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7 IN THE UNITED STATES DISTRICT COURT

8 FOR THE DISTRICT OF ARIZONA

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10 MERCHANT TRANSACTION) Case No. CV 02-1954-PHX-MHM
    SYSTEMS, INC.,)
11   ) **ORDER**
                       Plaintiff,)
12   )
    vs.)
13   )
    NELCELA, INC., an Arizona)
14 Corporation; LEN CAMPAGNA, an)
    Arizona resident; ALEC)
15 DOLLARHIDE, an Arizona resident;)
    EBOCOM, INC., a Delaware)
16 Corporation; POST INTEGRATIONS,)
    INC., an Illinois Corporation,)
17   )
                       Defendants.)
18 _____)
)
19 And Related Counterclaims, Cross-Claims,)
    and Third-Party Claims.)
20 _____)

21

22   Currently pending before the Court is the Lexcel Parties' (Lexcel, Inc., Lexcel

23 Solutions, Inc., Carl Kubitz, and Flora Kubitz), the POST Parties' (POST Integrations,

24 Inc., Ebocom, Inc., Mary Gerdts, and Douglas McKinney), and MTSI Parties' (Merchant

25 Transaction Systems, Inc., Gene Clothier, and Tone Clothier) (collectively, the "Joint

26 Parties") Motion to Exclude "Nelcela Authorization System" Source Code Not Timely

27 Produced. (Dkt. #649). Also pending are the Nelcela Parties' (Nelcela, Inc., Len

28 Campagna, and Alec Dollarhide) Motion in Limine To Exclude Evidence of Copyright

1 Ownership By MTSI (Dkt. #645) and MTSI's Motion for Reconsideration of Part of The

2 Court's Order of June 25, 2009 (Dkt. #662). The Court heard oral argument on these

3 motions at the Final Pretrial Conference on July 15, 2009, at which time the Court

4 granted the motion for reconsideration and directed the parties to file supplemental

5 briefing on the motions in limine. (Dkt. #s 676, 682). The instant order explains the

6 Court's reasons for granting MTSI's motion for reconsideration and rules on the parties'

7 remaining motions in limine.

8 **I.   MTSI's MOTION FOR RECONSIDERATION**

9   On July 8, 2009, MTSI moved the Court pursuant to LRCiv 7.2(g) to reconsider

10 the part of its June 25, 2009 order dismissing MTSI's claim for conversion against the

11 Nelcela Parties as preempted by the Copyright Act. (Dkt. #662, pp. 1-2). Specifically,

12 MTSI asserts that it did not have a chance to brief the issue of preemption and contends

13 that although the Copyright Act has broad preemptive powers, a state law claim such as

14 conversion is not preempted if it contains elements in addition to the improper

15 reproduction, performance, distribution, or display of the copyrighted or copyrightable

16 works that are the exclusive domain of the Copyright Act. (Id., p.2). In other words, "[i]f

17 an extra element changes the nature of the state law claim so that it is qualitatively

18 different from a copyright infringement claim, the state-law claim is not preempted."

19 (Id.). To that end, MTSI argues that its conversion claim is not preempted because it

20 contains two "extra" elements: intentional unlawful possession of the property of another

21 and the conversion of that property to one's own use, i.e. unlawful benefit to the Nelcela

22 Parties. (Id., p.5)

23   The Nelcela Parties respond that MTSI's conversion claim does not in fact contain

24 an "extra element" that prevents it from being preempted by the Copyright Act. (Dkt.

25 #670). The Nelcela Parties contend that Alec Dollarhide was in lawful possession of the

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1   MTSI software because he was employed by MTSI (id., p.4),[1] and argue that if

2   intentional and wrongful possession of the property of another supplied the necessary

3   extra element, then that would "prevent preemption of any conversion claim under

4   Arizona law" (id., pp. 4-5).

5   First, the Court notes that MTSI is correct; the Nelcela Parties inappropriately

6   raised the issue of preemption of MTSI's claims for the first time in their reply brief. As

7   such, the Court should not have addressed the issue (as it did with the remaining issues of

8   preemption);[2] but did so in an effort to streamline the remaining issues for the Phase II

9   trial and because the Joint Parties had previously raised the issue of preemption with

10 respect to the conversion in its August 22, 2007 Motion for Partial Summary Judgment

11 (Dkt. #548).

12   Second, the parties do not dispute that a state law claim is not preempted by the

13 Copyright Act "if there is an 'extra element' that is required in place of or in addition to

14 the acts of reproduction, performance, distribution, or display in order to constitute a

15 state-law cause of action, and the 'extra element' required by state law changes the nature

16 of the action so that it is qualitatively different from a copyright infringement claim. . . ."

17 Firoozye v. Earthlink Network, 153 F.Supp. 2d 1115, 1125 (N.D. Cal. 2001) (citations

18 omitted); see also Sybersound Records, Inc. v. UAV Corp., 517 F.3d 1137, 1150 (9th Cir.

