cal. Rules of Court, rule 8.208]

Appellant knows of no entity or person that must be listed under subsections (1) or (2) of Rule 8.208. (Cal. Rules of Court, rule 8.208 (d)(3).)

APPELLANT'S OPENING BRIEF

INTRODUCTION

The trial court ruling in this case, if left undisturbed, threatens to destroy the uniform licensing scheme underlying one of the most successful entertainment innovations of all time – the DVD.

To protect against unlawful copying, the content contained on DVDs is protected by a patented encryption/decryption technology known as the Content Scramble System (CSS). Every company that seeks to manufacture a device authorized to play back DVD content must license CSS from the DVD Copy Control Association (the DVDCCA), a non-profit licensing entity made up of representatives from the entertainment, consumer electronics, and information technology industries. The standardized license agreement, which reflects a delicate balance among industries with significantly divergent interests, requires licensees like defendant-appellee Kaleidescape to follow certain “Technical Specifications” that are delivered upon completion of the license agreement and payment of an administrative fee.

The main question in this case is whether a document entitled “CSS General Specifications,” which was delivered to Kaleidescape after it entered into the license agreement (the Agreement) and paid its fee, is a component of the Technical Specifications with which Kaleidescape must comply. The General Specifications contain crucial protections against unauthorized copying of DVD content, including, as relevant here, the requirement that when a machine plays back DVD content for viewing, the physical DVD itself must be present in the device.

The court ruled that the General Specifications are *not* a subset of the Technical Specifications. But this interpretation, which is subject to de

novo review, is clearly wrong. Overwhelming evidence, including the language of the license agreement and a wealth of undisputed extrinsic evidence, shows that the parties mutually understood the General Specifications to be a subset of the Technical Specifications.

Kaleidescape's own witnesses testified that this was their understanding, and during the course of this litigation – at the summary judgment stage and right up to the moment of trial – Kaleidescape affirmatively took the position that the General Specifications were Technical Specifications. The trial court could reach a contrary reading of the Agreement only by erroneously deeming dispositive extrinsic evidence to be irrelevant. In so doing, the court reached the absurd result of reading out of the license agreement provisions that are essential to the agreement's central purpose – to prevent the unauthorized copying of copyrighted DVD content.

The court also ruled in the alternative that, regardless of whether Kaleidescape had to comply with the General Specifications, the DVDCCA was not entitled to the injunctive remedies it sought. The court ruled out specific performance on the grounds the General Specifications were purportedly too uncertain. The court also refused to enforce a contract provision stipulating to irreparable harm in the case of breach by a licensee and then ruled out injunctive relief against Kaleidescape out of concern the company might suffer if compelled to follow the Agreement's requirements. With respect to all its remedies-related rulings, the court misapprehended the governing law and disregarded the unequivocal intent of the parties that, to preserve uniformity among companies licensing CSS, injunctive remedies should be available for breaches of the Agreement.

For more than a decade, consumers and businesses alike have shared the enormous benefits that come from widely distributing content through a secure digital medium. The CSS licensing regime – by which all licensees have access to the essential encryption/decryption technology on the exact

same terms – has played no small role in this success. With no sound justification, the trial court has dramatically upset this carefully-wrought system. Its ruling should be reversed.

STATEMENT OF THE CASE

A. The Formation and Purpose of the DVDCCA.

Today, hundreds of millions of people throughout the world take for granted the DVD technology that allows them to watch movies and television programs at their convenience. But this stunningly successful technological breakthrough – virtually unimaginable a generation ago – did not develop spontaneously. It is the product of a delicate set of compromises achieved through painstaking negotiation among the companies that produce the content for DVDs and the consumer electronics and information technology companies that make the devices consumers use to play back the DVDs and enjoy their content. (4RT294:17-304:7.)¹

All three industries recognized a common interest – shared with consumers – to achieve a single format (the DVD) for delivering digital content to the public. (2RT92:6-13; 4RT295:24-296:4.) To obtain this uniformity, however, the content providers needed strong assurance that the content delivery system would render it very difficult for the typical consumer to make unauthorized copies of their copyrighted materials. (2RT92:14-22; 4RT299:26-27.) The consumer electronics and information technology companies, for their part, needed a content protection system that would not add unduly to the price of their products. (2RT92:15-22; 4RT299:27-300:4.)

¹ References to the Reporter’s Transcript are cited as “[volume]RT[page:line]” and references to the Appellant’s Appendix are cited as “[volume]AA[page].”

Enormous effort across industries with widely differing perspectives produced a solution to the problem of protecting copyrighted works at a manageable cost – the DVD-Video Content Scramble System (CSS). (4RT303:21-304:7.) Under this patented system (which was designed by Matsushita Electric Industrial Co, Ltd. and Toshiba Corporation in 1996), the video data on every DVD is encrypted – that is, the data on the disc is scrambled so that it cannot be copied or played coherently without first being decrypted through a process employing a set of decryption “keys.” (2AA273-277; 1AA78-79.) Anyone wanting to manufacture a product (hardware, software or other related technology) used for playing back DVD content would be able to license these decryption keys and the authorized methods and processes for decryption. (*Id.*; 1AA130.) In exchange for this permission to use CSS, licensees would simply have to pay an administrative fee and agree to observe detailed specifications for the decryption process in order to achieve CSS’s underlying goal of preventing casual users from creating unauthorized copies. (*Id.*; 1AA136.)² Licensees, who pay no royalty whatsoever for using the CSS license, are all subject to the exact same rules for the license’s use.

The DVDFCA is the not-for-profit entity that acts as the licensing agency for CSS. (2RT91:25-92:13; 1AA200.) Its membership consists of all the companies that take a CSS license and want to participate in the organization. (2RT92:6-93:10; 5RT434:9-14.) Its governing Board of Directors consists of six members elected by content providers, three members elected by companies from the consumer electronics industry, and three members elected by companies from the information technologies

² See *Universal City Studios, Inc. v. Corley* (2d Cir. 2001) 273 F.3d 429, 436-437, and *Universal City Studios v. Reimerdes* (S.D.N.Y. 2000) 111 F.Supp.2d 294, 310, for a discussion of the development of CSS.

sector.³ (2RT93:11-16; 3RT151:9-28.) Its functions include administering the CSS license, considering amendments to the license, and enforcing the license to safeguard the widespread availability of DVD content through a secure medium. (2RT92:6-13, 94:25-95:15; 1AA217-255.)

B. The CSS License Agreement.

To preserve the delicate balance of interests that CSS serves, the CSS License Agreement (the Agreement) is uniform in nature. Rights to the CSS system are made available to licensees – more than 350 since 1997 – on equal terms through an easy to use administration process.

(5RT429:28-430:5, 432:6-14.) This process begins with a prospective licensee filling out and signing the Agreement (available on the DVDCCA website) and paying an administration fee. (5RT410:27-412:3; *see generally* 1AA127, 2AA322.) In connection with signing the Agreement, the prospective licensee chooses to participate in one or more of 14 “membership categories.” (5RT413:9-21; 1AA136, 178.) Through this category selection, the prospective licensee identifies the type (or types) of technology – e.g., DVD Player, DVD Drive, descrambler, authenticator – for which the license is sought. (*Id.*)

The Agreement begins by reciting the core underlying purpose of CSS: “to provide protection for” the content placed on DVDs “against unauthorized consumer copying.” (1AA127.) To effectuate this goal, the Agreement requires the licensee “to comply with the CSS Specifications,” which contain the requirements that a licensee must meet in using CSS to preserve the integrity of the content protection scheme. (1AA136.)

³ In keeping with the delicate balance of interests that created the DVDCCA, its By-Laws allocate voting powers equally across the founding industries so that no single industry group controls how CSS is administered. (1AA187-263.)

The CSS Specifications are defined in the Agreement as having two parts: the “Procedural Specifications” and the “Technical Specifications.” (1AA130.) Every membership category is subject to the publicly available documentation entitled “Procedural Specifications.” (2AA277.) In addition, some membership categories (including the two selected by Kaleidescape) are governed by confidential Technical Specifications, which include trade secrets of how CSS works. (*Id.*; 5RT419:5-14.)

As DVDFCA President John Hoy explained at trial, once a licensee selects one or more of these membership categories, the DVDFCA delivers to the licensee the appropriate confidential Technical Specifications documentation. (5RT413:9-414:1, 414:11-18, 417:10-19.) This documentation comes in two forms. First, there is a set of “General Specifications,” which, according to Hoy’s uncontroverted testimony, are overarching Technical Specifications that apply to every membership category for which Technical Specifications exist. (5RT420:8-17, 421:11-14; 1AA74-99.) Second, there are category-specific Technical Specifications that are exclusive to the specific membership category selected. (5RT413:9-414:1, 417:10-420:20; 1AA1-73.)

The Agreement itself outlines this process, linking the definition of the CSS Specifications with which a licensee must comply to the documentation delivered by the DVDFCA to the licensee. As described in Section 4.1,

Upon Licensee’s selection of one or more Membership Categories . . . and the payment of the appropriate Administration Fee(s), Licensor shall distribute to Licensee the portions of . . . CSS Specifications appropriate to its Membership Category or Categories[.]”⁴

⁴ Along the same lines, the Agreement defines the “CSS Specifications” as “the documentation relating to CSS entitled ‘CSS

(1AA136.) Thus, under the DVDCCA practice that Hoy described, a licensee (like Kaleidescape) that selects the “Descrambler Manufacturer” and “Authenticator Module for CSS Decryption Module” membership categories would receive and have to comply with three sets of Technical Specifications – the General Specifications, and two sets of category-specific Technical Specifications, which are labeled to reflect the category at issue (e.g., “DVD-Video Descrambler”). (See 1AA1-73.)

The Agreement reflects the extraordinary importance of strictly observing the CSS Specifications. It explicitly recognizes that a breach of its specifications will cause lasting and ultimately irreparable harms, “including making available the means for widespread unauthorized copying of copyrighted content[.]” (1AA150.) Accordingly, the Agreement provides that “money damages alone will not adequately compensate an injured party” for the damages caused by their breach, and “injury to such party will be irreparable.” (*Id.*) The Agreement further states that an injured party, “upon showing to the relevant court’s satisfaction that applicable factors other than [irreparable harm and inadequate monetary remedy] have been fulfilled,” will be entitled to equitable relief, including specific performance or injunctive relief. (*Id.*)

C. Kaleidescape and Its Product.

Kaleidescape was founded in 2001 by Michael Malcolm, Daniel Collens, and Cheena Srinivasan with no particular product in mind. (5RT475:8-23.) Over time, they decided to use their computer and engineering expertise to create a high-end video content storage and playback system designed mainly to exploit the content on DVDs. (5RT476:13-479:25.) From the outset, the founders understood that their

Specifications’ (including the Procedural Specifications and the Technical Specifications) [that] Licensor makes available to Licensee.” (1AA130.)

product would have to accommodate the intense concern of content providers about the proliferation of unauthorized copies of their copyrighted content. (5RT483:22-484:13, 487:10-20.) To this end, Kaleidescape started examining the Procedural Specifications and other materials available on the DVDCCA website. (5RT493:9-22, 494:25-495:13; 6RT619:13-26.)

In the course of this study and against the backdrop of the broad public attention given to the problem of unauthorized copying, Kaleidescape's founders explicitly discussed the very problem that became the basis of this lawsuit – namely, that they were considering a device design that would allow an end-user to play back content that had been copied from a DVD without having the actual disc present in the device. (1AA101-104; 4RT354:16-359:7.) As Kaleidescape recognized, this feature would permit consumers to make and play back unauthorized, permanent digital copies of rented or borrowed DVDs and would also allow for the spread of unauthorized copies if Kaleidescape's affiliated dealers “pre-loaded” DVD content into the device's library, thus allowing playback by an end-user who never owned the DVD being played. (1AA104.)

