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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

REALNETWORKS, INC., a Washington Corporation; and REALNETWORKS HOME ENTERTAINMENT, INC., a Delaware Corporation

No. C 08-04548 MHP

Plaintiffs and Counter-defendants,

v.

DVD COPY CONTROL ASSOCIATION, INC., a Delaware nonprofit corporation, DISNEY ENTERPRISES, INC., a Delaware corporation; PARAMOUNT PICTURES CORP., a Delaware corporation; SONY PICTURES ENTER., INC., a Delaware corporation; TWENTIETH CENTURY FOX FILM CORP., a Delaware corporation; NBC UNIVERSAL, INC., a Delaware corporation; WARNER BROS. ENTER. INC., a Delaware corporation; and VIACOM, Inc., a Delaware Corporation,

Defendants and Counter-complainants.

UNIVERSAL CITY STUDIOS PRODUCTIONS L.L.P., UNIVERSAL CITY STUDIOS L.L.P., PARAMOUNT PICTURES CORPORATION, TWENTIETH CENTURY FOX FILM CORP., SONY PICTURES TELEVISION INC., COLUMBIA PICTURES INDUSTRIES, INC., SONY PICTURES ENTERTAINMENT INC., DISNEY ENTERPRISES, INC., WALT DISNEY PICTURES and WARNER BROS. ENTER. INC.,

No. C 08-04719 MHP

Plaintiffs,

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v.

REALNETWORKS, INC., a Washington Corporation; and REALNETWORKS HOME ENTERTAINMENT, INC., a Delaware Corporation

Defendants.

MEMORANDUM & ORDER

Re: Plaintiffs’ Motion to Dismiss DVD CCA’s Second Counterclaim; Plaintiffs’ Motion to Preclude Claims Based on Non-CSS Technologies; Defendants’ Motion for Sanctions for Spoliation of Evidence.

Plaintiffs RealNetworks, Inc. and RealNetworks Home Entertainment, Inc. (together, “Real”) seek a declaratory judgment that they have neither breached a license agreement with DVD Copy Control Association, Inc. (“DVD CCA”) nor violated the anti-circumvention provisions of the Digital Millennium Copyright Act, 17 U.S.C. sections 1201, et seq. (“DMCA”). Now before the court are three motions: (1) Real’s motions to dismiss DVD CCA’s second counter-claim for breach of the implied covenant of good faith and fair dealing; and (2) Real’s motion to preclude claims based on non-Content Scramble System (“non-CSS”) technologies or, alternatively, to continue the preliminary injunction hearing, and for the appointment of a discovery referee; and (3) Defendants’ motion for sanctions for spoliation of evidence. Having considered the parties’ submissions and for the reasons set forth below, the court enters the following memorandum and order.

BACKGROUND

RealNetworks, Inc. is a company incorporated and based in Seattle, Washington, that develops, manufactures and sells platforms for the delivery of digital media. Amended Complaint for Declaratory Relief, Docket No. 62, ¶ 10, Exh. A (“Amended Complaint”).¹ RealNetworks Home Entertainment, Inc. is a subsidiary of RealNetworks, Inc. and is incorporated in Delaware, with its principal place of business in Seattle, Washington. Id. ¶ 11.

Real sells and distributes a software product known as RealDVD. Id. ¶ 2. The RealDVD product has a variety of different functions, such as playing back DVDs placed into the computer’s DVD drive, looking up information about the DVD from Internet databases, providing links to various information websites relevant to the chosen DVD and storing an image of the copy-protected DVD to a computer hard drive for safekeeping and later playback purposes. Id. Moreover, the

1 RealDVD allows users to create personal copies of DVDs on a computer's hard drive. Id. ¶ 24.

2 Real also has a new product called "New Platform" or "Facet." Id. ¶ 2.

3 Columbia Pictures Industries, Inc., Disney Enterprises, Inc., Paramount Pictures Corp., Sony
4 Pictures Entertainment, Inc., Sony Pictures Television, Inc., Twentieth Century Fox Film Corp.,
5 NBC Universal, Inc., Walt Disney Pictures, Warner Bros. Entertainment, Inc., Universal City
6 Studios Productions L.L.L.P., Universal City Studios L.L.P. and Viacom, Inc. (collectively, "Studio
7 defendants") are motion picture companies that are members of DVD CCA, a not-for-profit
8 corporation that consists of companies in the motion picture, consumer electronics and computer
9 industries. Id. ¶ 4. DVD CCA licenses Content Scramble System ("CSS") technology to
10 manufacturers of devices and software pursuant to a standard license agreement ("CSS License
11 Agreement"). Id.

12 CSS technology scrambles the DVD content so that it cannot be copied or played coherently
13 without first being decrypted through a process employing a set of decryption keys. Id. ¶ 20.
14 Studio defendants use CSS technology to encrypt the content on their copyrighted DVDs. Id. The
15 CSS License Agreement imposes restrictions on the use of CSS technology, according to CSS
16 specifications and provides a licensee with decryption keys and the authorized methods and
17 processes for decryption. Id. ¶ 21. DVD CCA has a strong interest in protecting DVD content and
18 preventing unauthorized copying of the content providers' copyrighted materials. See Counter-
19 Complaint by Disney Enterprises, Inc., Paramount Pictures Corporation, Sony Pictures
20 Entertainment Inc., Twentieth Century Fox Film Corporation, and Warner Bros. Entertainment Inc.,
21 Docket No. 15, ("Counter-Complaint") ¶¶ 24, 26-27.

22 On August 13, 2007, DVD CCA licensed its CSS technology to Real pursuant to a CSS
23 License Agreement. Amended Complaint ¶ 23; see also Docket No. 2, Exh. 1 to Complaint (CSS
24 License Agreement). Under this license, Real obtained the CSS technology with authorization to
25 build a product to play DVDs. Approximately a year later, Real was contacted by various studios
26 objecting to the impending release of the RealDVD product, expressing concerns that RealDVD
27 violated terms of the CSS License Agreement by making playable, permanent copies of DVDs.