19 2008).

20   Here, MTSI's claim for conversion involves the element of the wrongful taking,

21 i.e., theft, of their computer software. Although MTSI's claims do not involve tangible

22 property, the element of theft is not analogous to unauthorized reproduction or

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[1] That, however, is a question of fact; it does not establish that MTSI's conversion claim is preempted as a matter of law.

[2] See, e.g., Reed ex rel. Reed v. Astrue, 2009 WL 1638630, at * 1 n.1 (9th Cir. 2009) ("[Courts] do not address any arguments raised for the first time in [a party's] reply brief.") (citing Sanchez v. Pac. Powder Co., 147 F.3d 1097, 1100 (9th Cir. 1998)); Coos County v. Kempthorne, 531 F.3d 792, 812 n.16 (9th Cir. 2008) (declining to consider an argument raised for the first time in a reply brief).

1 distribution. But see Firoozye, 153 F.Supp. 2d at 1130 ("[W]hile a claim for conversion

2 typically involves tangible property and thus may be immune from preemption, where a

3 plaintiff is only seeking damages from a defendant's reproduction of a work – and not the

4 actual return of a physical piece of property – the claim is preempted."). In Firoozye, the

5 defendants were legally in possession of the copyrighted material. 153 F.Supp. 2d at

6 1130. But here, MTSI's conversion claim "requires [MTSI] to demonstrate that [the

7 Nelcela Parties] wrongfully obtained possession over a specific piece of property," i.e.,

8 the MTSI software. Meridian Project Systems, Inc. v. Hardin Const. Co., LLC, 2006 WL

9 1062070, at *4 (E.D. Cal. 2006). In addition, damages for conversion include not only

10 "the value of the property taken, but also damage suffered because of the wrongful

11 detention or deprivation of the property, such as damages for loss of use." Collins v. First

12 Financial Services, Inc., 168 Ariz. 484, 486 (App. 1991). And the damages sought by

13 MTSI extend beyond the Nelcela Parties' alleged unlawful reproduction of their software.

14 See G.S. Rasmussen & Associates, Inc. v. Kalitta Flying Service, Inc., 958 F.2d 896, 907

15 n.15 (9th Cir. 1992) (conversion claim based on deprivation of plaintiff's property right

16 was not preempted because "[t]he property right is in the use of the [property], not in the

17 physical possession of the [property]"). MTSI's conversion claim thus contains the extra

18 element necessary to save it from preemption;[3] and the Court will grant MTSI's Motion

19 for Partial Reconsideration and reinstate its state law claim against the Nelcela Parties for

20 conversion (Count 7).

21 **II.   NELCELA'S MOTION IN LIMINE**

22   On July 1, 2009, the Nelcela Parties moved to exclude evidence of copyright

23 ownership by MTSI. (Dkt. #645). The Nelcela Parties' object to one of MTSI's disputed

24 issues of fact in the parties' joint proposed pretrial order: "If Nelcela is found not to have

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26   [3]This does not mean, however, that no conversion claim in Arizona is preempted by
the Copyright Act. For example, the Nelcela Parties' conversion claims remain preempted,
27 as discussed in the Court's March 17, 2009 order, as they do not involve the element of
28 unlawful taking. (Dkt. #607, p.33).

infringed the Lexcel 1994/95 software, then [the question is] whether Nelcela infringed the MTSI software." (Dkt. #645, p.1). The Nelcela Parties contend that "any copyright claim by MTSI and any evidence related to infringement of any MTSI copyright must be excluded as immaterial." (Id., p.2). MTSI, however, responds that it is not seeking to pursue a copyright infringement claim in this action.[4] (Dkt. #653, p.1). Nonetheless, MTSI argues that because the Lexcel Parties own both the Lexcel software and the MTSI software (a derivative work), and the Nelcela Parties are not permitted to infringe either one, "if the jury finds that Nelcela did not infringe the 'Lexcel Software,' it must also consider whether Nelcela infringed the 'MTSI Software' owned by Lexcel too." (Id., p.2).

First, based on the Court's review of the parties' supplemental briefing on this issue (Dkt. #s 677, 680), it appears undisputed that "a plaintiff may bring a suit for unauthorized distribution of an unregistered derivative work as long as the suit is based on elements 'borrowed' from a registered underlying work and not on elements original to the derivative work." Johnson v. Gordon, 409 F.3d 12, 20 (1st Cir. 2005); see also Dalton Ross Homes, Inc. v. Williams, 2007 WL 2461892, at *3 (D. Ariz. 2007) ("[C]opying an unregistered derivative may give rise to liability based upon copyright registration of the underlying original work contained in the derivative."); 2-7 NIMMER ON COPYRIGHT § 7.16[B][2][b] at 7-174.1. "Put another way, elements distinct to an unregistered work cannot draw protection from a registered work. . . ." Id. (citing 2-7 NIMMER at § 7.16[B][2][b]). Thus, the MTSI software may serve as a basis for the Lexcel Parties' infringement claim only to the extent that the MTSI software contains the same identified, protectable elements as the Lexcel software. The Lexcel Parties may not, on the other hand, assert their infringement claims based on any elements unique to the

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[4]The Nelcela Parties' motion in limine is thus moot as styled; but beyond the title, the substance of the motion is to prevent the Lexcel Parties from asserting copyright infringement of the MTSI software, not to exclude evidence of copyright ownership by MTSI.