In August 2001, David Bryant, the analyst Kaleidescape hired in part to evaluate content protection issues, summarized his findings regarding compliance with anticipated CSS restrictions and, in particular, the problem associated with a machine that would play back DVD content from a server or hard drive rather than from the disc itself. (1AA107.) Bryant was unequivocal, warning his bosses that, “Methods that don't rely on physical possession of the DVD are not going to cut it with the [DVD]CCA.” (*Id.*)

Given his appraisal of “a near 100% chance” that Kaleidescape would need a CSS license, Bryant recommended a secure vault for housing an end-user's DVDs as the best (though not guaranteed) path to potential compliance. (1AA185; see also 4RT373:7-10.) Although the device would

actually play the DVD content from a copy on a hard drive, the vault system would at least guarantee that consumers could not then give away the DVD disc itself to another user or return it for further rental.

(1AA185.) Kaleidescape also considered other product designs aimed at providing the kind of content protection they expected the DVDCCA to require. For example, Kaleidescape considered a system that would destroy the physical discs once their content had been “imported” into the Kaleidescape storage system. (1AA125; 5RT486:24-487:9.)

Kaleidescape’s founders, however, had severe doubts about the commercial attraction of these approaches and were rankled by Bryant’s analysis of what the DVDCCA would, at a minimum, require. (1AA120; 6RT592:7-25.) The reaction of Srinivasan, a Kaleidescape founder and its Chief Operating Officer, was typical. Srinivasan did not dispute Bryant’s conclusions about what the DVDCCA would require as part of its license. But he did not think the vault concept would catch on with consumers. In Srinivasan’s view, Kaleidescape had “a lot more to worry about meeting the needs of the consumer than the content owners.” (1AA121.)

Accordingly, Srinivasan urged that Kaleidescape shift its focus away from compliance with anticipated DVDCCA licensing requirements towards completion of a device that would win awards and wow consumers. (1AA121-123.)

D. Kaleidescape’s Participation in the Agreement.

In September 2002, after a year of study, Kaleidescape licensed CSS from the DVDCCA. (1AA127.) It selected two membership categories – “Descrambler Manufacturer” and “Authenticator Module for CSS Decryption Module.” (1AA178.) As called for in the Agreement, DVDCCA delivered to Kaleidescape (and Kaleidescape signed for) the Technical Specifications for these categories. (1AA184.) Specifically, the DVDCCA delivered the General Specifications (applying to both

categories) and the documentation labeled “DVD-Video Descrambler” and “Authenticator Module for CSS Decryption Module,” comprising the category-specific Technical Specifications for the two membership categories that Kaleidescape elected to join. (*Id.*; 4RT375:7-20; 1AA1-99.)

E. The Kaleidescape System.

Neither executing the license nor studying all of these Technical Specification documents deterred Kaleidescape from Srinivasan’s suggested change of focus away from compliance and towards commercial pizzazz. By early 2003, the company had produced a prototype for a high-end system for DVD copying and playback that did not require the physical disc to be in the machine during playback. (4RT372:15-20.) The product introduced into the marketplace by Kaleidescape, known as the “Kaleidescape System,” incorporated none of the safeguards (such as the vault system) that Kaleidescape considered during its earlier evaluation of potential product designs.

Basically, when a user puts a DVD into the Kaleidescape System, the content of the DVD is copied (“imported”) onto a server, which can store permanent copies of more than 1000 DVDs. (3RT215:26-216:5, 202:20-203:17; 5RT505:6-22; 2AA353 at 17:8-12, 18:1-17.) Once the content of the DVD has been copied onto the server, the user does not need to retain physical possession of the DVD. (2AA354-355 at 22:18-23:2.) Whenever the user wants to play back the DVD’s content, the system simply plays directly from the copy on the server. (3RT200:19-201:17, 232:17-233:7; 2AA354 at 22:7-17.) Accordingly, the user can return, sell, or give away the DVD because the Kaleidescape System permanently stores a perfect digital copy of the content.

The Kaleidescape System has no mechanism for verifying that a user continues to possess the DVD or for distinguishing among owned, borrowed, or rented DVDs. (6RT676:8-677:9; 2AA355 at 23:3-7, 80:20-

23; 2AA364 at 74:17-75:07) And far from discouraging unauthorized copying, the Kaleidescape System automatically removes the “FBI Warnings” from DVDs imported into the system – which means that users will not be admonished about the illegality of making unauthorized copies. (3RT191:17-26, 217:6-13.)

F. The DVDFCA’s Efforts to Curb Kaleidescape’s Violation of the Agreement.

When the DVDFCA got wind of what Kaleidescape was doing, it wrote Kaleidescape on December 22, 2003 about its serious concern that Kaleidescape was violating the CSS Specifications because the Kaleidescape system did not require the DVD to be in the machine during playback. (2AA320.) In response, a new Kaleidescape analyst (together with several of Kaleidescape’s top executives) prepared a compliance presentation designed to convince the DVDFCA that it had taken sufficient precautions to minimize unlawful copying. (6RT653:7-654:6.)

Beginning in January 2004, the parties met and subsequently went through an ombudsman process, as required by the Agreement, but failed to resolve their differences. (4RT277:28-279:14, 281:18-282:5.) From the DVDFCA’s perspective, precautions Kaleidescape claimed it had taken were insufficient: having the disc in the system at the time of playback was vital to content protection.

As designed, the Kaleidescape system itself would surely produce some unlawful copying, especially from rental DVDs.⁵ But this was just the tip of the iceberg. Over time, systems like Kaleidescape’s were nearly certain to proliferate at much lower cost – and that development, in turn, would lead to the risk of widespread unlawful copying, to the severe

⁵ By his own admission, one of Kaleidescape’s founders, Daniel Collens, engaged in just such unauthorized copying of a rented DVD when trying out the machine. (6RT604:12-606:5.)

detriment of content providers and other businesses in the distribution chain. (3RT101:20-103:8, 145:7-146:2; 4RT305:11-306:26, 333:14-334-6.)

No one understood the destructive force such a system would unleash better than the people at Kaleidescape. As early as July 2001, Kaleidescape recognized in its internal strategy meetings that a system – like the one it chose to develop – that plays back content from a permanent stored copy (rather than from the disc) would “become[] a value-loss proposition for content owners and rental businesses because there is no repeat business ever Rental business will die, and retail business will suffer because borrowing once to have a permanent copy forever seems too good to forego for the average consumer.” (1AA104.) Naturally, this would be the death knell for the delicate balance of interests – the DVD “ecosystem” as one board member called it – that gave the content providers the sense of security they needed to offer to consumers their incredibly valuable copyrighted works in an agreed-upon digital format. (3RT101:20-103:8, 145:7-146:2; 4RT305:11-306:26.)

G. The DVDCCA’s Lawsuit.

After the ombudsman process failed, the DVDCCA sued Kaleidescape on December 7, 2004, for failing to comply with the CSS Specifications as required in the Agreement. (2AA326.) In particular, the DVDCCA alleged that the Kaleidescape system failed to comport with Sections 1.5 and 2.1.2 of the General Specifications. (See 3RT184:13-19, 186:12-18, 217:18-23, 226:4-8; 2AA477-479; 3AA607-611.)

The General Specifications contain, among other things, detailed technical information specifying how components of a DVD playback system interact with one another to carry out essential functions, such as data authentication and descrambling. (1AA83-99.) It is the only set of

specifications that addresses how components should connect and work together to perform the playback of CSS data. (1AA89-90, 94.)

With respect to the two provisions on which the DVDCCA based its lawsuit, Section 1.5 describes the “General Security Requirements” for the DVD-Video Disc, the first of which is that “[t]he DVD-Video Content Scramble System is intended to prevent casual users from the unauthorized copying of copyrighted materials recorded on DVD-Video/Audio Discs.” (1AA81; see also 1AA127.) Because the Kaleidescape system makes unauthorized copies during the process of “importing” DVD content onto its server, it violates this provision. (3RT184:13-19, 219:5-220:18.)

Section 2.1.2, which dictates the process for using CSS’s encryption and decryption keys, requires that products made by licensees play back DVD content from an actual disc. (1AA83-84.) More particularly, this section requires a compliant playback system to obtain – *at the time of playback* (“in real time”) – two of the three keys from the “hidden Lead-in Area” and the “hidden Sector Header area,” which are specific locations on a DVD. (*Id.*) The Kaleidescape System does not do this. (3RT232:2-234:19.)

To remedy these violations, the DVDCCA sought specific performance or, in the alternative, an injunction precluding Kaleidescape from manufacturing or selling its non-compliant system. (2AA334.) The DVDCCA based its claim for injunctive relief in part on Kaleidescape’s agreement in signing the license that any breach of the CSS Specifications would cause the DVDCCA irreparable harm. (2AA333-334; 1AA150.)

H. Kaleidescape’s Defense.

As outlined in its trial brief (filed March 16, 2007), Kaleidescape intended to rebut these allegations by arguing that its system complied with the CSS Specifications and that, in any event, the DVDCCA was not entitled to the equitable remedies it was seeking. (2AA484.) On March 20,

however, virtually on the eve of trial, Kaleidescape filed a supplemental trial brief raising a new argument – that the General Specifications (which contain the provision underlying the DVCCA’s suit) were not “CSS Specifications” as defined in the contract and were not otherwise incorporated into the contract. (2AA519.)

Kaleidescape made this argument even though Stephen Watson, the compliance analyst who worked hand-in-glove with the company’s founders to create the company’s compliance analysis, treated the General Specifications in the compliance analysis as a subset of “Technical Specifications” – which the contract specifically defines as one type of the “CSS Specifications” with which licensees must comply. (1AA270-272; 6RT645:1-646:11.) Watson’s compliance analysis (completed with the help of Collens, Malcolm, and others at the company) repeatedly refers to the General Specifications as part of the Technical Specifications and tries to argue that the Kaleidescape system conforms with “the CSS General Specifications part of TS” – TS being Kaleidescape’s shorthand for the Technical Specifications. (1AA270-272.) So ingrained was the idea that the General Specifications were a subset of the Technical Specifications that Kaleidescape even gave the General Specifications an acronym reflective of this view – “TS-GS.” (*Id.*)

In his deposition, Watson repeatedly confirmed this point. For example, when asked, “So the CSS General Specifications are among the technical specifications that Kaleidescape received upon becoming a licensee?,” Watson answered with a definitive, “that is correct.” (3AA582 at 101:8-11.) Similarly, Srinivasan testified in deposition that he had absolutely no reason to doubt that the General Specifications were Technical Specifications. (3AA586 at 80:10-20].)

Kaleidescape’s own brief in support of its summary judgment motion explicitly declares the General Specifications to be one of the “three

basic components” of the Technical Specifications that are part of the CSS License (the other two parts being the category-specific Technical Specifications Kaleidescape received). (2AA379, 390.) Kaleidescape’s counsel’s supporting declaration makes the same concession. (2AA414.) And Kaleidescape’s initial trial brief, filed just four days before its last-minute about-face, also treats the General Specifications as part of the Technical Specifications. (2AA488 [“The CSS Technical Specifications that pertain to Kaleidescape also have three component parts with the titles ‘CSS General Specifications,’ ‘Authenticator Module for CSS Decryption Module’ and ‘DVD-Video Descrambler’”].) Indeed, until the eve of trial, no person associated with Kaleidescape ever questioned that the General Specifications were part of the Technical Specifications. To the contrary, for over four years between receiving the General Specifications and trial, Kaleidescape’s officers and employees confirmed at every turn their understanding that the General Specifications were Technical Specifications and part of the Agreement.

At the trial itself, Kaleidescape did not contest the central allegation that its system plays back DVD content from a server, not a physical DVD, and is thus susceptible to unlawful copying by users. Instead, Kaleidescape explained the various precautions it built into its system to discourage such copying and also presented expert testimony that the CSS Specifications do not, in fact, require the CSS-protected DVD to be physically present in the system during playback. As an equitable matter, Kaleidescape faulted the DVDCCA for failing to provide better compliance guidance, for failing to adopt DVD technologies that would have made it easier for Kaleidescape to prevent unauthorized copying, and for failing to establish irreparable harm. Finally, Kaleidescape argued that the DVDCCA’s license agreement, if construed to prohibit Kaleidescape’s system, amounted to copyright misuse. (2AA508.)