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1 Shortly before September 8, 2008 Studio defendants and DVD CCA (together, “defendants”)
2 formally advised Real that it was in violation of the CSS License Agreement, because Real’s
3 RealDVD product allows digital-to-digital copying of DVD content in a personal computer
4 environment. DVD CCA also advised Real that the RealDVD product violates the anti-
5 circumvention provisions of the DMCA. Based on these communications, Real decided to postpone
6 the RealDVD product launch from September 8, 2008 to later that month. See Lang Dec. ISO
7 Real’s Opposition to Def.’s Motion for TRO, Docket No. 28, ¶ 7. On September 9, 2008, following
8 negotiations, Real and Studio defendants entered into a tolling/standstill agreement regarding
9 RealDVD. On September 25, 2008, counsel for defendants sent a letter to Real informing it that
10 Studio defendants intended to file a lawsuit against Real and seek injunctive relief. Lane Dec. ISO
11 Pls.’ Opp. to Mot. for Sanctions for Spoliation, Docket No. 181, Exh. F (“First Lane Dec.”).

12 On September 30, 2008, Real filed an action for declaratory judgment pursuant to 28 U.S.C.
13 sections 2201 and 2202 against defendants, seeking a declaratory judgment that, in marketing and
14 selling its RealDVD product, Real did not breach the CSS License Agreement and did not violate
15 the anti-circumvention provisions of the DMCA. See Complaint, Docket No. 1. That same day,
16 Real released and made the RealDVD product available for download. Lang Dec., Docket No. 28, ¶
17 11. Also that day, some of the Studio defendants (along with Universal City Studios Productions
18 L.L.L.P., Universal City 23 Studios L.L.L.P., Walt Disney Pictures, Sony Pictures Television Inc.,
19 and Columbia Pictures Industries, Inc.) filed an action in the Central District of California, alleging
20 that RealDVD did, in fact, breach the CSS License Agreement and violate the anti-circumvention
21 measures of the DMCA. On October 14, 2008, that suit was formally transferred to the Northern
22 District of California, and shortly thereafter related to Real’s declaratory judgment action. See
23 Order Relating Cases, Docket No. 52.

24 Following an October 3, 2008 hearing, the court issued Studio defendants’ requested
25 Temporary Restraining Order to restrain and enjoin Real from further distribution of the RealDVD
26 product. See Docket No. 43. Minute Entry: Temporary Restraining Order Hearing (filed under seal).
27 That same day, Studio defendants filed a counter-complaint against Real alleging DMCA violations
28 and breach of contract of the CSS license agreement, brought as a beneficiary claim by certain of the

1 Studio defendants as Eligible Content Providers and third-party beneficiaries with standing to sue
2 under the agreement. See Counter-Complaint, ¶¶ 34-50.

3 On October 6, 2008, Real’s legal department e-mailed a document preservation
4 memorandum to members of the RealDVD team, instructing recipients to “preserve all documents
5 and electronic and hard copy data from July 2007 to the present relating to any aspect of RealDVD,
6 the CSS License Agreement and the DVD CCA.” Godfrey Dec., Docket No. 160, Exh. A (copy of
7 e-mail). On October 8, 2008, Real’s Chief Executive Officer Rob Glaser sent an e-mail instructing
8 employees to “retain all emails and documents relating to RealDVD.” Godfrey Dec., ¶ 3.

9 On November 11, 2008, DVD CCA filed a motion for a preliminary injunction to join the
10 Studio defendants to enjoin Real from producing, selling, offering, marketing or otherwise
11 trafficking its RealDVD product. See Docket No. 61. That same day, Real filed a motion to amend
12 its complaint to add claims for a second Real product that “shares many of the functionalities of
13 RealDVD, including DVD playback from both a physical drive and from a secure digitally-stored
14 copy of the DVD, i.e., Facet (the New Platform), so that both products could be adjudicated at once.
15 See Docket No. 62 at 2:18-20.

16 On December 22, 2008, the court granted Real’s motion to amend its complaint to include
17 the Facet product. See Docket No. 92 (Minute Entry) and Amended Complaint ¶¶ 1-2. Real
18 currently seeks a judgment declaring that the CSS License Agreement permits Real to manufacture
19 and offer for sale the RealDVD (which is also referred to as Vegas) and Facet products and that Real
20 has not violated the DMCA. Id. ¶ 37. Real asserts that the RealDVD and Facet products preserve
21 the CSS encryption and enhance the original protection by incorporating an additional layer of
22 protection at a level beyond what is required by the CSS License Agreement. Id. ¶ 34. Real argues
23 that the RealDVD product is neither primarily designed nor produced for the purpose of
24 circumventing a technological measure that effectively controls access to a copyrighted work and
25 has other commercially significant purposes. Id. ¶ 36. Real also notified defendants that the Facet
26 product would be brought to market shortly. Id. ¶ 25.

27 DVD CCA subsequently filed counterclaims against Real for breach of contract and breach
28 of the implied covenant of good faith and fair dealing. See DVD CCA Answer to Amended

1 Complaint, Docket No. 96. DVD CCA alleges that the CSS License Agreement does not permit
2 Real to manufacture and/or offer for sale the RealDVD and Facet products, and further, that these
3 products allow for circumvention of the protections that the CSS-protected DVDs embody. Studio
4 defendants have also alleged that RealDVD bypasses the CSS protection measures by making a
5 complete, bit-for-bit copy of the entire contents of a CSS-protected DVD onto either a local
6 computer hard drive or a connected external USB hard drive. See Counter-Complaint, ¶ 30.