1 MTSI software, such as the files identified by the Joint Parties in their List of Common

2 Features and Elements.[5] (Dkt. #555 §B(10)).

3   However, the Court is skeptical of the Joint Parties' apparent contention that the

4 Phase II jury could find that the Nelcela Parties did not infringe the Lexcel software, but

5 did infringe the MTSI software. As stated above, the Lexcel Parties may maintain an

6 action for copyright infringement based on the MTSI software, an unregistered derivative

7 work, only to the extent the MTSI software contains protectable elements derived from

8 the pre-existing, copyrighted Lexcel software. Thus, because any infringement must be

9 based on copying of the protected elements common to both the Lexcel and MTSI

10 software, the Court fails to see at this time how the Phase II jury could find copying of the

11 MTSI software but not the Lexcel software.

12   Nonetheless, the specific question before the Court is whether the Lexcel Parties

13 may maintain an action for infringement of the derivative MTSI software in addition to

14 the original Lexcel software. As stated above, the answer is yes: the Copyright Act

15 protects against "unauthorized copying or other infringing use of the underlying work *or*

16 *any part of that work contained in the derivative product* so long as the underlying work

17 itself remains copyrighted." Russell v. Price, 612 F.2d 1123, 1128 (9th Cir. 1979)

18 (emphasis added); see also Montgomery v. Noga, 168 F.3d 1282, 1292 (11th Cir. 1999)

19 (where the evidence at trial showed that an unregistered derivative of the plaintiff's

20 copyrighted work "incorporated over seventy percent of the original source code from the

21 registered work," the defendants, by downloading and incorporating the later work as a

22 utility on its product, "infringed [plaintiff's] registered copyright in the original work").

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24   [5]Not to mention the fact that the Court explicitly declined to conduct analytic

25 dissection of those elements in its March 17, 2009 order on analytical dissection, stating "that
    as the only issue presently before the Court is whether Nelcela copied protected elements of

26 the Lexcel software, the Joint Parties' reference to various sections of the MTSI source code
    is inapposite." (Dkt. #607, p.16 n.10). To the extent the Joint Parties now challenge that

27 determination, it is long past the time to request reconsideration and ask the Court to conduct

28 analytic dissection of the MTSI code.

1 Thus, the Court will deny the Nelcela Parties' motion in limine as reflected in this order.

2 However, in an abundance of caution, the Court will reiterate that "in order to

3 successfully assert an infringement claim based on the unregistered [MTSI software], [the

4 Lexcel Parties] must show that in copying the [MTSI software], [the Nelcela Parties] also

5 copied protectable elements of the registered [Lexcel software]." Dalton Ross, 2007 WL

6 2461892, at *3.

7 **III.   THE JOINT PARTIES' MOTION IN LIMINE**

8   On June 18, 2009, the day before the parties' deadline to exchange copies of trial

9 exhibits for the Phase II trial, Mr. Harris, counsel for the Nelcela Parties, gave the Joint

10 Parties written copies of a computer file(s) comprised of approximately two hundred

11 pages of source code, which allegedly belong to the Nelcela Authorization System. (Dkt.

12 #649, p.2; Dkt. #682, p.59). These documents, marked as Trial Exhibits 1006 and 1007

13 in the parties' Joint Proposed Pretrial Order, were not disclosed by the Nelcela Parties

14 prior to this time. (Id.; Dkt. #661, p.3). As a result, the Joint Parties filed a motion in

15 limine to exclude Trial Exhibits 1006 and 1007 pursuant to Rule 37(c)(1) of the Federal

16 Rules of Civil Procedure, arguing that the Nelcela Parties' failed to comply with their

17 disclosure obligations under Rules 26(a)(1), 26(e)(1)(A), and 34. (Dkt. #649). In

18 response, the Nelcela Parties state that "[p]rior to the Phase I trial Nelcela believed that

19 the parties' [ ] Authorization System(s) were not at issue in this litigation" (Dkt. #661,

20 p.2); contend that "no party ever asked for the Nelcela Authorization System after the

21 Phase I trial" (id., p.5); complain that "Lexcel never provided any independent

22 'Authorization System,' nor did any other party" (id., p.3); and assert that "Nelcela would

23 suffer great prejudice" (id., p.6) if the Court were to exclude Trial Exhibits 1006 and 1007

24 because "[i]n order for Nelcela to put on a proper defense, . . . [the Nelcela Parties] must

25 be permitted to show the jury the entirety of an Authorization System to show the

26 changes are not trivial" (id., p.5).