I. The Trial Court's Ruling.

1. The Court reads the language of the Agreement unambiguously to exclude the General Specifications.

The trial court ruled from the bench following a seven-day trial. The court concluded that all the evidence showing that Kaleidescape itself understood the General Specifications to be a subset of the Technical Specifications was irrelevant to the interpretation of the Agreement, and decided as a matter of law that the General Specifications were not part of the parties' agreement because "no part of [the Agreement] specifically calls out in clear words the General Specifications." (8RT864:20-22; see 8RT875:17-24.) The court did not elaborate further, but referred the parties to two of Kaleidescape's briefs interpreting the language of the Agreement. (8RT875:25-876:15, citing Kaleidescape briefs filed March 20 and March 27 ["Those briefs adequately state in detail without beating you over the head with it the court's analysis on the proper construction[.]".]) The court initially adopted these two briefs by reference (*id.*), but later decided it merely "found the[ir] legal analysis . . . persuasive" (3AA689-690).

In its March 20 supplemental trial brief, Kaleidescape stated that it had always "[taken] for granted" that the General Specifications were part and parcel of the Technical Specifications and were thus included in the Agreement, but had suddenly "come to realize" that the General Specifications were not part of the Agreement after all. (2AA520-523.) Kaleidescape based its new understanding of the Agreement on its reading of the integration clause, which provides that the Agreement includes the Procedural and Technical Specifications. Because the integration clause does not list the General Specifications by name, Kaleidescape argued that they must not be part of the Agreement. (*Id.*)

In its March 27 brief, Kaleidescape repeated and embellished on this argument. According to Kaleidescape, the General Specifications are not

part of the Technical Specifications, as the DVDCCA contends and as Kaleidescape had always believed, because the Technical Specifications are “category-specific” and because the General Specifications are not listed by name. Kaleidescape also observed that the General Specifications are “aspirational” rather than “specific nuts-and bolts instructions” and, thus, ill-suited to be considered Technical Specifications. (3AA596-597.)

2. The court states that it considered all of the extrinsic evidence.

Although the trial court’s ruling was based on its reading of the plain language of the contract, it assured the parties that it understood the requirements of *Pacific Gas & Elec. Co. v. G. W. Thomas Drayage & Rigging Co.* (1968) 69 Cal.2d 33 (*PG&E*) (see p. 22, *infra*), and had “considered everything,” including all of the extrinsic evidence and witness testimony. (8RT836:3-4, 837:4-10; see 8RT876:6-15; 3AA689-690.) The court recited the entire witness list and walked through each witness’s testimony, not because it believed the testimony was necessary to its decision, but because it viewed this recitation as “an important part of my obligation as a public official.” (8RT857:5-15; see 8RT836:2-857:2.) The court did not, however, explain how any of the testimony supported its ruling.

With an explicit eye to appellate review, the court declared that it had “resolve[d] all issues of credibility in favor of the findings which are necessary, explicit, implicit or appropriate.” (8RT837:7-10, 876:13-15.) It also admonished the parties repeatedly that an appellate court must defer to a trial court’s findings when the evidence is in conflict. (8RT861:7-863:24, 865:21-27, 873:4-5.) However, the court did not note any conflict in the evidence; to the contrary, it observed, “there really is no conflict.” (8RT877:16-17.)

To the extent the extrinsic evidence was at odds with the court's interpretation of the Agreement – i.e., evidence that Kaleidescape understood that the General Specifications *were* Technical Specifications and made efforts to comply with them – the court declined to give this evidence any weight. (8RT879:17-21 [“I assign no weight to the fact that memos were being prepared in Kaleidescape [by people with Ph.Ds and MBAs] . . . talking about what they could do and not do.”]; see also 8RT868:11-26 [observing that Kaleidescape's understanding of the contract was irrelevant because DVDCCA “would have no basis to know what [Kaleidescape] believed” the contract meant].) Although the court stated it was entitled to reject evidence of Kaleidescape's conduct based on the rule that “a court can consider the conduct of only one party” (see 8RT871:4-6) – a rule it misconstrued – the court suggested that the real reason it was disregarding Kaleidescape's conduct was that the Agreement was not the product of negotiated bargaining. (8RT876:20-23 [“I saw this as a case in which everyone tried to do discovery in a way to kind of make up for the fact that nobody sat down and met and talked”]; see also 8RT868:17-26, 870:23-26, 876:24-877:9.)

For the same reason, the court invoked the rule of “*contra proferentem*,” which permits a court, as a last resort, to construe contractual ambiguities against the drafter. (8RT873:22-874:24, citing, *inter alia*, Civ. Code, § 1654). While the court did not think the rule applied in the absence of any ambiguity, it decided to “resort to [it] as well.” (8RT877:18-21.)

Finally, the court relied on the testimony of Kaleidescape's expert, Daniel Harkins, to support the ruling that the General Specifications are not part of the Agreement. The court characterized Harkins as testifying that the General Specifications are “informative, not normative” (8RT855:8), and thus are not used by “people in his line of work . . . to determine what shall and shall not be done[.]” (8RT855:15-16.) Although Harkins never

suggested at trial that Section 2.1.2 (the second provision relied on by the DVDCCA) was merely informative – indeed, he testified in his deposition that this provision was normative (2AA465-466 at 62:25-63:11) – the court nonetheless concluded that the supposed informative nature of the General Specifications meant that they merely state “aspirational goals.”

(8RT855:17-18.) Based on that conclusion, the court reasoned that the General Specifications did not impose binding obligations on Kaleidescape.

3. In the alternative, the court rules on specific performance and irreparable injury.

As alternative grounds for its decision, the trial court ruled in passing that even if the General Specifications were part of the Agreement, the DVDCCA was not entitled to either specific performance or a permanent injunction – the two remedies that the DVDCCA sought for Kaleidescape’s breaches of the contract.

The court held that specific performance was unavailable because, in its view, the General Specifications were not “sufficiently definite for the court to know what to enforce.” (8RT880:8-9.) The court’s rationale for this ruling was minimal. First, the court surmised that the “words seem to be statements of what the computer scrambling device is supposed to do” (8RT880:12-13), but it did not explain why this rendered specific performance unobtainable. Second, the court reiterated that the General Specifications do not refer to the Agreement, and thus are “outside of that document.” (8RT880:16-17.)

The court also held that the DVDCCA was not entitled to a permanent injunction. The linchpin of this ruling was the court’s refusal to give effect to the parties’ contractual stipulation that any breach by Kaleidescape would cause irreparable injury to the DVDCCA, thus warranting injunctive relief. In brushing aside the stipulation, the trial court posited that “the parties cannot control the sound exercise of jurisdiction by

the trial court acting in equity.” (8RT881:26-28.) The court stated that it “did not find persuasive [the DVDCCA’s] claim of irreparable harm,” because the damages had not yet “occurred.” (8RT882:1-28; see also 883:12-14.) By contrast, the court opined, Kaleidescape would experience “great hardship” if it could not continue selling its system to consumers. (5RT532:23-533:17) The court further declared that the “equities are strongly in favor of [Kaleidescape]” because it played no role in negotiating the contract. (8RT884:23-26.)⁶

4. The DVDCCA requests rulings on certain issues, and the court issues an Addendum to its Statement of Decision.

The DVDCCA asked for clarification of the trial court’s ruling, specifically whether the court had found that the License was “reasonably susceptible” to the DVDCCA’s interpretation. (3AA684.) The court responded that this “never was a contested issue.” (3AA689.) The court asserted that its oral opinion was complete and unambiguous, but corrected its statement that it had “adopted” Kaleidescape’s briefs; instead, it decided that it found them “persuasive.” (3AA690.)⁷

The DVDCCA timely appealed.

⁶ The court granted the DVDCCA’s motion for nonsuit on Kaleidescape’s cross-claims, which were dependent on mediator testimony, based on its determination that such testimony was inadmissible as a matter of law. (8RT816:12-829:28.) Kaleidescape has not cross-appealed from this ruling.

⁷ The DVDCCA also asked the court to consider Kaleidescape’s response to a DVDCCA request for admission that was not addressed at trial. In its response, Kaleidescape admitted that exhibit 3 (the General Specifications) is “a copy of the *CSS Technical Specifications*, *CSS General Specifications*, that Kaleidescape received after executing the CSS License Agreement.” (3AA670, 684-685, emphasis added.) The court declined to consider this additional admission on the grounds it was offered belatedly.

LEGAL DISCUSSION

STANDARD OF REVIEW

The California Supreme Court has succinctly defined the standard to be applied in reviewing a trial court's interpretation of a contract: "It is solely a judicial function to interpret a written contract unless the interpretation turns upon the credibility of extrinsic evidence, even when conflicting inferences may be drawn from uncontroverted evidence." (*Hess v. Ford Motor Co.* (2002) 27 Cal.4th 516, 527, quoting *Garcia v. Truck Ins. Exchange* (1984) 36 Cal.3d 426, 439.)

This statement derives from Justice Traynor's watershed decision in *PG&E*, which established a two-step process for determining whether extrinsic evidence should be admitted to construe a written instrument. (*PG&E, supra*, 69 Cal.2d at pp. 37-41.) Over the years, California courts have summarized the key elements of the *PG&E* process as follows: "First, the [trial] court provisionally receives (without actually admitting) all credible evidence concerning the parties' intentions to determine 'ambiguity' – i.e., whether the language is 'reasonably susceptible' to the interpretation urged by a party." (*City of Chino v. Jackson* (2002) 97 Cal.App.4th 377, 383-384, quoting *Winet v. Price* (1992) 4 Cal.App.4th 1159, 1165-1166, quoting in turn *PG&E, supra*, 69 Cal.2d at p. 37, internal quotations omitted.) "If in light of the extrinsic evidence the court decides the language is 'reasonably susceptible' to the interpretation urged, the extrinsic evidence is then admitted to aid in the second step – interpreting the contract." (*Ibid.*, citations omitted.)

As the courts have explained, each step of the process is reviewed in turn. The trial court's threshold determination of ambiguity (whether the proffered evidence is relevant to prove a meaning to which the language is reasonably susceptible) is a question of law reviewed de novo. (*City of*

Chino, supra, 97 Cal.App.4th at p. 383; accord *Wagner v. Columbia Pictures Industries, Inc.* (2007) 146 Cal.App.4th 586, 589; *Morey v. Vannucci* (1998) 64 Cal.App.4th 904, 913; *Wolf v. Superior Court* (2004) 114 Cal.App.4th 1343, 1350–1351, 1356–1357; see *id.* at p. 1351 [“[I]t is reversible error for a trial court to refuse to consider ... extrinsic evidence on the basis of the trial court’s own conclusion that the language of the contract appears to be clear and unambiguous on its face.”].)

The second step – interpretation of the contract in light of all the admissible evidence – is also a question of law reviewed *de novo*, unless the meaning of the contract “turns upon the credibility of [conflicting] extrinsic evidence.” (*Parsons v. Bristol Dev. Co.* (1965) 62 Cal.2d 861, 865; accord *City of Chino, supra*, 97 Cal.App.4th at p. 383; see *id.* at p. 866, fn. 2; *Delucchi v. County of Santa Cruz* (1986) 179 Cal.App.3d 814, 821.) If the material evidence is not in conflict, then “[this Court] do[es] not defer to the trial court’s findings,” even if that evidence is “subject to different interpretations[.]” (*Wagner, supra*, 146 Cal.App.4th at p. 589; accord *Okun v. Morton* (1988) 203 Cal.App.3d 805, 815.)

In this case, the trial court’s threshold determination whether the language of the contract is “reasonably susceptible” to the interpretation urged by a party is reviewed *de novo*. Because, as we explain, the extrinsic evidence proffered by the parties is not in conflict (although inferences to be drawn from it are disputed), the court’s interpretation of the contract is also reviewed *de novo*.

As to the other issues on appeal, whether a contract’s words are sufficiently definite to render it amenable to specific performance is a question of law subject to *de novo* review. (*Okun, supra*, 203 Cal.App.3d at p. 816; *Robinson & Wilson, Inc. v. Stone* (1973) 35 Cal.App.3d 396, 407.) Whether to enforce a stipulated remedy provision is also an issue of law reviewed *de novo*. (*Beasley v. Wells Fargo Bank* (1991) 235

Cal.App.3d 1383, 1393; *Harbor Island Holdings v. Kim* (2003) 107

Cal.App.4th 790, 794.)