7 Also at the December 22, 2008 hearing, the court permitted defendants to introduce claims
8 that Real's products circumvent non-CSS technologies, named "ARccOS" and "Ripguard," in the
9 forthcoming preliminary injunction proceedings and instructed parties to confer regarding discovery
10 relating to these non-CSS technologies. See Lane Dec. ISO Pls.' and Counterclaim Defs.' Mot. to
11 Shorten Time and Mot. to Preclude or Continue, Docket No. 105, ¶ 4 ("Second Lane Dec."); see also
12 Transcript of Proceedings held on February 3, 2009, Docket No. 125, at 4:18-5:6 ("February
13 Transcript"). ARccOS and Ripguard are technologies that work in conjunction with CSS technology
14 to prevent ripping of DVDs. These technologies were developed by independent companies,
15 Macrovision and Sony DADC, and sold to Studio defendants. See February Transcript at 4:18-5:6.

16 On January 16, 2009, Real filed a motion to dismiss DVD CCA's second counterclaim for
17 breach of the implied covenant of good faith and fair dealing, alleging that in adhesion contracts, of
18 which the CSS Licensing Agreement is one, it is improper to read in implied terms. Defendants
19 oppose, arguing that it is (1) not an adhesion contract, and (2) even if it was, the implied covenant of
20 good faith and fair dealing still applies. On January 26, 2009, plaintiffs filed a motion to preclude
21 claims based on non-CSS technology at the preliminary injunction hearing, alleging inadequate
22 discovery review time.

23 On February 25, 2009, Studio defendants filed a motion for sanctions for Real's alleged
24 spoliation of evidence. On March 2, 2009, DVD CCA joined this motion. Defendants allege that
25 Real has failed to take adequate steps to preserve evidence from the April 2007 inception of the
26 disputed Facet product, and spoliated key evidence, specifically notebooks of Senior Program
27 Manager Nicole Hamilton on the Facet project and an ARccOS.zip file. Real opposes, arguing that
28 (1) there was no duty to maintain documents until at least the beginning of negotiations between the

1 parties in September 2008, and shortly thereafter, in October 2008, Real instituted a document hold;
2 (2) that Real was unaware of the existence of these notebooks, because Hamilton had failed to turn
3 them over when Hamilton's supervisor had previously asked for all Facet-related materials; and (3)
4 contrary to defendants' argument, Real management issued no orders to destroy related evidence.
5 Real also subsequently produced the disputed ARccOS.zip file on March 4, 2009.

6 On March 20, 2009, one business day before the oral hearing, Real withdrew its motion to
7 dismiss DVD CCA's second counterclaim, alleging it will raise the arguments at the upcoming
8 preliminary injunction hearing. The court nonetheless addresses this motion, for the benefit of the
9 parties moving forward, along with the other two pending motions herein. The court turns first to
10 the two motions to dismiss/preclude claims.

11 LEGAL STANDARD

12 I. Motion to Dismiss (Rule 12(b)(6))

13 A motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) "tests the legal
14 sufficiency of a claim." Navarro v. Block, 250 F.3d 729, 732 (9th Cir. 2001). Because Rule
15 12(b)(6) focuses on the "sufficiency" of a claim rather than the claim's substantive merits, "a court
16 may [typically] look only at the face of the complaint to decide a motion to dismiss." Van Buskirk
17 v. Cable News Network, Inc., 284 F.3d 977, 980 (9th Cir. 2002). A motion to dismiss should be
18 granted if plaintiff fails to proffer "enough facts to state a claim to relief that is plausible on its face."
19 Bell Atl. Corp. v. Twombly, 550 U.S. 544, ----, 127 S. Ct. 1955, 1974 (2007). Dismissal can be
20 based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a
21 cognizable legal theory. Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir. 1990).
22 Allegations of material fact are taken as true and construed in the light most favorable to the
23 nonmoving party. Cahill v. Liberty Mutual Ins. Co., 80 F.3d 336, 337-38 (9th Cir. 1996). The court
24 need not, however, accept as true allegations that are conclusory, legal conclusions, unwarranted
25 deductions of fact or unreasonable inferences. See Sprewell v. Golden State Warriors,
26 266 F.3d 979, 988 (9th Cir. 2001); Clegg v. Cult Awareness Network, 18 F.3d 752, 754-55 (9th Cir.
27 1994).
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1 II. Sanctions for Spoliation of Evidence

2 District courts may impose sanctions as part of their inherent power “to manage their own
3 affairs so as to achieve the orderly and expeditious disposition of cases.” Chambers v. NASCO,
4 Inc., 501 U.S. 32, 43 (1991); see also Unigard Sec. Ins. Co. v. Lakewood Eng’g & Mfg. Corp., 982
5 F.2d 363, 368 (9th Cir. 1992) (excluding evidence as a sanction for spoliation). This power includes
6 the “broad discretion to make . . . evidentiary rulings conducive to the conduct of a fair and orderly
7 trial.” Id. at 368, quoting Campbell Indus. v. M/V Gemini, 619 F.2d 24, 27 (9th Cir. 1980).

8 District courts’ inherent power to sanction may be invoked in response to destruction of
9 evidence. If a party breaches its duty to preserve evidence, the opposing party may move the court
10 to sanction the party destroying evidence. See Unigard, 982 F.2d at 365.

11 Courts may sanction parties responsible for spoliation of evidence in three ways. First, a
12 court can instruct the jury that it may draw an inference adverse to the party or witness responsible
13 for destroying the evidence. See Glover v. BIC Corp., 6 F.3d 1318, 1329 (9th Cir. 1993); Akiona v.
14 United States, 938 F.2d 158, 161 (9th Cir. 1991). Second, a court can exclude witness testimony
15 proffered by the party responsible for destroying the evidence and based on the destroyed evidence.
16 See, e.g., Glover, 6 F.3d at 1329; Unigard, 982 F.2d at 368-69. Finally, a court may dismiss the
17 claim of the party responsible for destroying the evidence. See Allstate Ins. Co. v. Sunbeam Corp.,
18 53 F.3d 804, 806-07 (7th Cir. 1995); see also Chambers, 501 U.S. at 45 (“outright dismissal . . . is a
19 particularly severe sanction, yet is within the court’s discretion”); Alexander v. Nat’l Farmers Org.,
20 687 F.2d 1173 (8th Cir. 1982) (noting dismissal of claims is a severe sanction and may be warranted
21 for “outrageous” destruction of evidence).