27   Federal Rule of Civil Procedure 26(a) imposes an automatic initial disclosure

28 requirement on each party to a lawsuit to produce, among other things, "a copy – or a

description by category and location – of all documents, electronically stored information, and tangible things that the disclosing party . . . may use to support its claims or defenses. . . ." Fed.R.Civ.P. 26(a)(1). In addition, Rule 26(e) imposes a supplemental disclosure requirement:

> A party . . . must supplement or correct its [initial] disclosure or response: (A) in a timely manner if the party learns that in some material respect the disclosure or response is incomplete or incorrect, and if the additional or corrective information has not otherwise been made known to the other parties during the discovery process or in writing; or (B) as ordered by the court.

Fed.R.Civ.P. 26(e)(1). "Rule 37(c)(1) gives teeth to these requirements by forbidding the use at trial of any information required to be disclosed by Rule 26(a) that is not properly disclosed." Yeti by Molly Ltd. v. Deckers Outdoor Corp., 259 F.3d 1101, 1106 (9th Cir. 2001). Specifically, Rule 37(c)(1) provides that "[i]f a party fails to produce information . . . required by Rule 26(a) or (e), the party is not allowed to use that information . . . to supply evidence . . . at a trial, unless the failure was substantially justified or is harmless." Fed.R.Civ.P. 37(c)(1); see Dickenson v. Cardia and Thoracic Surgery of Eastern Tenn., P.C., 388 F.3d 976, 983 (6th Cir. 2004) ("The exclusion of non-disclosed evidence is automatic and mandatory under Rule 37(c)(1) unless non-disclosure was justified or harmless."). The burden of proving "substantial justification" or "harmlessness" is on the party that failed to comply with its disclosure obligations under Rule 26(a) or (e). Yeti by Molly, 259 F.3d at 1106.

A. The "Software" At Issue

The Nelcela Parties contend that they did not have an obligation to disclose the entirety of the Nelcela Authorization System prior to the Phase I trial because they did not believe it was at issue prior to the Phase I trial. The Court, however, disagrees with that contention.

In its original complaint, MTSI asserts claims against the Nelcela Parties for, among other things, quiet title of copyrights in "the software (hereinafter 'the software')" developed by Alec Dollarhide during his employment with Credit Card Services, Ltd.,

1 Credit Card Services, Inc., and MTSI. (Dkt. #1, ¶¶ 21-23). The Nelcela Parties

2 counterclaimed against MTSI for, among other things, copyright infringement, alleging

3 that although "Nelcela and Dollarhide believe that MTSI is claiming ownership of the

4 copyrighted 'Merchant System'" (Dkt. #83, ¶ 23), "Alec Dollarhide (and others) authored

5 and developed the software that is at issue here, and regardless of which software MTSI is

6 now claiming ownership, the software was initially owned solely by Alec Dollarhide."

7 (Dkt. #83, ¶50). Thus, despite MTSI's failure to more specifically identify in their

8 complaint the software at issue, the Nelcela Parties recognized that MTSI's claims might

9 involve software allegedly developed by Mr. Dollarhide other than the Merchant System,

10 allegedly including the Authorization System. That in an of itself was sufficient to raise

11 the Nelcela Parties' Rule 26(a)(1) obligation to disclose, "without awaiting discovery," at

12 the very least a description of the Nelcela Parties' Authorization System and its location.[6]

13 Fed.R.Civ.P. 26(a)(1).

14 However, the Court is aware that "[p]arties are expected to use discovery, not the

15 pleadings, to learn the specifics of the claims being asserted." Sagan v. Apple Computer,

16 Inc., 874 F.Supp. 1072, 1077 (C.D. Cal. 1994). And based on the lack of specificity in

17 MTSI's complaint and the representations made by the parties during the Court's March

18 31 and June 17, 2005 hearings, the Court does not necessarily doubt that the Nelcela

19 Parties proceeded through Phase I discovery under the impression that the only software

20 at issue in the claims between MTSI, the POST Parties, and the Nelcela Parties was the

21 parties' respective merchant systems.

22 For example, at the March 31, 2005 status hearing, Mr. Steimel, counsel for MTSI,

23 asserted that MTSI had produced a "Merchant Suites's source code." (Dkt. #126, p.13).

24 But despite the fact that the case was almost two years old by that time, neither Mr.

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26 [6]The Court is unable to locate the Nelcela Parties' initial disclosure statement; it does
not appear to have been submitted to the Court. As such, the Court may not speculate as to
27 whether the Nelcela Parties failed to comply with their initial disclosure obligations in
28 response to MTSI's complaint.

1 Steimel nor Mr. Firestone, counsel for the Nelcela Parties, apparently knew what software

2 or systems were contained in that code. (Id., p.19).