I. UNDER THE CSS LICENSE AGREEMENT, THE GENERAL SPECIFICATIONS ARE TECHNICAL SPECIFICATIONS WITH WHICH LICENSEES MUST COMPLY AND THE TRIAL COURT ERRED AS A MATTER OF LAW IN REACHING A CONTRARY INTERPRETATION.

A. The Language of the Agreement and the Extrinsic Evidence Show that the Parties Mutually Intended and Understood the General Specifications to be a Subset of the Technical Specifications.

1. The Agreement is Reasonably Susceptible to the DVDCCA's Interpretation

A proper application of *PG&E* to the facts of this case permits only one conclusion – that the General Specifications are, as the DVDCCA has always maintained and as Kaleidescape itself agreed until the eve of trial, a subset of the Technical Specifications with which all CSS licensees must “comply.” (1AA136.)

Despite its repeated invocation of *PG&E*, the trial court never engaged in the initial *PG&E* inquiry as to whether the contract is reasonably susceptible to both of the competing interpretations offered by the DVDCCA and Kaleidescape in light of the proffered extrinsic evidence. Instead, the trial court correctly observed that it “never was a contested issue” that the Agreement was “reasonably susceptible” to the DVDCCA’s interpretation, while never addressing whether Kaleidescape’s reading was reasonable. (3AA689.) It is doubtful that the interpretation Kaleidescape belatedly advanced – under which the Agreement miraculously omitted the content protection provisions that are essential to the entire licensing scheme that the DVDCCA administers – can meet this threshold test. But even if the contract were reasonably susceptible to both interpretations, the extrinsic evidence – without contradiction by Kaleidescape – shows that

prior to and throughout the litigation the DVDCCA and Kaleidescape shared the mutual intent and understanding that the General Specifications were a subset of the Technical Specifications.

2. The Language of the Agreement, the Purposes Underlying the Licensing Regime, and the Conduct of the Parties all Support the DVDCCA's Interpretation.

The starting point for interpreting the contract is the contract's language and the context in which the parties signed the Agreement at issue. Kaleidescape wanted to get into the business of making a product that would require the use of a technology – CSS – controlled by the DVDCCA. (4RT373:7-10.) To get permission (a license) to use this technology, Kaleidescape had to enter into the exact same licensing arrangement as every other party seeking to use CSS. (5RT432:6-14.) The bargain was very straightforward. The DVDCCA would receive from Kaleidescape the standard administration fee for each of the membership categories that Kaleidescape selected. In return, Kaleidescape would get permission to use CSS subject to the DVDCCA's limitations on its use. Like every other licensee, Kaleidescape would know in advance the publicly available limitations (those in the Procedural Specifications). (5RT408:19-409:19, 411:14-27.) But Kaleidescape also agreed to be bound by other limitations – the confidential Technical Specifications – that, due to the trade secret nature of the materials, it would receive from the DVDCCA only after Kaleidescape signed the Agreement. (5RT413:9-414:1, 414:11-18, 417:10-19.) This, too, comported with the DVDCCA's uniform licensing practice. (2AA322.)

The language of the Agreement lays all this out. Pursuant to Article 3, upon execution of the Agreement, a licensee selects a membership category or categories and pays the accompanying administrative fee. (1AA136.) Pursuant to Article 4.1 (“Delivery of CSS Specifications”), the

DVDCCA “shall distribute to Licensee the . . . CSS Specifications appropriate to its membership Category or Categories[.]” (*Id.*) Article 1 also explicitly defines the CSS Specifications as the “documentation relating to CSS entitled ‘CSS Specifications’ (including the Procedural Specifications and the Technical Specifications) that Licensor makes available to Licensee[.]” (1AA130.)

There can be no dispute that in signing the Agreement, the parties mutually intended and Kaleidescape fully understood that it would have to comply with the CSS Specifications that the DVDCCA delivered to it, whatever those confidential Specifications entailed. Kaleidescape would then be free to use CSS or not at its discretion. But if it wanted to use CSS, Kaleidescape would have to obey whatever limitations the DVDCCA imposed on all its licensees. Kaleidescape’s own witnesses confirmed that in signing the Agreement, they understood that they would have to comply with the specifications the DVDCCA imposed – including the confidential Technical Specifications that Kaleidescape had not seen in advance. (6RT598:9-599:1; 2AA371-372 at 64:13-65:13.)

The only question then is whether the General Specifications fall within the ambit of the Technical Specifications that the DVDCCA delivered to Kaleidescape consonant with their mutual intent that Kaleidescape would abide by the specifications that the DVDCCA sent it. This question is easily answered – yes.

It is a “cardinal rule of construction that when a contract is ambiguous or uncertain the practical construction placed upon it by the parties before any controversy arises as to its meaning affords one of the most reliable means of determining the intent of the parties.” (*Sterling v. Taylor* (2007) 40 Cal.4th 757, 772-773, internal quotation omitted; see also *Kennecott Corp. v. Union Oil Co.* (1987) 196 Cal.App.3d 1179, 1190; *Oceanside 84, Ltd. v. Fid. Fed. Bank* (1997) 56 Cal.App.4th 1441, 1448 [“It

is well settled that although an agreement may be indefinite or uncertain in its inception, the subsequent performance of the parties will be considered in determining its meaning for they are least likely to be mistaken as to the intent.”], citations omitted; *Salton Bay Marina, Inc. v. Imperial Irrigation Dist.* (1985) 172 Cal.App.3d 914, 936 [a court “is required to give ‘great weight’ to the conduct of the parties in interpreting the instrument before any controversy arose”].) The extrinsic evidence uncontroverted by Kaleidescape shows that both the DVDCCA and Kaleidescape believed that the General Specifications were a subset of the Technical Specifications and acted accordingly.

It is also uncontroverted that the DVDCCA treated the General Specifications as a subset of its Technical Specifications (the subset that applied across the board to the membership categories for which Technical Specifications apply). John Hoy, the President of the DVDCCA, testified without contradiction that the General Specifications were the generally applicable Technical Specifications. (5RT420:8-17, 421:11-14.) The DVDCCA’s conduct confirmed his testimony. The General Specifications share an identical format with and have the same version number as all the other Technical Specifications. The DVDCCA also included the General Specifications as part of the Technical Specifications “documentation” package delivered to Kaleidescape in conformity with Article 4.1 of the Agreement. (5RT421:11-17; *comp.* 1AA1-99.)

What makes this case so unusual is that there is also no reasonable dispute that Kaleidescape, when it received the Technical Specifications package including the General Specifications, understood the General Specifications to be part of the Technical Specifications (and thus a CSS Specification with which they had to comply). Their compliance analyst so testified. (3AA582 at 101:8-11.) One of their founders so testified. (3AA586 at 80:10-20.) And Kaleidescape’s post-contractual conduct

proves the point conclusively. In creating its carefully crafted CSS compliance analysis, Kaleidescape explicitly treated the General Specifications as Technical Specifications. (1AA270-272.) Kaleidescape’s summary judgment papers and its original trial brief did the same. (2AA488.)

In short, the parties mutually intended in entering into the contract that Kaleidescape would have to comply with the Technical Specifications created and distributed by the DVCCA. Until Kaleidescape’s eve-of-trial change of heart, the parties agreed that the General Specifications the DVCCA distributed to Kaleidescape in the package containing the Technical Specifications were among the Technical Specifications that Kaleidescape had to obey under the Agreement. Both parties acted accordingly. The trial court nonetheless ruled that the General Specifications were not Technical Specifications binding on Kaleidescape because, in essence, the DVCCA called the specifications at issue “General Specifications” – as opposed to, for example, calling them the “Generally Applicable Technical Specifications” or using a label that did not include the word “Specifications” at all, as is the case with the documentation containing the category-specific Technical Specifications.⁸

3. Kaleidescape’s Interpretation, Accepted by the Trial Court, Contradicts the Extrinsic Evidence and Yields an Absurd Result.

California law does not countenance setting aside evidence of the parties’ mutual understanding of the contract in favor of the “gotcha” style

⁸ The category-specific Technical Specifications are titled by reference to the membership category selected without being labeled as “Technical Specifications.” (1AA184.) For example, a licensee joining the “Descrambler Manufacturer” membership category receives the Technical Specifications entitled “DVD-Video Descrambler” (along with the “CSS General Specifications”). (*Id.*)

reading Kaleidescape advanced. Here, moreover, such a reading leads to precisely the absurd result that contract interpretation is supposed to avoid. (*Kashmiri v. Regents of Univ. of California* (2007) 156 Cal.App.4th 809 [67 Cal.Rptr.3d 635, 660] [interpretation of contract “must be fair and reasonable, not leading to absurd conclusions”], quoting *Transamerica Ins. Co. v. Sayble* (1987) 193 Cal.App.3d 1562, 1566.) As the Agreement states, the fundamental purpose of the licensing scheme is “to provide protection for such copyrighted content against unauthorized consumer copying.” (1AA127.) Yet according to Kaleidescape and the trial court, the licensing agreement should be read to exclude the key specifications protecting against such copying – based not on what the parties intended or understood or relied upon, but rather on an inartful choice of title for a document. Even more broadly, by ruling that licensees need not comply with any of the General Specifications (let alone the two provisions on which the DVDCCA relied), the trial court excluded from the Agreement a host of technical requirements essential to the creation of a functional and integrated CSS playback system. This makes no sense.

In so ruling, the trial court proclaimed that it had considered the extrinsic evidence. But it never explained how it could be that the Agreement is reasonably susceptible to the eviscerated reading Kaleidescape advanced. Nor did the trial court explain how, even if the agreement is deemed to be reasonably susceptible to Kaleidescape’s interpretation, this interpretation could prevail over the DVDCCA’s interpretation given all the extrinsic evidence showing that the parties intended and understood the General Specifications to be Technical Specifications. (8RT857:5-15; see 8RT836:2-857:2.) No plausible explanations exist. The contract is best read exactly as the parties did read it until Kaleidescape concocted its *deus ex machina* reinterpretation on the eve of trial.

B. The Trial Court’s Disparaging View of the Agreement as One the Parties “Failed” to Negotiate Reflects A Fundamental Misapprehension of Uniform Licensing Agreements.

As the trial court made clear at several junctures, it was disposed to construe the terms of the Agreement in favor of Kaleidescape because it was disturbed by the fact that the Agreement was not individually negotiated with Kaleidescape. Although the court declined to rule that the Agreement was a contract of adhesion, it remarked that it “certainly has elements of an adhesion contract” (8RT874:18-19), because “nobody sat down and met and talked” (8RT876:20-23). The court characterized the contract “as a product created by a committee of lawyers” (8RT877:21-22) that “ultimately was presented for people to take it or not” (8RT879:15-17).

By their very nature, however, standardized agreements to license intellectual property can rarely, if ever, be subject to separate negotiation with each prospective licensee. Far from being unfair, as the trial court implied, it is *essential* that licensors, including licensing entities like the DVCCA, be free to set uniform terms of use for intellectual property. This uniformity ensures a level playing field for all licensees without which it becomes exceedingly difficult to share intellectual property assets with the public at large. That is why, as discussed below, courts regularly enforce even patently adhesive contracts like click-wrap and shrink-wrap licenses.⁹ Prospective licensees wishing to enjoy the benefits of others’ intellectual property know that they must either accept the unvarying rules set forth by the licensor, or forego permission to use the technology whose

⁹ A “click-wrap” license appears on the user’s computer screen and requires him to agree to the license terms before being able to use the software or service. A “shrink-wrap” license is included in a retail software package that is covered in cellophane shrink-wrap; opening the package triggers the license. (See, e.g., *ProCD, Inc. v. Zeidenberg* (7th Cir. 1996) 86 F.3d 1447, 1449.)

benefits they seek. Accordingly, there is nothing unusual, let alone unseemly, about the DVDCCA's effort to hold Kaleidescape to the General Specifications that both parties understood to be part and parcel of the Technical Specifications governing Kaleidescape's use of the licensed technology.