22 A party’s destruction of evidence need not be in “bad faith” to warrant a court’s imposition
23 of sanctions. Glover, 6 F.3d at 1329; Unigard, 982 F.2d at 368 n.2. District courts may impose
24 sanctions against a party that merely had notice that the destroyed evidence was potentially relevant
25 to litigation. See Glover, 6 F.3d at 1329; Akiona, 938 F.2d at 161; cf. Unigard, 982 F.2d at 368 n.2
26 (sanctions may be imposed for “willfulness or fault by the offending party”). However, a party’s
27 motive or degree of fault in destroying evidence is relevant to what sanction, if any, is imposed.
28 Baliotis v. McNeil, 870 F. Supp. 1285, 1291 (M.D. Pa. 1994); see also Schmid v. Milwaukee Elec.

1 Tool Corp., 13 F.3d 76, 79 (3rd Cir. 1994) (courts should choose “the least onerous sanction
2 corresponding to the willfulness of the destructive act and the prejudice suffered by the victim”).

3 As soon as a potential claim is identified, a litigant is under a duty to preserve evidence
4 which it knows or reasonably should know is relevant to the action. Nat’l Ass’n of Radiation
5 Survivors v. Turnage, 115 F.R.D. 543, 556-57 (N.D. Cal. 1987) (Patel, J.); Baliotis, 870 F. Supp. at
6 1290; see also Unigard, 982 F.2d at 365, 369 (upholding the district court’s exclusion of plaintiff’s
7 expert testimony based on evidence plaintiff destroyed two years before filing suit). The future
8 litigation must be “probable,” which has been held to mean “more than a possibility.” Hynix
9 Semiconductor Inc. v. Rambus, Inc., 591 F. Supp. 2d 1038, 1061 (N.D. Cal. 2006) (Whyte, J.). The
10 duty to preserve evidence also attaches when “a party should have known that the evidence may be
11 relevant to future litigation.” In re Napster, Inc. Copyright Litig., 462 F. Supp. 2d 1060, 1068 (N.D.
12 Cal. 2006), quoting Zubulake v. UBS Warburg LLC, 220 F.R.D. 212, 216 (S.D.N.Y. 2003).

13 14 DISCUSSION

15 I. Real’s Motion to Dismiss DVD CCA’s Second Counterclaim

16 Real contends that DVD CCA’s second counterclaim does not assert a claim as a matter of
17 law. DVD CCA asserts that Real breached the implied covenant of good faith and fair dealing
18 because it created the RealDVD and Facet products to copy CSS-protected DVD content to a
19 computer hard drive for later playback without the DVD, which frustrates the purpose of the CSS
20 License Agreement.

21 To support its contention, Real argues that the CSS License Agreement was a contract of
22 adhesion and should be interpreted to comport with the adhering party’s, i.e., Real’s, reasonable
23 interpretation. Real also argues that defendants are using the implied covenant of good faith and fair
24 dealing to supplement terms to the contract, and “should not benefit . . . from allegedly implied
25 terms it did not explicitly include into the standardized contract [DVD CCA] drafted.” Pls. Mot. at
26 2:20-21.

27 A covenant of good faith and fair dealing is *implied* in law in every contract and “exists
28 merely to prevent one contracting party from unfairly frustrating the other party’s right to receive the

1 benefits of the Agreement actually made.” Guz v. Bechtel Nat’l Inc., 24 Cal. 4th 317, 349 (2000).
2 As the name of the common-law claim — *implied* covenant of good faith and fair dealing — makes
3 explicitly clear, the terms need only be *implied*, not, as plaintiffs suggest, “explicitly include[d] into
4 the standardized contract.” For the court to find, even in putative adhesion contracts, that a licensor
5 cannot plead a breach of the implied covenant of good faith and fair dealing because the licensor
6 failed to explicitly include terminology directed at the licensee’s allegedly bad faith actions, would
7 completely eviscerate the protection of this common-law claim. Furthermore, the court need not —
8 and should not — decide the merits of Real’s “adhesion contract” claim at this point. Ruling at the
9 pleading stage on whether or not the CSS Licensing Agreement is an adhesion contract is
10 inappropriate. See Woodard v. S. Cal. Permanente Med. Group, 171 Cal. App. 3d 656, 677 (1985)
11 (“Whether a contract is one of adhesion generally would present a mixed question of law and fact.”).
12 Perhaps Real recognized this fact and so chose to withdraw its motion at this stage.

13 The purpose of the CSS Licensing Agreement is to “prevent casual consumers from making
14 unauthorized copies of the DVD content.” CSS Licensing Agreement at Recital A. DVD CCA, at
15 this stage, has adequately pled that there was a contract, that its purpose was to prevent unauthorized
16 copying of DVD content, and that Real, through the use of its product allowing copying of DVDs to
17 hard drives, allegedly breaches the implied covenant of good faith and fair dealing. DVD CCA’s
18 second counter-claim will be duly considered on the merits at the forthcoming preliminary
19 injunction hearing.

20 II. Real’s Motion to Preclude Claims Based on Non-CSS Technologies

21 Real seeks to preclude the adjudication of whether it circumvents the non-CSS technologies,
22 ARccOS and Ripguard, from the preliminary injunction proceedings previously scheduled for March
23 3, 2009, because Real alleges it has been deprived of complete discovery of basic technological
24 information regarding ARccOS and Ripguard technologies. Real argues that between the sheer
25 volume of documents received, as well as being precluded from using its experts to examine the
26 documents due to the protective order placed on the documents, Real will be inadequately prepared
27 for the preliminary injunction hearing. Second Lane Dec. ¶ 11-12. Alternatively, Real requests a
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1 continuance for the hearing to allow it to more adequately review the documents and prepare, and
2 also requests appointment of a magistrate judge as a discovery referee.