3   Mr. McKirgan, counsel for the POST Parties, explained that he was unable to

4 determine what software was at issue because the Nelcela Parties had not produced their

5 software in electronic format, and as a result the POST Parties' expert could not compare

6 the parties' software to determine whether, and to what extent, anything had been copied.

7 (Id., p.20). Although Mr. Firestone agreed that "it's hard to really hone in on what's

8 going to be at issue until the parties have had the opportunity to have their experts make

9 these comparisons of these *various source codes* that are in the possession of the different

10 parties" (id., p.37) (emphasis added), he then stated that it would be "preposterous" for

11 the Nelcela Parties to have to produce the "nine or twelve copyrighted pieces of software

12 that [they] ha[ve] copyrighted," including an authorization source code,[7] when only the

13 merchant system was at issue (id., pp. 38-39). Mr. Steimel, however, expressed hesitation

14 with that contention, stating that he wanted the Nelcela Parties to determine what

15 software or systems were in MTSI's disclosed Merchant Suites source code and then

16 disclose any source code possessed by the Nelcela Parties that related to MTSI's source

17 code. (Id., p.45). Mr. Firestone agreed to that request, but only if MTSI was required to

18 do same, i.e., take the Nelcela Merchant System source code and then have its experts

19 determine whether there is additional source code that MTSI wants the Nelcela Parties to

20 produce. (Id., p.49). Mr. Steimel did not object, and the Court imposed those obligations

21 on the parties.[8] (Id.).

23   [7]Based on the Court's review of the docket, this is the first time any party referred to
24 an "authorization source code."

25   [8]With the benefit of hindsight, the Court recognizes that it may have been preferable
   simply to direct the Nelcela Parties to disclose, pursuant to a protective order, all software
26 that the Nelcela Parties' alleged to have independently created during the time in question,
   i.e., during Alec Dollarhide's relationship with CCSL, CCSI, and MTSI. The parties' experts
27 then would have been able to match any similarities in the parties' respective software and
28 conclusively determine what software was at issue in this case. Unfortunately, none of the

1   MTSI disclosed additional source code to the Nelcela Parties on May 12, 2005.

2   (Dkt. #181, p.9). And at a June 17, 2005 hearing, Mr. McKinnon, counsel for MTSI,[9]

3   explained that MTSI's experts had recently discovered that the source code originally

4   produced by MTSI, which Mr. Dollarhide had provided to MTSI, was not a complete

5   verison of the MTSI source code. (Dkt. #181, pp. 10-11). After further discussion, the

6   Court noted that "[i]t seems quite clear . . . that the parties have been playing games with

7   production of the source code in the state litigation and here." (Dkt. #181, p.23). Thus,

8   the Court directed "[e]very party and Lexcel [to] produce their source code in its entirety,

9   in a . . . machine-readable format."[10] (Id., pp. 31-38).

10   In sum, while counsel for MTSI and the POST Parties sometimes indicated that

11   systems other than the merchant system may be at issue, they did not expressly contend

12   that Nelcela Parties' belief that only the merchant system was at issue was mistaken. As

13   of June 2005, neither MTSI, the POST Parties, nor the Nelcela Parties had conducted the

14   discovery necessary to determine exactly what software was at issue, other than the

15   parties' merchant systems. And while nothing at those hearings indicates exactly what

16   systems are contained in either version of the MTSI software, after reviewing the parties'

17   Phase I expert reports, it appears that neither MTSI nor the POST Parties' experts referred

18   to any sort of authorization system within the MTSI software. (Dkt. #337, Exhs. 14, 16).

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21   parties clearly raised this option to the Court.

22   [9]Mr. Steimel withdrew as counsel for MTSI on May 22, 2006. (Dkt. #319).

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24   [10]The parties did not appear to be discussing the authorization system source code at
this hearing. In reference to the software at issue in this discussion, Mr. McKinnon stated
25   that "the copyrighted versions that were produced [we]re the first 35 pages and the last 35
pages out of something that is almost 500 pages long"; and Ms. Manolio responded that the
26   Nelcela Parties "have produced 500 pages, so they don't just have 35 pages at the beginning
and 35 pages at the end. (Dkt. #181, p.32). The parties do not dispute that the Nelcela
27   Authorization source code filed with the U.S. Copyright Office comprised only 18 pages of
28   source code.

1   As such, it is difficult to fault the Nelcela Parties for believing at that time that only their

2   merchant system was at issue.