Courts and scholars have recognized that standardized contracts play a vital role in the efficient mass marketing of a wide variety of goods and services, and should be enforced unless they include objectionable terms. In *Carnival Cruise Lines, Inc. v. Shute* (1991) 499 U.S. 585, for example, the United States Supreme Court upheld a forum selection clause in a cruise line ticket over plaintiff's objection that the term was not negotiated, observing that, "[c]ommon sense dictates that a ticket of this kind will be a form contract the terms of which are not subject to negotiation[.]" (*Id.* at pp. 593-594.) In the absence of evidence of fraud or overreaching, such contracts benefit both consumers and service providers by keeping costs down and should be enforced according to their terms. (*Id.* at p. 595.) The Restatement (Second) of Contracts likewise recognizes the utility of standardized contracts: "Standardization of agreements . . . are essential to a system of mass production and distribution. Scarce and costly time and skill can be devoted to a class of transactions rather than to details of individual transactions." (Rest.2d Contracts, § 211, com. a.)¹⁰

In the intellectual property context, standardized licensing agreements are the norm. Scholars and courts have observed that such agreements should be embraced because they serve the laudable goal of

¹⁰ *Carnival Cruise Lines* and section 211, comment a, of the Restatement 2d of Contracts are regularly cited in the intellectual property context. See, e.g., *ProCD, supra*, 86 F.3d at p. 1451; *Barnett v. Network Solutions, Inc.* (Tex.Ct.App. 2001) 38 S.W.3d 200, 204; *Feldman v. Google, Inc.* (E.D. Pa. 2007) 513 F.Supp.2d 229, 242.)

allowing widespread access to information and information technology at a relatively low cost. As Professor Raymond Nimmer has explained, “[l]icensing contributes to the efficient tailoring of an information product and its cost to meet diverse market demands.” (Nimmer, *Licensing in the Contemporary Information Economy*, 8 Wash. U. J.L. & Pol’y 99, 104; see *id.* at pp. 136, 162-165 [discussing in detail the vital role played by licensing in distributing information technology broadly and cheaply].)

Unlike a contract in the sale of goods context, a licensing agreement is an inherent part of an intellectual property asset: what the licensee buys is not the intellectual property asset per se, but permission to *use* it within the limits set forth by the accompanying license. (Nimmer, *supra*, at pp. 119-124; see *id.* at pp. 136-137, 162-165.) “The license defines the rights and, thus, defines the focus of the transaction and what value the transferee receives in a way that is simply not possible to replicate in the world of transactions in goods.” (*Id.* at p. 123.)

Applying these principles, the Seventh Circuit held that a shrink-wrap license accompanying a database/decryption package was enforceable even though its terms did not appear on the outside of the package. (*ProCD, supra*, 86 F.3d at p. 1450.) Judge Easterbrook observed that “[t]erms of use are no less a part of the ‘product’ than are the size of the database and the speed with which the software compiles listings,” and could not simply be ignored by a consumer who wished to disseminate the data for his own profit. (*Id.* at p. 1453; see *id.* at pp. 1452-1453 [noting that the consumer was free to return the product if he did not wish to honor the terms of the license].) California courts have likewise held that terms in click-wrap licenses are enforceable. (*Net2Phone, Inc. v. Superior Court* (2003) 109 Cal.App.4th 583, 588-589 [upholding forum selection clause within click-wrap license]; *Cairo, Inc. v. Crossmedia Servs.* (N.D. Cal., Apr. 1, 2005, No. 04-04825) 2005 WL 756610, *4 [same].)

If consumer shrink-wrap and click-wrap licenses are presumptively enforceable in the absence of fraud or illegal terms, then the Agreement here surely passes muster. Far from being a shrink-wrap style license, the Agreement was a written (hard copy) document that Kaleidescape, a sophisticated business, had every opportunity to review and reject. Kaleidescape knew CSS was devised to prevent the creation of unauthorized copies of DVDs; it was not unreasonable or improper for the DVDCCA to insist that licensees comply with that goal or decline to use CSS – i.e., that they “take it or leave it,” as they choose.¹¹ To conclude, as the trial court did here, that licensing agreements are suspect simply because they are not negotiated, or because they are presented on a take-it-or-leave-it basis, is to get matters backwards. A standardized license, especially when offered (as here) royalty-free to start-ups and behemoths alike, guarantees scrupulously fair and highly efficient dissemination of the technology at issue because the technology is made readily available to all comers on equal terms. The trial court’s reasoning, if upheld, will not only have the effect of needlessly upsetting a bargain the parties themselves

¹¹ Nor is there anything out of the ordinary about the DVDCCA’s uniform licensing practice of transmitting the confidential Technical Specifications to a licensee only after the licensee has signed the Agreement. (5RT413:9-414:1, 414:11-18, 417:10-19.) As this Court has recognized, the Technical Specifications contain carefully-guarded trade secrets describing the technical workings of CSS. (5RT419:5-14.) Thus, in order to protect the integrity of the entire CSS enterprise, the DVDCCA necessarily distributes the Technical Specifications only after a licensee has signed the Agreement. But this in no way prejudices the licensee. The Agreement itself and the publicly available Procedural Specifications inform prospective licensees about the purposes of CSS and its contours. The Technical Specifications merely contain detailed instructions for licensees seeking to manufacture particular types of products. Certainly Kaleidescape cannot claim to have been surprised by the Technical Specifications. As early as 2001, Kaleidescape analyst David Bryant understood their basic contours. (1AA107).

were perfectly willing to strike, it will threaten serious harm to the market for intellectual property and, ultimately, to the national economy.

C. Against the Backdrop of this Misapprehension, the Trial Court Committed A Series of Interpretive Errors.

In addition to its hostility to standardized licenses, the trial court made a series of specific interpretive errors that ultimately led it to misconstrue the Agreement. First, the court erroneously rejected the evidence of Kaleidescape’s post-contractual conduct showing overwhelmingly that it understood the General Specifications to be a part of the Technical Specifications that the parties mutually intended to be binding on Kaleidescape. In so doing, the court ignored the well-established rule (see p. 26, *supra*) that, “[t]he conduct of the parties after execution of the contract and before any controversy has arisen as to its effect affords the most reliable evidence of the parties’ intentions.” (*Kennecott, supra*, 196 Cal.App.3d at p. 1189; see also *Sterling, supra*, 40 Cal.4th at pp. 772-773.)

Although the court did not elaborate on its thinking, it appears to have declared Kaleidescape’s conduct irrelevant based on the notion that, because the contract was not negotiated, this conduct constituted inadmissible evidence of unexpressed subjective intent and of only one party’s conduct. But as the very case on which the court relied – *Southern Cal. Edison Co. v. Superior Court* (1995) 37 Cal.App.4th 839 – makes clear, the court was wrong on both counts.

With respect to introducing evidence of only one party’s conduct, *Southern California Edison* holds unequivocally that Party A can introduce evidence of Party B’s conduct when that evidence supports Party A’s interpretation of the contract:

“The practical interpretation of the contract by one party, evidenced by his words or acts, can be used against him on behalf of the other party In the litigation that has

ensued, one who is maintaining the same interpretation that is evidenced by the other party's earlier words, and acts, can introduce them to support his contention.”

(*Southern Cal. Edison, supra*, 37 Cal.App.4th at p. 851, quoting 3 Corbin on Contracts (1960) § 558, p. 256; accord *Heston v. Farmers Ins. Group* (1984) 160 Cal.App.3d 402, 414-415.)

This rule fits this case to a tee. Kaleidescape's efforts to comply with the General Specifications were introduced by the DVDCCA to show that Kaleidescape agreed with the DVDCCA's interpretation of the contract. This is exactly what *Southern California Edison* contemplates. In keeping with the rule set forth in that case, the trial court should have given great weight to the DVDCCA's evidence that Kaleidescape understood that the General Specifications were part of the Agreement. But the court got it backwards and *rejected* the evidence. (8RT879:17-21 [the court: “I assign no weight to the fact that memos were being prepared in Kaleidescape [by people with Ph.Ds and MBAs] . . . talking about what they could and could not do.”].)

The court also erred in relying on the rule of unexpressed subjective intent to disregard Kaleidescape's conduct. (8RT868:11-26 [observing that Kaleidescape's understanding of the contract was irrelevant because DVDCCA “would have no basis to know what [Kaleidescape] believed” the contract meant.].) Again *Southern California Edison* proves the point. This case holds that, while evidence of a party's unexpressed intent is often irrelevant, this rule gives way and the evidence is admissible when the party's conduct or writings are offered to show that they support the opposing party's interpretation of ambiguous contract language: “[t]he practical interpretation of the contract by one party, evidenced by his words or acts, can be used against him on behalf of the other party, *even though that other party had no knowledge of those words or acts when they*

occurred and did not concur in them.” (*Supra*, 37 Cal.App.4th at p. 851, quoting Corbin, *supra*, § 558, p. 256, emphasis added.)

The trial court exacerbated its error by invoking the rule of *contra proferentem*, which provides that courts may, in the last resort, construe irresolvable contractual ambiguities against the drafter. (Civ. Code, § 1654; *Pac. Gas & Elec. Co. v. Superior Court* (1993) 15 Cal.App.4th 576, 596 [“this canon applies only as a tie breaker, when other canons fail to dispel uncertainty”], citing *Decter v. Stevenson Properties, Inc.* (1952) 39 Cal.2d 407, 418.) Although the trial court perceived no ambiguity in the contract language, it sought to bolster its interpretation of the Agreement by “resort” to this rule:

I do find that ... there really is no conflict. Having resolved it, the court’s quite readily able to determine this without resort to [Civil Code section] 1654, but the court does resort to that as well because the lawyers say there’s an ambiguity.

(8RT877:16-21.)

But the rule of *contra proferentem* may not be used as a substitute for review of the relevant extrinsic evidence: “The rule does not stand for the proposition that, in every case where one of the parties to a contract points out a possible ambiguity, the interpretation favored by the nondrafting party will prevail. The rule remains that the trier of fact will consider any available extrinsic evidence to determine what the parties actually intended the words of their contract to mean.” (*Rainier Credit Co. v. W. Alliance Corp.* (1985) 171 Cal.App.3d 255, 263, citing *PG&E, supra*, 69 Cal.2d at p. 40.) The trial court abused the rule by using it to try to sweep ambiguities under the rug, rather than resolve them by meaningful review of the extrinsic evidence.

Finally, the trial court erred in relying on the trial testimony of Kaleidescape’s expert, Daniel Harkins, to support its ruling that the General Specifications are not part of the Technical Specifications with which a

CSS licensee must comply. According to the court, Harkins opined that the General Specifications are “informative, not normative,” (8RT855:8), and thus are not used by “people in his line of work . . . to determine what shall and shall not be done. . . .” (8RT855:15-16.) But this was a double-barreled mistake.

To begin with, Harkins’ testimony was strictly limited to the issue of whether Kaleidescape breached the General Specifications and did not address or purport to address the issue of whether the General Specifications are a subset of the Technical Specifications. Indeed, Harkins expressly denied that he had been asked to “form an opinion as to whether the CSS General Specifications are incorporated into the License Agreement.” (6RT664:8-11; see 6RT663:3-10.)¹²

Moreover, in making a distinction between “informative” and “normative” specifications, Harkins’ testimony dealt exclusively with Section 1.5. (6RT671:1-9.) He did not opine at trial that Section 2.1.2 was “informative.” On the contrary, at his deposition, Harkins testified that Section 2.1.2 was “normative.” (2AA465-466 at 62:25-63:11.) In short, Harkins’ views, to the extent they were relevant at all, supported the DVCCA’s allegations with respect to Section 2.1.2.¹³

¹² Nor could Harkins have rendered such an opinion: whether the General Specifications are incorporated into the Agreement is an ultimate legal question beyond the permissible purview of expert testimony. (*Summers v. A.L. Gilbert Co.* (1999) 69 Cal.App.4th 1155, 1179.)

¹³ In adopting Kaleidescape’s briefs, the court may also have relied on the Agreement’s integration clause (1AA153, § 10.1) for excluding the General Specifications from the Agreement. But the integration clause is irrelevant. The issue here is whether the General Specifications are a subset of the Technical Specifications as defined in the Agreement itself, not by dint of any outside agreement or modification.