3 The court previously moved the preliminary injunction hearing from its earlier date of March
4 3, 2009 to April 1, 2009. See Minutes Entry from February 3, 2009 Discovery Hearing. Real raised
5 this very issue during that telephone conference, and the court decided that a postponement of the
6 hearing would allow Real several additional weeks to prepare. Plaintiffs' motion to preclude is
7 hereby **DENIED** in light of the further continued preliminary injunction hearing date, now
8 scheduled to begin on April 24, 2009.

9 Finally, the court turns to the Studio defendants' motion, which has been joined by DVD
10 CCA, for sanctions based on spoliation of evidence.

11 III. Defendants' Motion for Sanctions for Spoliation of Evidence

12 Defendants assert that Real has failed to take adequate steps to preserve evidence and has
13 spoliated key evidence during the course of this litigation. Specifically, defendants allege that Real
14 employees were fully knowledgeable about the potential for litigation since early 2007, and
15 therefore carefully crafted any potentially discoverable document in a manner helpful to Real's
16 litigation by using specific words and avoiding certain word phrases.

17 Defendants base their motion on the deposition testimony of Real's former Senior Program
18 Manager Nicole Hamilton, Strategic Advisors Todd Basche and Richard Wolpert, and other Real
19 employees. See Lynch Dec. ISO Motion for Sanctions for Spoliation of Evidence, Docket No. 130,
20 Exhs. 1-7 ("Lynch Dec."). Hamilton, who was employed by Real until one week prior to the start of
21 this litigation, testified that she was told by her boss, Phil Barrett, to delete emails related to
22 ARccOS and Ripguard technologies on several occasions. Id., Exh. 6 at 39:23-41:20. Defendants
23 also learned about Hamilton's notebooks, which she stated were handed over to Real at the time of
24 her termination and may contain information regarding the Facet technology, but have not been
25 produced in discovery. Id. at 150:4-25, 21 & 22.

26 Wolpert stated in his deposition that his own "standard practice" was to keep documents that
27 he thought were relevant that he may need for his recollection in the future, but also to delete "tons
28 of stuff" every day. Lynch Dec., Exh. 7 at 157:3-9. Basche, a consultant for Real on the

1 RealDVD project, was never asked to preserve his documents and deleted everything he had related
2 to RealDVD project in April 2008, when his consulting arrangement ended, as was his customary
3 practice.² Basche Dec., Docket No. 156, ¶ 3.

4 Based on these depositions, defendants allege that Real failed to take steps to preserve
5 evidence, including: (1) failing to instruct employees to preserve evidence; (2) possibly destroying
6 Hamilton's notebooks for the Facet technology; (3) routinely instructing employees to delete
7 possibly relevant emails; (4) failing to produce ARccOS-related archive files; and (5) allowing
8 Strategic Advisors Basche and Wolpert on the RealDVD project to destroy project-related
9 documentation. Real has also refused to permit redeposition of Barrett, the supervisor allegedly
10 responsible for the destruction orders.

11 Defendants urge that appropriate sanctions are warranted in this situation. Defendants
12 request six different sanctions: (1) a preservation order for all existing and future documents relating
13 to RealDVD, CSS, ARccOS or Ripguard, including backup tapes; (2) precluding Real from
14 impeaching or controverting Hamilton's testimony on five areas which the controverted notebooks
15 purportedly cover; (3) inferring that Real knowingly purchased technologies to circumvent ARccOS
16 and Ripguard; (4) precluding Real from offering testimony from Basche and Wolpert; (5) requiring
17 Real to produce Barrett for a deposition on spoliation and Facet; and (6) requiring Real to pay
18 monetary sanctions as appropriate.

19 A. Preservation Order

20 (i) Pre-litigation Preservation of Evidence

21 Defendants argue that Real knew since early 2007 that litigation over RealDVD was
22 inevitable and that it failed to preserve documents and data since that time. Defendants assert that
23 the following indicates Real's knowledge of probable litigation in early 2007: (1) Real's April 2007
24 presentation describes the "DMCA" as a "risk" to RealDVD; (2) Real's July 2007 presentation
25 discusses the "threat of a lawsuit;" (3) Hamilton testified that she was told within hours of being
26 hired in July 2007 that there would be litigation over RealDVD and that the idea of litigation over
27 RealDVD was drummed into the team on a daily basis; and (4) Hamilton testified that there were
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1 concerns about litigation over Facet and with DVD CCA. See Lynch Dec., Exhs. 11, 13, 16 & 6 at
2 17:18-23; 27:3-17.

3 Defendants rely on Real’s April 2007 presentation, which has a bullet point slide with the
4 title “DVD Ripping Issues” and subtitle “Risks.” Lynch Dec., Exh. 13. There are bullet points for
5 “DVD CCA issues and tactics” and “DMCA issues.” Id. Real’s July 2007 presentation has a slide
6 that has a box labeled “threats” and a bullet point stating “[l]egal action by Hollywood on basis of
7 copyright, not DVD CCA license.” Lynch Dec., Exh. 16.

8 Given that Real entered into the CSS License Agreement in August 2007, it is not clear
9 whether the slide from the April 2007 presentation indicates knowledge of probable litigation with
10 DVD CCA or a possible discussion of plans to license CSS technology from DVD CCA. The July
11 2007 presentation merely references a theoretical threat of litigation “by Hollywood” and not an
12 actual threat by any particular party. Moreover, it indicates that Real did not believe that it would be
13 sued based on the DVD CCA license, given that it was a presentation created before the August
14 2007 CSS License Agreement. Thus, these presentation slides are not strong indicators of
15 knowledge of probable litigation with defendants. See Hynix, 591 F. Supp. 2d at 1061.