3   But on June 13, 2005, the Lexcel Parties moved to intervene. (Dkt. #169). The

4   Court granted the Lexcel Parties' request and permitted them to file a complaint in

5   intervention. (Dkt. #212). The Lexcel Parties asserted claims against the Nelcela Parties

6   for, among other things, copyright infringement of Lexcel's Merchant *and Authorization*

7   Systems. (Dkt. #277, ¶11, 12, 21, 37, 38). In addition, the Nelcela Parties subsequently

8   asserted a counterclaim against the Lexcel Parties for copyright infringement, stating that

9   "Dollarhide (and others) authored and developed the software that is at issue here, and

10   regardless of which software Lexcel is claiming ownership, the software is owned solely

11   by Nelcela." (Dkt. #399, ¶ 81). Based on that statement, it appears the Nelcela Parties

12   were well aware that the Lexcel Parties were asserting infringement of not only their

13   merchant system, but other systems as well, including their authorization system. The

14   Lexcel Parties' intervening complaint was sufficient to place the Nelcela Parties on notice

15   that the litigation was no longer restricted, to the extent it ever was, to the parties'

16   merchant systems. Therefore, the Nelcela Parties had an obligation under Rule 26(e) at

17   that time to supplement their disclosures and provide the Lexcel Parties with a description

18   of their authorization system.[11]

19   Then, on September 16, 2005, the Lexcel Parties served their first set of non-

20   uniform interrogatories and request for production of documents on the Nelcela Parties,

21   asking them to list and produce copies of their copyrighted software (Dkt. #253; Dkt.

22   #674, Exh. 5); to which the Nelcela Parties responded that they "ha[d] already produced

23   all software at issue in this case and that all information submitted to the copyright office

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         [11]There is, of course, an exception. Rule 26(e)(1)'s disclosure obligation is discharged
26   if the information has already been disclosed to the other parties during the discovery process
     or in writing. Fed.R.Civ.P. 26(e)(1). However, Mr. Firestone's single reference to the
27   existence of the Nelcela Authorization System during the March 31, 2005 hearing did not
28   satisfy that exception.

1 has been obtained by subpoena . . . and is already part of disclosure in this case." (Dkt.

2 #674, Exh. 5).

3   That response meant either that the Nelcela Parties still believed, despite the

4 Lexcel Parties' explicit complaint, that the only software at issue was their merchant

5 authorization system, or that the Nelcela Authorization System had already been

6 disclosed to the other parties. And as the Lexcel Parties did not file a Rule 37 motion to

7 compel, the Court must presume they either abandoned their copyright infringement

8 claim relating to the authorization system or simply assumed that the Nelcela Parties had

9 already disclosed the requested software. To that end, the Court notes that in early

10 January 2005, Fennemore Craig, P.C., the law firm that had filed the relevant copyright

11 applications on behalf of the Nelcela Parties, produced the Nelcela Parties' copyright

12 application for the Nelcela Authorization System pursuant to a January 11, 2005

13 subpoena duces tecum issued by the POST Parties. (Dkt. #674, Exh. 1). Importantly, the

14 copyright application for the Nelcela Authorization System included 18 pages of attached

15 source code. (Dkt. #674, p.2; Phase I Trial Exhibit 306). And based on the fact that a

16 party seeking to register a copyright in a computer program must deposit the entire source

17 code of its program "if the program is 50 pages or less," Syntek Semiconductor Co., Ltd.

18 v. Microchip Technology, Inc., 307 F.3d 775, 780 (9th Cir. 2002) (citing 37 C.F.R. §

19 202.20(c)(2)(vii)(A)(1), the Lexcel Parties most likely proceeded under a belief that those

20 18 pages comprised the entirety of the Nelcela Authorization System source code. (Dkt.

21 #674, p.7).

22   The Nelcela Authorization System was also at issue at the Phase I summary

23 judgment stage. First, the Lexcel Parties' expert report specifically compared the Lexcel

24 Authorization System with the Nelcela Authorization System, i.e., the 18 pages attached

25 to the Nelcela parties' copyright application. (Dkt. #337, Exh. 12, pp. 2, 8-23). The

26 Lexcel Parties' expert also testified during his deposition that the Nelcela Authorization

27 System copied the Lexcel Authorization System. (Dkt. #438, Exh. 2). Moreover, the

28 Nelcela Parties' expert report, dated September 26, 2005, compared the Lexcel

1   Authorization System with a "[p]aper copy of copyright code for Nelcela Authorization

2   System," i.e., the Nelcela Authorization Code (Dkt. #337, Exh. 17, p.14), and noted that

3   the Lexcel software and the Nelcela Authorization System "may have some similarities"

4   (id., p.9).

5   But the Nelcela Parties' experts went on to state that "according to counsel, it is

6   only the Merchant System that is at issue in this litigation. Any differences or similarities

7   between the Nelcela Authorization System and the Lexcel code should therefore be

8   ignored." (Id., p. 9). The direction given by the Nelcela Parties' counsel to their experts

9   is inexplicable in light of the Lexcel Parties' complaint, their expert report, and the fact

10   that the Nelcela Parties acknowledged that their authorization system was at issue when

11   they asserted in their response to the Joint Parties' motion for summary judgment that

12   "not one single expert has factually established that the Nelcela Merchant System,

13   Nelcela Terminal Driver *and Nelcela Authorization System* (collectively "the Nelcela

14   software") is derivative of the Lexcel software." (Dkt. #349, p.2) (emphasis added).