II. THE TRIAL COURT ERRED AS A MATTER OF LAW IN HOLDING THAT SPECIFIC PERFORMANCE WAS UNAVAILABLE.

Whether a contract may be enforced through specific performance is a remedies question that a court should resolve only after making a liability determination that the defendant breached the contract. (*Golden West Baseball Co. v. City of Anaheim* (1994) 25 Cal.App.4th 11, 49.) The trial court here did not reach the issue of breach because it ruled that the General Specifications underlying the DVDFCA's claims were not Technical Specifications with which Kaleidescape had to comply. The trial court nevertheless reached out to decide that the DVDFCA would not be entitled to specific performance in any event because it believed the General Specifications were not "sufficiently definite for the court to know what to enforce." (8RT880:8-9.) The trial court based this gratuitous ruling on its interpretation of the "words" of the General Specifications. (8RT880:12.) This holding was wrong as a matter of law. (*Okun, supra*, 203 Cal.App.3d at p. 816 [whether wording of a contract is sufficiently definite to support a specific performance order is a legal question reviewed de novo].)

As set forth below, California case law establishes that the provisions of the General Specifications on which the DVDFCA rested its request for specific performance, Sections 1.5, and 2.1.2, do not lack definiteness. Those provisions are more concrete than a host of contracts with nebulous or even missing terms, which, with no hesitation, California courts have held to be enforceable through specific performance. This Court should reverse the trial court's specific performance ruling with instructions that, if it is determined on remand that Kaleidescape breached

the contract, the DVDCCA is entitled to enforce the contract through specific performance.¹⁴

A. Sections 1.5 and 2.1.2 of the General Specifications Are Sufficiently Definite To Support Specific Performance.

In examining contract terms to determine whether they are sufficiently definite to support specific performance, California courts have long been mindful that “the law favors carrying out the parties’ intentions through the enforcement of contracts and disfavors holding them unenforceable because of uncertainty.” (*Blackburn, supra*, 117 Cal.App.4th at p. 766, internal quotations omitted.) In carrying out that fundamental principle, courts have routinely held that even contracts with imprecise or missing terms are sufficiently definite to support specific performance.

Sections 1.5 and 2.1.2 of the General Specifications are worlds apart from provisions that might be deemed problematic in this regard. In those cases, courts had to “fill[] [in] some of the gaps that the parties ha[d] left” in order to sustain a request for specific performance. (*Okun, supra*, 203 Cal.App.3d at p. 817, internal quotations omitted.) Here, the contract has no gaps or omissions and is perfectly well-suited for the remedy of specific performance explicitly agreed to by the parties themselves.

A comparison with other cases shows conclusively why specific performance is available here. In *Henry v. Sharma* (1984) 154 Cal.App.3d 665, 669-670, for example, the court ordered specific performance after implying into the contract a provision allowing a “reasonable time” for

¹⁴ In addition to definiteness of the contract’s terms, the other requirements for specific performance are: adequate consideration; mutuality of remedies; substantial similarity between the requested performance and the contract terms; and inadequacy of legal relief. (*Blackburn v. Charnley* (2004) 117 Cal.App.4th 758, 766.) These issues have never been disputed.

payment when the contract had no express timing provision. Similarly, in *Goodwest Rubber Corp. v. Munoz* (1985) 170 Cal.App.3d 919, 921, the court ordered specific performance of a contract that omitted an exact price term, and spoke only of payment of “fair market value.” And in *Hennefer v. Butcher* (1986) 182 Cal.App.3d 492, 501-502, the court held that a contract was sufficiently definite for specific performance even though neither the time nor the manner of payment was expressly addressed in the four corners of the agreement. (Accord *United Truckmen, Inc. v. Lorentz* (1952) 114 Cal.App.2d 26, 28-29 [contract was subject to specific performance even though it contained only approximate descriptions of size and location of its subject matter].) As this line of cases demonstrates, a contract need not “deal in specifics” to be enforced through specific performance because “neither law nor equity requires that every term and condition be set forth in the contract.” (*Okun, supra*, 203 Cal.App.3d at p. 818.)¹⁵

If the contracts in these cases were sufficiently definite to support specific performance, then Sections 1.5 and 2.1.2 easily meet the test for definiteness. There are no nebulous or missing terms here. The two provisions “deal in specifics.” They state plainly what is expected – and not expected – of licensees.

Section 1.5(1) sets forth the “general security requirements for the [CSS].” It states concretely that the system is “intended to prevent casual users from the unauthorized copying of copyrighted materials recorded on DVD-Video/Audio Discs.” (1AA81.) Section 2.1.2 describes in detail the

¹⁵ Although the contract in *Okun* did not “deal in specifics,” the court upheld a specific performance order on the grounds that the contract was drafted with sufficient certainty to make it fair to require the defendant to carry out the terms that the plaintiff sought to enforce. (*Okun, supra*, 203 Cal.App.3d at pp. 818-819.)

three-step playback process that is required to obtain the Video Disc Key and Video Title Key to descramble the data on DVDs:

For playback by a DVD-Video Player (stand-alone device), the decryption/descrambling process is accomplished through the following process:

(1) Disc Key Recovery logic in the DVD-Video Descrambler reads Secured Disc Key data from the hidden Lead-in Area and recovers the Video Disc Key.

(2) The DVD-Video Descrambler then reads (decrypts) the Encrypted Video Title Key from the hidden Sector Header.

(3) The DVD-Video Descrambler then descrambles the A/V data in real-time for playback.

Note: The DVD-Video Player is expected to have decryption capability.

For playback by a combination of DVD-Video DVD Drive and the DVD-Video CSS Decryption Module, the decryption/descrambling process is the same as the stand-alone players except for an additional step prior to the actual descrambling.

(1AA84.) The General Specifications make clear that the “hidden Lead-in Area” and “hidden Sector Header area” referenced in Section 2.1.2 are located on the physical DVD. (1AA83.) Taken together, Sections 1.5 and 2.1.2 plainly state that descrambling of DVD content for playback requires retrieval of the Disc Key and Title Key from the physical DVD.

The evidence presented by Kaleidescape at trial does not render Sections 1.5 and 2.1.2 uncertain. No Kaleidescape witness testified that Section 1.5 or 2.1.2 is indefinite. Rather, Kaleidescape presented evidence that touted supposed precautions it built into its system to discourage unlawful copying. But this evidence does not speak to whether the contract is sufficiently definite to support specific performance.

The testimony of Kaleidescape’s expert, Daniel Harkins, addressed the issue of breach, not the issue of definiteness. As indicated above, Harkins testified that Section 1.5 of the General Specifications is

“informative,” rather than “normative,” by which Harkins meant that the provision does not impose obligations with which licensees must comply. (See pp. 36-37, *supra*.) But Harkins’ characterization of Section 1.5 as “informative” does not reflect a view that the provision is too vague to support a specific performance order, only that Kaleidescape did not breach a provision with which compliance is required.

As to Section 2.1.2, Harkins testified that the operations of Kaleidescape’s system comply with various subparts of that provision. (6RT665:7-669:10.) Harkins based this testimony on his technical interpretation of Section 2.1.2 and his view of how Kaleidescape’s system operates. The DVDCCA’s witnesses subscribed to a different technical interpretation of Section 2.1.2 and to a different view of how Kaleidescape’s system operates (an interpretation supported by Harkins’ own deposition testimony on the operation of the system, which conflicted with his trial testimony on that subject). (2AA465-466 at 63:25-64:11.) But this divergent understanding is not a reflection of contractual uncertainty. Rather, it shows only that the DVDCCA and Kaleidescape dispute the meaning of Section 2.1.2 and dispute whether Kaleidescape’s system complies with the provision.

Parties to a contract frequently contest its requirements and whether one side or the other is meeting them. Such conflicts do not, however, compel the conclusion that the contract is too indefinite to support a specific performance order. (*Okun, supra*, 203 Cal.App.3d at pp. 818-820 [upholding specific performance order despite parties’ disagreement over contractual obligations].) Once the parties’ disagreements over the meaning of the contract and over the breach issue are resolved, any seeming uncertainty stemming from the disagreements will be eliminated. (See Rest.2d Contracts, § 362, com. b [“Before concluding that the required certainty is lacking . . . a court will avail itself of all of the usual aids in

determining the scope of the agreement,” and thus as a result, “[a]pparent difficulties of enforcement due to uncertainty may disappear[.]”).) If the law were otherwise, then specific performance rarely could be awarded, for any dispute about the meaning of a contractual term or whether the defendant breached that term would automatically bar specific performance on the grounds of uncertainty.

Applying these principles here, if this Court holds that the General Specifications are part of the Agreement, then the trial court on remand will have to address the meaning of Section 2.1.2 and whether Kaleidescape’s system complies with that provision. If the trial court agrees with the DVDDCA’s position on the meaning of Section 2.1.2 and with the DVDDCA’s position that Kaleidescape’s system does not comply with the provision, there will be no uncertainty. At that point, Section 2.1.2 will have a single, definite meaning, and the DVDDCA will be entitled to enforce it through specific performance.¹⁶

¹⁶ The specific performance order the DVDDCA asked the trial court to enter was substantially similar to the terms of Sections 1.5 and 2.1.2, and therefore satisfied the requirement that a specific performance decree be tailored to the relevant contractual language that the plaintiff seeks to enforce. (See *supra* note 15.) As discussed above, Section 1.5 states that the general intent of the license is to prevent casual users from making unauthorized copies of DVDs, while Section 2.1.2 mandates that playback devices obtain a Video Disc Key and Video Title Key from the physical DVD disc for playback. The proposed order tracks these two Sections, stating that:

In the event Kaleidescape makes, has made, sells, offers to sell, markets, imports or otherwise transfers a DVD Playback Product after the date of this decree, Kaleidescape shall ensure that the DVD Playback Product:

- a. obtains any Video Disc Key and Video Title Key from the DVD Disc each time a request to playback one or more Titles is made;

B. The Trial Court's Two Other Justifications for Refusing to Order Specific Performance Are Legally Untenable.

The trial court advanced two other justifications for its specific performance ruling, neither of which stands up to scrutiny.¹⁷

First, the trial court remarked that the “words seem to be statements of what the computer scrambling device is supposed to do.” (8RT880:12-14.) This is correct. But it actually supports, rather than undercuts, the DVDCCA’s request for specific performance. As discussed above, Sections 1.5 and 2.1.2 of the General Specifications tell licensees how their products are supposed to operate in conformity with the “computer scrambling device,” and thus, by implication, what the products are not supposed to do. What the trial court failed to apprehend, however, is that it is precisely this feature of the provisions that makes them sufficiently definite. There is no guesswork involved as to what is expected of the licensees’ products.

b. ensures that the DVD Disc is physically present in the DVD Playback Product when playback of one or more Titles is occurring; and

c. does not make any permanent copy of any Video Disc Key or Video Title Key.

(3AA617.)

¹⁷ When instructing the parties to submit trial briefs on specific performance, the trial court pointed to the particular section of Witkin’s treatise that cites cases in which specific performance was ordered notwithstanding inexact or missing terms. (4RT263:7-8, referring to 14 Witkin, Summary of California Law (10th ed. 2007) § 44.) In issuing that instruction, the trial court also discussed and quoted at length from *United Truckmen*. (4RT262:19-265:12.) In its specific performance ruling, however, the trial court failed to explain how its conclusion that the General Specifications are insufficiently definite squared with any of the cases cited in the section of the Witkin treatise to which it previously had pointed or with *United Truckmen*.

Second, the trial court recycled its primary holding that the General Specifications are not part of the Agreement. Alluding to the relationship between the General Specifications and the Agreement, the trial court stated that the General Specifications “refer[] not to this contract, but there is another contract which very much applies. It is outside of that document. It’s just a big omission if the lawyer committee in a hundred meetings didn’t do it.” (8RT880:14-18.) This reasoning is beside the point. Whether or not the General Specifications are part of the Agreement has nothing to do with whether the General Specifications are sufficiently definite for purposes of specific performance.