16 Defendants also assert that there were discussions among employees about litigation
17 concerning RealDVD during Hamilton’s employment. Defendants argue that according to
18 Hamilton, Barrett instructed employees to use certain words in emails or documents because there
19 may be “litigation one day.” Lynch Dec., Exh. 6 at 101:18-102:1. For instance, Barrett stated in an
20 email that ARccOS was not encryption and that he wouldn’t call it copy protection. Lynch Dec.,
21 Exh. 12. Barrett acknowledged that he instructed members of the Facet team to minimize use of
22 words like “ripping” because the term may be misconstrued. Barrett Dec. ISO Pls. Opp. to Mot. for
23 Sanctions for Spoliation, Docket No. 168, ¶ 5.

24 Real argues that even if a few employees recognized that litigation concerning a new product
25 was a possibility—a possibility that exists with many new products—Real was under no obligation
26 to preserve all documentation until there was an actual threat or notice of a lawsuit. The court
27 agrees with Real that a general apprehension of lawsuits does not create a duty to preserve all
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1 documentation related to RealDVD. The cited statements do not rise to a probability that the instant
2 litigation by or against Studio defendants would result.

3 A general concern over litigation does not trigger a duty to preserve evidence. Real had no
4 duty to preserve relevant documents or evidence until a potential claim was identified or future
5 litigation was probable. See Turnage, 115 F.R.D. at 556-57; Baliotis, 870 F. Supp. at 1290; Hynix,
6 591 F. Supp. 2d at 1061. Real participated in discussions about RealDVD with Studio defendants in
7 August 2008, but Real asserts that it was negotiating in good faith and that none of the
8 representatives from the studios threatened litigation during those meetings. See Coppinger Dec.,
9 Docket No. 184, ¶ 3. However, shortly before its September 8, 2008 planned announcement of
10 RealDVD, Real was on notice that litigation was probable and a potential claim was identifiable
11 because various studios objected to RealDVD's release and expressed concern that RealDVD
12 violated the CSS License Agreement. As a result of the objections by the studios, Real entered into
13 a tolling/standstill agreement concerning RealDVD. Real was also given actual notice of litigation
14 on September 25, 2008, which created a duty to ensure preservation of its relevant documents and
15 data.

16 Thus, beginning in early September 2008, Real knew that there was probable litigation and
17 had a duty to preserve all documents and evidence related to this action. The court finds that Real
18 was not under a duty to preserve evidence in anticipation of litigation prior to September 2008.

19 (ii) Willful Destruction of Documents

20 Based mostly on Hamilton's deposition testimony, defendants argue that (1) Real has not
21 preserved or produced Hamilton's notebooks, (2) Real's employees or team members destroyed
22 documents or emails and (3) Real has not produced the arccos.zip file purchased from overseas
23 hackers. The court examines each in turn.

24 On October 6, 2008, Real distributed an email to members of the Facet and Vegas RealDVD
25 teams, as well as other employees, consultants and officers who may have documents and materials
26 relevant to the litigation, instructing them to preserve documents and hard copy data from July 2007
27 to the present relating to any aspect of RealDVD, the CSS License Agreement and the DVD CCA.
28 Godfrey Dec., Exh. A. The memorandum states:

1 Please do not destroy, discard, alter or erase any document or computerized
2 information generated on or after July 1, 2007 to the present relating to: (1)
3 RealDVD, including the development, marketing and distribution of RealDVD; (2)
the CSS License Agreement and Real's activities under that Agreement, and (3) the
DVD CCA, including any communications with the DVD CCA.

4 Id.

5 It further states that the retention policy applies to all electronic and hard copy information,
6 including letters, memos, reports, handwritten notes, e-mails, computer records and programs, data
7 stored on hard drives and backup tapes. Id.

8 Real's employees have maintained that they have not deleted emails related to RealDVD in
9 ordinary business practice or since this litigation hold instruction. See, e.g., Barrett Dec. ¶ 4; Moore
10 Dec. ¶ 4; Wood Dec. ¶ 4; Coppinger Dec. ¶ 5. There is an obvious gap between early September
11 2008 and October 6, 2008, where Real did not have a preservation policy in place for documents or
12 data related to RealDVD or DVD CCA, although they were on notice of this action against them.
13 However, defendants have not alleged that Real willfully destroyed any documents or data relating
14 to RealDVD or this litigation during that period of time. Defendants do allege, however, that Real
15 may have destroyed documents or data relating to Facet, given that the litigation hold in October did
16 not mention the preservation of documents related to Facet. Real alleges, however, that the term
17 "RealDVD" includes all RealDVD products, including Facet. The litigation hold notice went to
18 members of both the Facet and Vegas teams, as well as other employees. Godfrey Dec. ¶ 2.
19 Moreover, on oral argument, Real's Senior Vice President and General Counsel Robert Kimball
20 stated that the custom at Real was to refer to all RealDVD technologies as "RealDVD" and that
21 those working at Real would know that included both the Vegas and Facet products. The
22 depositions of Real employees seem to be consistent with this assertion.

23 The court finds this preservation policy is sufficient for comprehensive preservation of
24 evidence going forward, with regard to RealDVD, which includes both Vegas and Facet documents.
25 To ensure the preservation of relevant documents by Real going forward, the court hereby instructs
26 the parties to negotiate and file a stipulated proposed Preservation Order for all existing and future
27 documents relating to all products at issue or likely to be at issue in this litigation, specifically at this
28 time Vegas, Facet, and any other RealDVD products, as well as any items relating to CSS, ARccOS
and Ripguard, including backup tapes.

1 With regard to Hamilton's notebooks, defendants contend that Real has not produced three or
2 four of Hamilton's notebooks, which were handed to Real's officers, DeWhitt and Mathew, upon
3 Hamilton's termination. Plaintiffs contend that Hamilton only handed over a single notebook which
4 was placed in her locked office for three months after her termination and that they do not know
5 what happened to the notebook. DeWhitt Dec. ¶ 7; Mathew Dec. ¶ 6. Plaintiffs also argue that they
6 cannot locate Hamilton's notebooks, did not destroy her notebooks and that her notes were
7 unintelligible or unreadable to others. DeWhitt Dec. ¶ 10; Mathew Dec. ¶ 6; First Lane Dec., Exh. G
8 at 86:6-9. They also believe that it does not contain material related to Facet because Hamilton had
9 not worked on the Facet project for three months prior to her termination, i.e., since June 2008.
10 DeWhitt Dec. ¶ 9; Mathew Dec. ¶ 6.