15   Even if the Nelcela Parties continued to believe that only their merchant system was at

16   issue after the Lexcel Parties intervened, the Lexcel Parties' expert report and the Phase I

17   summary judgment motions made it abundantly clear that the parties' authorization

18   systems were part of the software at issue. Certainly, at that point, the Nelcela Parties had

19   an Rule 26(e) obligation to disclose the existence of any source code apart from the 18

20   pages of code attached to their copyright application. That obligation is self-effectuating;

21   contrary to the Nelcela Parties' contention, there is no requirement for the opposing party

22   to serve a request for production when the offending party becomes aware of its lack of

23   disclosure. See Johnson v. United Parcel Service, Inc. 236 F.R.D. 376, 378 (E.D. Tenn.

24   2006).

25   Nonetheless, on January 19, 2007, the Nelcela Parties filed a motion in limine to

26   exclude expert analysis of "authorization" systems, continuing to assert that "[t]he only

27   software that has ever been at issue at any phase of this litigation is a . . . Merchant

28

System." (Dkt. #423, p.1).[12] At the first Phase I Final Pretrial Conference on March 26,

2007, Mr. Firestone, on behalf of the Nelcela Parties again insisted that the only software

at issue was the merchant system. (Dkt. #462, p.38). Mr. Firestone also stated that the

Nelcela Authorization System "has not been produced in this matter whatsoever. . . ."

(Id.). But Mr. Firestone also recognized that the Lexcel Parties' expert had compared the

Lexcel Authorization System with the Nelcela Authorization System, and averred that the

"printouts of Nelcela's [source] code . . . submitted to the U.S. Copyright [O]ffice" that

the Lexcel Parties' expert had examined "*is* the authorization system."[13] (Id., p.40)

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[12]In support of their motion, the Nelcela Parties asserted that the Court's July 28, 2005 order stated that the Lexcel Parties "would be permitted to intervene on the express understanding that the issues [in the case] were not expanded" (Id., p.3), and that Lexcel intervened only to litigate the Nelcela Merchant System (id., p.4). One only need glance at the Court's July 28, 2005 order and the Lexcel Parties' complaint to realize those assertions are incorrect. The Court permitted the Lexcel Parties to intervene because they claimed "an interest in the copyright registration that *may* be the same or basis of the software *programs* at issue in this litigation." (Dkt. #209, p.4). Further, the Court noted that "Lexcel is aware this litigation has been placed on an expedited track and Lexcel will comply with current deadlines in this litigation." (Id., p.3). And although the Lexcel Parties' intervening complaint may have broadened the software programs at issue as defined through the parties' initial discovery, it did not broaden the scope of the original complaint or alter the underlying nature of the proceedings. Compare Vinson v. Washington Gas Light Co., 321 U.S. 489, 499 (1944) ("[A]n intervenor is admitted to the proceeding as it stands, and in respect of the pending issues, but is not permitted to enlarge those issues or compel an alteration of the nature of the proceeding.") with Stewart-Warner Corp. v. Westinghouse Electric Corp., 325 F.2d 822, 827 (2d Cir. 1963) ("Where there exists a sufficiently close relationship between the claims and defenses of the intervenor and those of the original defendant to permit adjudication of all claims in one forum and in one suit without unnecessary delay- and to avoid as well the delay and waste of judicial resources attendant upon requiring separate trials- the district court is without discretion to deny the intervenor the opportunity to advance such claims."); accord Spangler v. U.S., 415 F.2d 1242, 1245 (9th Cir. 1969). See also NSK Corp v. U.S., 547 F.Supp.2d 1312, 1316-19 (Ct. Int'l Trade 2008) (discussing Vinson and holding that "the principle of enlargement [is] better reserved for situations in which an intervenor adds new legal issues to those already before the court. Moreover, the fact that an intervenor brings additional entries to the litigation carries no weight with regard to enlargement.").

[13]Mr. Firestone again affirmed that "the copyrighted source code, the 18 pages that we are required by law to file to get a copyright, of which I did not produce in this litigation"

1 (emphasis added). After considering the matter and recognizing that "the posture of this

2 case clearly changed when this Court granted Lexcel's request to intervene back in July

3 of 2005," and that "for Nelcela to argue that the authorization system is not at issue would

4 be simply ignoring Lexcel's position since it intervened" (id., p.47), the Court concluded

5 that it was inappropriate "to exclude the joint parties from introducing evidence relating

6 to the authorization system portion of the software versions in dispute" and so denied the

7 Nelcela Parties' motion in limine (id., p.48-49).[14]

8   There can be no dispute that the Nelcela Parties, knew, at the very, very least, as of

9 the March 26, 2007 Phase I Final Pretrial Conference that the Nelcela Authorization