III. THE TRIAL COURT ALSO ERRED AS A MATTER OF LAW IN HOLDING THAT INJUNCTIVE RELIEF WAS UNAVAILABLE.

In the Agreement, the parties expressly acknowledged the “critical importance of maintaining the integrity of CSS,” “the unique nature” of the Agreement, and “the lasting effect of and harm” that would result “from a breach of [its] provisions.” (1AA150.)¹⁸ The parties further acknowledged that a violation of the agreement could “mak[e] available the means for widespread unauthorized copying of copyrighted content intended to be protected,” and that, given the uniquely sensitive nature of the technology being licensed, the harm from a breach of those particular licensing provisions would be “irreparable.” (*Id.*)

Based on this understanding, the parties stipulated that “money damages alone will not adequately compensate an injured party” for a violation of the Agreement. (1AA150.) Accordingly, they included an “irreparable injury” provision, which states that, should the licensee breach

¹⁸ Section 4.2 of the Agreement requires licensees to comply with the CSS Specifications, which include both the Procedural and Technical Specifications. (1AA136.)

designated provisions, the DVDFCA “would be entitled to specific performance or other temporary, preliminary, or permanent injunctive relief,” based on the parties’ acknowledgement that the “harm will be irreparable and that monetary damages are not sufficient to remedy the injury.” (*Id.*)

Although the trial court did not decide whether Kaleidescape had breached the contract, it ruled that the parties’ irreparable injury stipulation was ineffectual because “the parties cannot control the sound exercise of jurisdiction by the trial court acting in equity.” (8RT881:26-28.) The court went on to hold that it “did not find persuasive the claim of irreparable harm.” (8RT882:12-13.) In reaching its decision, the trial court relied on findings that the equities favored Kaleidescape because the company would be harmed if it could not continue selling its system to consumers, and because it played no role in negotiating the contract. (8RT883:20-884:26.)

The trial court erred as a matter of law in failing to defer to the parties’ remedial stipulation in the contract and, in particular, to Kaleidescape’s contractual concession that its breach inflicted irreparable harm – thereby voluntarily relieving the DVDFCA of the burden of proving such harm at trial. In any event, even if the stipulation is not honored, the DVDFCA was entitled to permanent injunctive relief because, if the Agreement was breached, the record conclusively establishes that the DVDFCA will be irreparably harmed.

A. The Trial Court Erred as a Matter of Law in Refusing to Enforce the Contractual Stipulation of Irreparable Harm.

1. California courts regularly honor stipulated remedies.

The DVDFCA is aware of no California case addressing a stipulated remedy based on a contractual presumption that a breach of the agreement

will result in irreparable harm.¹⁹ But California courts regularly enforce agreements to apply specified remedies in the event of breach, and there is ample precedent to support enforcement of the provision at issue here.

¹⁹ Non-California courts widely honor such stipulations. (E.g., *Pacific Realty Trust v. APC Investments, Inc.* (9th Cir. 1982) 685 F.2d 1083, 1085, fn. 5 [“The parties here have stipulated that absent disclosure by APC about the bylaw, irreparable harm would result. We accept their stipulation and do not pass on the issue of irreparable harm.”]; *Ticor Title Ins. Co. v. Cohen* (2d Cir. 1999) 173 F.3d 63, 68 [contractual provision stipulating irreparable injury could “be viewed as an admission by Cohen that plaintiff will suffer irreparable harm were he to breach the contract[.]”]; accord *Verizon Communications Inc. v. Pizzirani* (E.D. Pa. 2006) 462 F.Supp.2d 648, 660; *Estee Lauder Cos. v. Batra* (S.D.N.Y. 2006) 430 F.Supp.2d 158, 174; *PAM, S.p.A. v. United States* (C.I.T. 2004) 347 F.Supp.2d 1362, 1366; *Peabody Holding Co. v. Costain Group PLC* (E.D. Mo. 1993) 813 F.Supp. 1402, 1414; *Hough Assocs., Inc. v. Hill* (Del. Ch., Jan. 17, 2007, No. 2385-N) 2007 WL 148751, *18 [“The public policy of this State permits parties to ... agree[] that breaches of their contracts will create irreparable harm and should be remedied by injunctive relief.”]; *Cirrus Holding Co. Ltd. v. Cirrus Industries, Inc.* (Del. Ch. 2001) 794 A.2d 1191, 1209 [“This Court has repeatedly held that contractual stipulations as to irreparable harm alone suffice to establish that element for the purpose of issuing preliminary injunctive relief.”]; *Mann v. Johnson Mem. Hosp.* (Ind.Ct.App. 1993) 611 N.E.2d 676, 679 [reversing trial court’s denial of a permanent injunction because “[t]he parties have stipulated to the proof of irreparable harm”].)

Some courts have held that a contractual stipulation of irreparable harm is a significant, but not deciding, factor to be considered by the courts. While the standard for enforcement is articulated somewhat differently in those cases, in practice, the courts have disregarded such stipulations only in the unusual circumstances where the record was entirely devoid of evidence of harm. (See, e.g., *Dominion Video Satellite, Inc. v. Echostar Satellite Corp.* (10th Cir. 2004) 356 F.3d 1256, 1266 [noting that “the district court articulated no other ground to substantiate a finding of irreparable harm”]; *Smith, Bucklin & Assocs., Inc. v. Sonntag* (D.C. Cir. 1996) 83 F.3d 476, 481 [“appellant’s only real ground for asserting irreparable injury is the effect that the district court’s opinion – which casts substantial doubt on the enforceability of the covenant – will have on present employees”]; *Baker’s Aid v. Hussmann Foodservice Co.* (2d Cir. 1987) 830 F.2d 13, 16 [“plaintiff[] fail[ed] to produce any evidence of

As a rule, California courts give contracting parties wide leeway to contract as they please. (See, e.g., *Aerojet-General Corp. v. Transport Indem. Co.* (1997) 17 Cal.4th 38, 75, citing *Linnastruth v. Mut. Benefit etc. Assn.* (1943) 22 Cal.2d 216, 218.) “It is competent for the parties to make whatever contracts they may please, so long as there is no fraud, or deception or infringement of law.” (*Greenberg v. Continental Cas. Co.* (1938) 24 Cal.App.2d 506, 514, quoting *Herbert v. Lankershim*, 9 Cal.2d 409; *Aerojet, supra*, 17 Cal.4th at p. 75 [“As a general matter . . . we do not add to, take away from, or otherwise modify a contract for ‘public policy considerations.’”].)

This freedom of contract includes the right of the parties to pre-determine remedies in the event of breach, in negotiated and standard form contracts alike. California courts thus routinely honor liquidated damages provisions. Indeed, such provisions are encouraged as a matter of public policy and – in the case of nonconsumer contracts – categorically presumed valid pursuant to statute. (Civ. Code, § 1671, subd. (b) [a liquidated damages provision “is valid unless the party seeking to invalidate the provision establishes [it] was unreasonable under the circumstances existing at the time the contract was made”].) In consumer contracts (not at issue here), liquidated damages provisions are not presumptively valid, but are nevertheless upheld when “it would be impracticable or extremely difficult to fix the actual damage.” (Civ. Code, § 1671, subs. (c) and (d).)

In determining whether to enforce a liquidated damages provision in a consumer contract, the court does not consider whether it was negotiated, but rather whether it “represents a reasonable endeavor by the parties to estimate fair compensation for the loss sustained.” (*Utility Consumers’*

irreparable harm, other than the conclusory statement of its president”]; cf. *Kansas City Southern v. Grupo TMM, S.A.* (Del. Ch., Nov. 4, 2003, No. 20518-NC) 2003 WL 22659332, *5.)

Action Network, Inc. v. AT&T Broadband of Southern Cal., Inc. (2006) 135 Cal.App.4th 1023, 1029, quoting *Rice v. Schmid* (1941) 18 Cal.2d 382, 385-386; see *id.* at pp. 1035-1044 [rejecting argument that enforceability of liquidated damages provision depended on whether the provision was negotiated by the parties, and upholding such a provision in a standardized form service contract]; see also *Allen v. Smith* (2002) 94 Cal.App.4th 1270, 1275, 1278-1280 [upholding liquidated damages clause in standardized form real estate contract]; *Better Food Mkts. v. American Dist. Teleg. Co.* (1953) 40 Cal.2d 179, 187 [upholding liquidated damages provision in standardized form contract].)

California courts also enforce judgments imposing equitable relief, including injunctions, based on the parties' agreement, so long as they comport with public policy and are not unlawful. (*California State Auto Ass'n Inter-Ins. Bureau v. Superior Court* (1990) 50 Cal.3d 658, 664.) A familiar example is the consent decree, which in California sometimes takes the form of a "stipulated judgment." (E.g., *id.* at pp. 663-664; *People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.* (2004) 116 Cal.App.4th 1253, 1258; see also *Frew v. Hawkins* (2004) 540 U.S. 431, 437 [a consent decree "embodies an agreement of the parties" and is also "an agreement that the parties desire and expect will be reflected in, and be enforceable as, a judicial decree that is subject to the rules generally applicable to other judgments and decrees."].) Like injunctions, consent decrees commonly require the adoption and implementation of specific procedures and create "mandatory, enforceable obligation[s]." (*Frew, supra*, 540 U.S. at p. 438; see also *California State Auto Ass'n, supra*, 50 Cal.3d at pp. 663-664; *United States v. City of Hialeah* (11th Cir. 1998) 140 F.3d 968, 974 ["A consent decree will always contain injunctive relief."].)

The trial court's objection here that the parties' remedial stipulation was improper because "the parties cannot control the sound exercise of

jurisdiction by the trial court acting in equity” (8RT881:26-28) was thus simply wrong. Stipulated remedies do not tie the hands of the court, which retains its duty to decide whether they are unconscionable before it orders the parties to comply with them. (E.g., *California State Auto Ass’n Inter-Ins. Bureau, supra*, 50 Cal.3d at p. 664.) Far from hampering the judicial process, stipulated remedial provisions streamline litigation, facilitate the fair and efficient resolution of disputes, and ensure full protection of the parties’ interests consistent with the underlying law. (See *Utility Consumers, supra*, 135 Cal.App.4th at p. 1038.)

2. The parties’ stipulation is particularly appropriate and reasonable here.

Stipulations like the one at issue here serve much the same function as liquidated damages provisions, which are encouraged in California because “they remove the uncertainty factor from determining damages from a breach of contract and reduce litigation.” (*Utility Consumers, supra*, 135 Cal.App.4th at p. 1038; see also *Allen, supra*, 94 Cal.App.4th at p. 1278.) The parties’ irreparable injury stipulation likewise narrows the areas of dispute and promotes efficiency by removing uncertainty.

In this case, the DVDCCA’s insistence that licensees adhere to the licensing requirements ensures a delicate balance is maintained between content owners and the consumer electronics and information technology companies that make the devices consumers use to play back DVDs. Content owners require adequate protection for their intellectual property – in particular, prohibitions on copying – before they will allow others to market devices to distribute their content. And the consumer electronics and information technology companies, whose products distribute that content, also depend on the level playing field created by uniform licensing rules limiting distribution. The CSS License is what permits these groups to come together; that union comes unglued if the integrity of the CSS is

cast into doubt. If licensees are permitted – even once – to get around the CSS to make unlawful copies of DVD content, the entire system is undermined.

Instead of trying to speculate in advance as to the amount of damages such harm would cause or leave that speculation to a jury, the parties here came up with a simple and equitable solution – they agreed in advance that a breach would result in irreparable injury and that the remedy should be cessation of the breach. The stipulated remedy to which they agreed comprehensively assesses the injury the DVDCCA will suffer from the degradation of its system for protecting intellectual property, from the attendant risk that other licensees will forsake their obligations and follow the violator’s lead, resulting in cumulative harms, and from the destruction of critical trust relationships with other businesses.

The trial court should have held Kaleidescape to its concession that the “harm [caused by a breach of the Agreement] will be irreparable and that monetary damages are not sufficient to remedy the injury.” (1AA150.) As an equitable matter, a party is estopped from denying facts to which it has stipulated: “[t]he general rule is that when a person with the capacity of reading and understanding an instrument signs it, he is, in the absence of fraud and imposition, bound by its contents and is estopped from saying that its provisions are contrary to his intentions or understanding.” (*Jefferson v. California Dep’t of Youth Authority* (2002) 28 Cal.4th 299, 303, citation and internal quotations omitted; see Evid. Code, § 622 [“[t]he facts recited in a written instrument are conclusively presumed to be true as between the parties thereto”].)