11 Since Hamilton was terminated less than one week prior to this action, which was within the
12 time period when Real was on notice of probable litigation from Studio defendants, Real was
13 required to preserve any of her relevant work documents. See In re Napster, Inc. Copyright Litig.,
14 462 F. Supp. 2d at 1068. Even though Hamilton had not worked on the RealDVD project since June
15 2008, Real should have known at the time of her termination that her notebooks from the period of
16 time in which she worked on RealDVD were relevant to this action. There is no indication that
17 these notebooks were willfully destroyed by Real, and they may have been inadvertently lost in the
18 course of termination of an employee. However, Real failed to preserve the notebooks after
19 Hamilton's termination, which was during the time they knew about litigation with Studio
20 defendants. Even if it was a single notebook with little relation to the Facet product, as plaintiffs
21 contend, this notebook should have been preserved for possible relevance to this litigation. Id.

22 Thus, sanctions for failure to preserve Hamilton's notebooks are appropriate. Pursuant to the
23 court's inherent power to impose sanctions, the court GRANTS sanctions against Real for failing to
24 preserve Hamilton's notebooks in relation to this litigation. See Chambers, 501 U.S. at 43.

25 Next, defendants assert that Real's Senior Strategic Advisor Barrett instructed RealDVD
26 team members to destroy emails. There is a discrepancy between what Hamilton has testified in
27 regards to instructions to destroy documents or emails and what Real employees have declared in
28 regards to their regular practice and in relation to this action. Hamilton has testified that Barrett

1 instructed her to delete emails, but Barrett stated that he never told anyone to delete emails related to
2 this action, either before September 30, 2008, or thereafter. Lynch Dec., Exh. 6 at 39:23-41:20;
3 Barrett Dec. ¶ 5. However, there have been no allegations that documents or emails were
4 specifically destroyed or deleted from early September 2008 until October 6, 2008. Thus, this
5 discrepancy is therefore of no moment because any practices of deleting emails were stopped under
6 the preservation memo sent in October 2008.

7 Defendants also assert that Wolpert and Basche deleted documents or emails. Wolpert's
8 statement that he deleted "tons of stuff" every day was vague as to what he had deleted, and it was
9 not clarified or questioned further by the deposition attorney. Lynch Dec., Exh. 7 at 157:3-9.
10 Wolpert has since testified in a post-deposition declaration that he did not mean that he deleted
11 emails or documents he received or generated in connection with his work on either Vegas or Facet
12 technology. Wolpert Dec., Docket No. 163, ¶ 7. Wolpert stated in his declaration that he saved all
13 emails related to his work on Vegas and Facet and all Vegas and Facet-related non-email files on his
14 hard drive and that he had never been told to delete any email by anyone at Real. Id. ¶¶ 3 & 6.
15 Basche stated that he deleted everything he had related to the RealDVD project in April 2008, but
16 has subsequently located a back-up drive (from his home residence) with a substantial number of the
17 non-email documents and provided these documents to Real. Basche Dec. ¶ 4. Any documents that
18 Basche may have destroyed were lost before Real had a duty to preserve them in early September
19 2008.

20 Real's employees also state that they were never instructed to delete documents or emails
21 related to RealDVD. Barrett Dec. ¶ 5; Wood Dec. ¶ 5; Buzzard Dec. ¶ 4; Coppinger Dec. ¶ 5;
22 Albertson Dec. ¶ 4. There is no other indication that Real's employees have willfully disobeyed the
23 preservation instructions implemented since October 6, 2008. Thus, it is difficult to conclude that
24 Real's employees or team members willfully destroyed evidence related to this action.

25 Lastly, defendants argue that sanctions are appropriate because Real did not initially produce
26 its arccos.zip file, which was obtained by Jeff Chasen, head of the RealDVD project, from the CEO
27 of Rocket Division Software. Lynch Dec., Exhs. 14 & 15. Real first alleged that the file was
28 corrupted by a virus, but then produced the arccos.zip file to Studio defendants on March 4, 2009.

1 Defendants argue that sanctions are still necessary because Real prevented the production of the file,
2 even though it was not corrupted and contained highly relevant evidence.

3 Since the file has been subsequently produced by Real, defendants have not shown that they
4 were seriously prejudiced by the delay, particularly given the multiple continuances of deadlines in
5 this litigation, and Real has not engaged in willful destruction of the file. Thus, the court DENIES a
6 defendants' request for sanctions in regards to the arccos.zip file.

7 B. Order Precluding Real from impeaching or controverting Hamilton's Testimony

8 Defendants move for an order precluding Real from impeaching or controverting Hamilton's
9 testimony based on the following five areas purportedly covered in Hamilton's notebooks: (1) Real's
10 awareness of, and strategies undertaken to circumvent ARccOS and Ripguard; (2) Real's use of
11 CSS-cracking code in the development of Facet and its knowledge that such code was non-
12 compliant with the CSS license specifications; (3) Real's knowledge at the time of entering the CSS
13 license that DVD CCA would view RealDVD to be non-compliant; (4) Real's knowledge that its
14 product would be used by consumers for rent/rip/return or borrow/rip/return purposes; and (5) Real's
15 awareness that movies marked with CGMS flags were marked "do not copy" by content owners.

16 The content of Hamilton's notebooks is unknown, but the above listed topics purportedly
17 covered in the notebooks may be discoverable by other sources of evidence. Hamilton's notebooks
18 were only one possible relevant source of evidence relating to RealDVD, and there are other sources
19 of evidence that are relevant to Real's knowledge or awareness of the above listed issues. Real
20 employees maintain that the notebooks were not a comprehensive record on the development of
21 Facet, and the source code is the most comprehensive record. Barrett Dec. ¶ 6; Wood Dec. ¶ 8.
22 Moreover, defendants have not met their burden of showing that the notebooks are in some way
23 unique evidence for showing Real's knowledge or awareness of its non-compliance with the CSS
24 License Agreement or strategies to circumvent ARccOS and Ripguard.

25 On oral argument, counsel for Studio defendants asserted that Hamilton testified that her
26 notebooks had dates and notes of relevant meetings, in chronological order and describing the Facet
27 project in detail. However, this argument is controverted by Hamilton's deposition testimony where
28 she stated: "I don't want to make too much of the quality of my notes, they were just for me so I

1 expect they might be either unreadable or intelligible to other people most often . . .” Lynch Dec.,
2 Exh. 6 at 86:6-9.

3 Thus, the court DENIES defendants’ request to preclude Real from impeaching or
4 controverting Hamilton’s testimony related to the above listed topics.

5 C. Adverse Inference Re: ARccOS and Ripguard

6 Defendants argue that the court should infer that Real knowingly purchased technologies to
7 circumvent ARccOS and Ripguard. They argue that this inference should be made based on the
8 arccos.zip file that was purchased by Real from overseas and was suddenly made unavailable. Since
9 Real provided the arccos.zip file to defendants, the production of this file is no longer an issue.

10 The court will, however, infer from communications between Real’s Jeff Chasen and the
11 CEO of Rocket Division Software that Real was aware of the non-CSS technologies, ARccOS and
12 Ripguard. Lynch Dec., Exhs. 14 & 15. An inference that Real knowingly purchased technologies to
13 circumvent ARccOS and Ripguard, however, is premature at this stage of the litigation and is
14 DENIED.

15 D. Preclusion of Basche and Wolpert Testimony

16 Defendants argue that because Basche deleted all of his files relating to RealDVD and
17 Wolpert deleted “tons” of emails everyday, Real should be precluded from offering testimony from
18 Basche and Wolpert. Wolpert’s statement regarding deleting emails was vague as to what he had
19 deleted, and he has stated that he did not delete RealDVD-related emails. Wolpert Dec. ¶ 7. Basche
20 has stated that he has since retrieved documents through back-up and relayed them to Real for
21 production. Basche Dec. ¶ 3. Real has also implemented a preservation policy on all documents and
22 emails related to RealDVD shortly after the start of this action. This has reduced any prejudice to
23 defendants related to discovery of evidence from Basche and Wolpert. Thus, the court DENIES
24 precluding the testimony of Basche and Wolpert.

25 E. Producing Barrett for a Deposition

26 On December 22, 2008, the court instructed the parties to work out the depositions they
27 needed, specifically for deposing experts, with regard to Facet by January 9, 2009. Lynch Dec., Exh
28 8 at 74:11-14; 75:8-76:2. Defendants argue that the court ruled that they were entitled to a

1 redeposition of Barrett on Facet, and because Barrett had a campaign to destroy documents
2 unfavorable to Real's litigation, there is a greater reason for this deposition to go forward.
3 Accordingly, even though defendants have already deposed Barrett once, the court hereby GRANTS
4 defendants' request for a deposition on spoliation and Facet and instructs Real to produce Barrett for
5 a second deposition on these topics.

6 F. Monetary Sanctions

7 Although the court finds no evidence of willful destruction of documents, Real failed to
8 preserve Hamilton's notebooks when it knew there was probable litigation with Studio defendants
9 and knew that Hamilton's notebooks could contain relevant notes from the RealDVD project.

10 The court chooses not to draw an adverse inference against Real for alleged spoliation of
11 evidence, nor will the court exclude witness testimony proffered by Real or dismiss Real's claims
12 based on this failure to preserve evidence at this time. See Glover v. BIC Corp., 6 F.3d at 1329.

13 Pursuant to the court's inherent power to impose sanctions, the court GRANTS monetary
14 sanctions against Real for failing to preserve evidence in relation to this litigation. See Chambers v.
15 NASCO, Inc., 501 U.S. at 43. An award of attorneys' fees and related costs is GRANTED to
16 defendants for pursuing the evidence of spoliation of Hamilton's notebooks and for bringing this
17 part of the sanctions motion.

18
19 CONCLUSION

20 Real's motions to dismiss DVD CCA's second counterclaim has been withdrawn. Real's
21 motion to preclude claims based on non-CSS technologies is **DENIED**.

22 Defendants' motion for sanctions for spoliation of evidence is **GRANTED IN PART** and
23 **DENIED IN PART**. Defendants' motions are granted insofar as: (1) the court instructs the parties
24 to negotiate and file a stipulated proposed Preservation Order for all existing and future documents
25 relating to all products at issue in this litigation, including RealDVD, or Vegas, and Facet; (2) the
26 court imposes monetary sanctions for Real's failure to preserve Hamilton's notebooks; (3) the court
27 awards reasonable attorneys' fees and related costs for pursuing the evidence of spoliation of
28

1 Hamilton's notebooks and for bringing this part of the sanctions motion; (4) the court will draw an
2 adverse inference as to Real's knowledge of ARccOS and Ripguard.

3 Defendants' remaining motions for sanctions are denied.

4 Defendants are granted leave to file an application and declaration(s) for a monetary award
5 (and a proposed order) including attorneys' fees and costs in accordance with the preceding
6 paragraph within thirty (30) days of the filing of this order. Real may respond as to reasonableness
7 of the fees only and shall do so within thirty (30) days of the filing of the application.

8 IT IS SO ORDERED.

9
10 Dated: May 5, 2009



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12 MARILYN HALL PATEL
13 United States District Court Judge
14 Northern District of California
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ENDNOTES

1. All Docket numbers refer to the Electronic Court File for the declaratory judgment suit filed by Real, under the assigned case number C 08-04548 MHP.
2. The portion of Basche’s deposition testimony cited by Studio defendants mentions nothing about preserving documents. Accordingly, the court refers to the testimony in the Basche declaration provided by Real on opposition to the motion for sanctions that acknowledges what Studio defendants are contending he said.