In enforcing this rule, courts do not pass judgment on the validity of a stipulation. Facts that are conclusively presumed to be true “need not have a logical basis, and no evidence may be received to contradict it.” (1 Witkin, Cal. Evidence (4th ed. 2000) Burden § 160, p. 301, citations

omitted; see *Kristine H. v. Lisa R.* (2005) 37 Cal.4th 156, 165 [“We need not, and do not, therefore, determine whether the stipulated judgment entered into by [the parties] is valid; we hold only that Kristine may not now challenge the validity of that judgment.”]; *Palermo v. Pyke* (1952) 111 Cal.App.2d 350, 356 (“the [contractual] recital in the present case that ‘irreparable damage’ was caused by Palermo, was a recital of fact and was conclusive”).) The trial court’s assertion that it “did not find persuasive the claim of irreparable harm” (8RT882:1-13) was thus entirely inappropriate. (See *Smith v. Mendonsa* (1952) 108 Cal.App.2d 540, 544 [“It is not the business of courts, either of law or of equity, to remake contracts fairly entered into by persons who are capable of contracting. On the contrary, it is the duty of courts to encourage the keeping of agreements so made and to give adequate remedy for the breach thereof when it occurs.”].)

The court’s rationale that “the parties cannot control the sound exercise of jurisdiction by the trial court acting in equity” (8RT881:26-28) was equally misplaced. As discussed above, California courts readily honor stipulations for injunctive relief, e.g., in the context of consent decrees – which often require a great deal more judicial involvement and implementation than the stipulation here demands. (E.g., *People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.* (2003) 107 Cal.App.4th 516, 520 [noting that consent decree “placed various detailed express restrictions on Reynolds’s advertising and marketing practices”]; see *Frew, supra*, 540 U.S. at p. 435 [consent decree was 80 pages long and “order[ed] a comprehensive plan for implementing” the Medicaid statute].) If courts can honor complex and judicially cumbersome stipulations for injunctive relief, they can surely honor simple remedial stipulations of the kind to which the parties agreed here.

B. In any event, the DVDFCA established that the harm flowing from any breach of the agreement by Kaleidescape necessitates injunctive relief.

Even if this Court decides that the irreparable harm stipulation is unenforceable, it should reverse the trial court's decision to deny injunctive relief because, as unequivocally demonstrated at trial, the harmful effects of Kaleidescape's breach (assuming such breach is found) cannot be rectified by money damages. (Civ. Code, § 3422; *Anderson v. Souza* (1952) 38 Cal.2d 825, 833-834.)

The DVDFCA's right to relief is not contingent on showing that these effects have fully materialized, as the trial court seemed to believe. It is well-established that injunctive relief may be appropriate to prevent harm from materializing or increasing. The Civil Code specifies that injunctions grant "*preventive relief*" and that "a final injunction may be granted to prevent the breach of an obligation" under appropriate circumstances. (Civ. Code, §§ 3420, 3422, emphasis added; *Syngenta Crop Protection, Inc. v. Helliker* (2006) 138 Cal.App.4th 1135, 1166-1167.)

It is undisputed that the DVDFCA's explicit purpose was to create an environment in which content providers could release their intellectual property on the DVD format without fear of unauthorized copying. (2RT92:7-22; 4RT299:26-27; 3RT144:16-145:1 [the Agreement's strict prohibitions on casual copying were designed to create a "trust environment" in which content providers could allow their intellectual property to be distributed through the DVD format.].) If even a single manufacturer is allowed to create and market a product capable of unauthorized copying, that trust environment is compromised across the board. The resultant harm is manifold.

The DVDCCA will itself be harmed, because its value as an organization depends on its ability to enforce the Agreement. As DVDCCA witness Dr. Alan Bell explained,

[T]o the extent the breaches remain unaddressed and the rules become progressively degraded and ignored, then the confidence of the content owner is lost. The company that is prepared and willing and understand[s] why following the rules in their products is reasonable is suffering in its business against those that don't pay any regard to the rules.

(4RT306:12-20.) Injury to the DVDCCA's reputation and goodwill alone warrants injunctive relief. (*eBay, Inc. v. Bidder's Edge, Inc.* (N.D. Cal. 2000) 100 F.Supp.2d 1058, 1066 [loss of customer goodwill is irreparable "because it is neither easily calculable, nor easily compensable and is therefore an appropriate basis for injunctive relief"].) And the damage here extends well beyond injury to goodwill – if the DVDCCA cannot control unauthorized copying, the organization will be effectively crippled.

It will also harm all of the groups who depend on the level playing field created by uniform licensing rules, including consumer electronics and information technology companies, manufacturers, retailers, and rental businesses. The effects will ultimately be felt by the consuming public. As content providers lose confidence in the DVDCCA's ability to control unauthorized copying, they will either release less content, delay the release of content through the DVD medium, or switch to other media, curtailing the vitality of one of the most successful consumer products in history.

(See 4RT306:12-20, 308:2-10.)

Kaleidescape's internal memos reflect these very concerns: its own officers were troubled by the fact "that someone can rent a DVD and store it permanently on one of our PVL products. We may have a rebel reseller that loads a lot of DVD content prior to sale[.] Many of us can do

something similar today with one person renting [a DVD] and others viewing [it].” (1AA104.)

What makes this . . . potentially a thorny issue is that the “burden of borrowing every single time” disappears with the PVL product. You just need to borrow once and you have a permanent copy in your library forever. . . . [T]his becomes a value-loss proposition for content owners and rental businesses because there is no repeat business[.] . . . Rental business will die and retail business will suffer because borrowing once to have a permanent copy forever seems too good to forego for the average consumer.

(Id.)

Kaleidescape did little at trial to deny the threat of such widespread, systemic harm; instead, it tried to shift the burden to the DVDCCA to avoid such harm and argued that the harm should be ignored in any event because it allegedly affected content provides more than other interests represented by the DVDCCA. (See 7RT775-786.) In the absence of any dispute regarding the irremediable consequences of breach, the trial court’s refusal to credit the DVDCCA’s harm evidence was completely unjustified. (See 8RT882:12-13.)

C. The trial court erred in purporting to balance the equities.

The trial court denied injunctive relief to the DVDCCA in the face of overwhelming evidence of irreparable injury based on its erroneous decision to “balance the equities.” Crediting Kaleidescape’s testimony that it could lose its business if it were not allowed to continue breaching, the court concluded that Kaleidescape stood to suffer greater harm from the granting of an injunction than the DVDCCA would suffer from its denial. (8RT882:1-884:19.) The trial court was dead wrong. A party may not resist an injunction prohibiting him from doing something he agreed not to do by complaining of relative hardship. Courts strenuously reject pleas for

balancing of the equities in injunctive relief cases where the anticipated hardship is the price of the complaining party's own doing:

It is ... generally recognized that a defendant who engages in deliberate misconduct . . . will be barred from raising disproportionality as a reason for refusing equitable relief.

(James M. Fisher, *Understanding Remedies* (2d ed. 2006) p. 213 & fn. 53, citing *Hollis v. Garwall, Inc.* (Wash. 1999) 974 P.2d 836, 845; *Kratze v. Ind. Order of Oddfellows* (Mich. 1993) 500 N.W.2d 115, 120-121.)

Thus, for example, “[o]ne who purchases property in anticipation of procuring a variance to enable him to use it for a purpose forbidden at the time of sale cannot complain of hardship ensuing from a denial of the desired variance.” (*City of San Marino v. Roman Catholic Archbishop of Los Angeles* (1960) 180 Cal.App.2d 657, 673, internal citation omitted; see *id.* at pp. 677-678.) Likewise, a party who agrees to keep the trees on his land at a fixed height cannot be relieved of his contractual duty on the grounds that keeping his promise will cause him greater damage than his breach will cause the other contracting party. (*Smith v. Mendonsa, supra*, 108 Cal.App.2d at pp. 543-545 [issuing injunction to enforce parties’ agreement to limit height of trees along property boundary].)

The notion that the DVDCCA should be compelled to do further business with Kaleidescape under a different license (and on Kaleidescape’s terms) contravenes the principle that “[no] man should be required to contract a second time with one who has without cause breached a prior contract with him.” (*Zanker Dev. Co. v. Cogito Systems Corp.* (1989) 215 Cal.App.3d 1377, 1382, internal quotations omitted.) It also runs counter to the cardinal tenet of contract law that it is the prerogative of the plaintiff, not the defendant, to elect the remedies for breach when there is a choice of remedy. As one California court aptly put it: “[T]he choice of the remedy is vested in the victim, not in the

wrongdoer. . . . It does not lie in the mouth of the wrongdoer to demand that his victim be limited to that cause of action which is most beneficial to the wrongdoer.” (*Gherman v. Colburn* (1977) 72 Cal.App.3d 544, 564 & fn. 12; see also *Navarro v. Perron* (2004) 122 Cal.App.4th 797, 802.)

The court’s additional observation that “the equities are strongly in favor . . . of the defense,” because Kaleidescape did not play a role in negotiating the contract (8RT884:19-26) adds nothing to its analysis. Whether the contract was the product of negotiation is irrelevant in determining whether the DVDCCA would be entitled to a remedy – equitable or otherwise – in the case of breach. Unless a contract is deemed unconscionable – and there was no allegation or hint of unconscionability here – a court is required to enforce it in keeping with the parties’ freely agreed-to terms. (E.g., *Dryer v. Los Angeles Rams* (1985) 40 Cal.3d 406, 416.)

CONCLUSION

For the foregoing reasons, this Court should reverse the trial court’s decision and remand for a new trial to decide the issue of breach. This court should instruct the trial court on remand that specific performance is available as a matter of law, and that the parties’ remedial stipulation is enforceable.

Respectfully submitted,

Dated: December 14, 2007

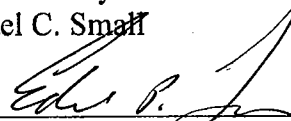
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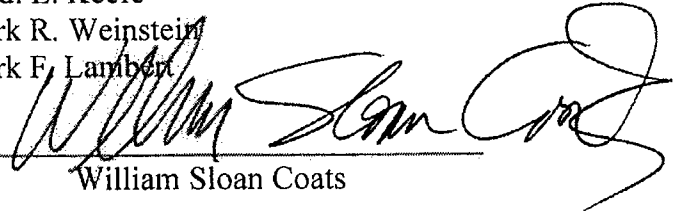
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CERTIFICATE OF COMPLIANCE

[Cal. Rules of Court, Rule 8.204(c)]

This brief consists of 16,358 words as counted by the Microsoft Word version 2002 word processing program used to generate the brief.

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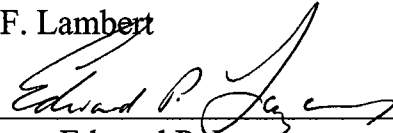
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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is: 2029 Century Park East, Suite 2400, Los Angeles, CA 90067. On December 14, 2007, I served the foregoing document(s) described as: **APPELLANT'S OPENING BRIEF** on the interested party(ies) below, using the following means:

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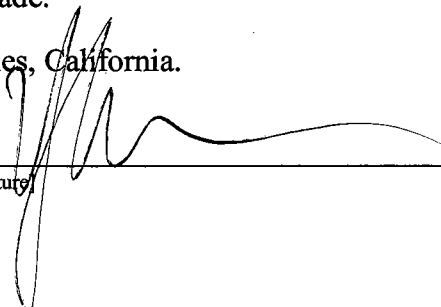
BY UNITED STATES MAIL I enclosed the documents in a sealed envelope or package addressed to the respective address(es) of the party(ies) stated above and placed the envelope(s) for collection and mailing, following our ordinary business practices. I am readily familiar with the firm's practice of collection and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the United States Postal Service, in a sealed envelope with postage fully prepaid at Los Angeles, California.

(STATE) I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

(FEDERAL) I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed on December 14, 2007 at Los Angeles, California.

Yvonne Shawver
[Print Name of Person Executing Proof]


[Signature]