10 System was at issue. The Nelcela Parties will not be heard to complain that "[p]rior to the

11 Phase I trial Nelcela believed that the parties' [ ] Authorization System(s) were not at

12 issue in this litigation." (Dkt. #661, p.2). In addition, it is abundantly clear that the

13 Nelcela Parties knew that the Nelcela Authorization System obtained by the Joint Parties

14 was comprised of the 18 pages of source code on file with the U.S. Copyright Office; that

15 was affirmed by Mr. Firestone as the Nelcela Authorization Code, despite the fact that he

16 had not produced it. Again, the Nelcela Parties had an obligation under Rule 26(e) to

17 disclose the existence of any source code apart from the 18 pages of code attached to their

18 copyright application.

19   **B.   The Phase I Trial**

20   However, on April 18, 2007, the fifth day of the Phase I trial, Mr. Firestone

21 showed Alec Dollarhide those 18 pages of source code and asked him whether that was

22 his entire authorization code," to which Mr. Dollarhide replied, "It's a very, very small

23 fragment." (Dkt. #529, p.990). Mr. Dollarhide also later stated that the entire Nelcela

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25 is the Nelcela Authorization System at the second Phase I Final Pretrial Conference on April
    9, 2007. (Dkt. #474, pp. 20-21).
26

27   [14]The Court emphatically reiterated that the Phase I trial was "trial for ownership of
    the Merchant and Authorization Systems" at the second Phase I Final Pretrial Conference on
28 April 9, 2007. (Dkt. #474, p.76).

- 16 -

1 Authorization System was "at least several hundred [pages], if not over a thousand." (Id.,

2 p.1004).

3   Counsel for the POST Parties objected to Mr. Firestone's line of questioning as the

4 Nelcela Parties had not produced any authorization source code beyond the 18 pages of

5 code. Mr. Firestone responded by placing large binders containing print-outs of the

6 Nelcela Merchant System source code on counsel's table and stating that he was "going

7 to ask [Mr. Dollarhide] if [he] printed the authorization code, would it look something

8 like this thick." (Id., p.992). Mr. Firestone also stated, for the first time, that "[t]he

9 authorization code is thousands of pages like the merchant code" (id., p.993), and stated

10 that it had not been produced was because none of the Joint Parties "asked where's the

11 remainder of it" (id., p.1000). Counsel for the POST Parties responded by pointing to the

12 copyright regulations that require a copyright registrant to file either the first and last

13 pages of a software program over 50 pages or if the program is less than 50 pages the

14 entire program, and reiterate that what was filed with by the Nelcela Parties with the U.S.

15 Copyright Office was the 18 pages of source code obtained by the Joint Parties when they

16 subpoenaed the copyright applications from Fennemore Craig, P.C. (Id., pp. 995-97).

17 The discussion then continued into the next day, at which time Mr. Firestone extensively

18 rehashed his arguments that he believed only the parties' merchant systems were at issue

19 and that no one specifically asked him to disclose the Nelcela Authorization System, in an

20 effort to excuse his failure to produce the allegedly "500 to a thousand pages" of the

21 entire Nelcela Authorization System source code. (Dkt. #530, pp. 1040-50, 1059). Mr.

22 Firestone also stated that the purpose of his question was "[o]nly [to show] that there's

23 more code, period." (Id., p. 1065). The Court permitted Mr. Dollarhide's answers to

24 stand, but recognized that the line of questioning was problematic because the alleged

25 hundreds of pages of authorization source code apart from the 18 pages attached to the

26 copyright application had never been produced, either prior to or at the Phase I trial. (Id.,

27 p.1066). The Court also noted that Mr. Firestone appeared to have violated his Rule 26(a)

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1 obligation to disclose the additional pages of the authorization source code. (Id., pp.
2 1069-70, 74).

3   **C.**   **Phase II**

4   The Nelcela Parties now argue, two years later, that they should be permitted to

5 present the entire Nelcela Authorization System source code (Trial Exhibits 1006 and

6 1007) – despite disclosing it for the first time approximately six weeks before the Phase II

7 trial on infringement and the day prior to the deadline for the parties to exchange exhibits

8 – because "[i]t is entirely clear that Nelcela made everybody aware in the Phase I trial that

9 the Nelcela Authorization Code was several [hundred] pages, not 17 or 18 pages

10 submitted to obtain its copyright." (Dkt. #673, p.4). In other words, "[w]hen Phase II

11 began, the Joint Parties clearly knew that they did not have the full, printed Authorization

12 Code. . . ." (Id.). In addition, the Nelcela Parties state that "[n]o party has asked Nelcela

13 for its Authorization Code in this Phase II either[.]" (Id.). As such, the Nelcela Parties

14 implicitly contend that did not violate any disclosure obligations under Rule 26(e) of the

15 Federal Rules of Civil Procedure.

16   The Court, however, does not agree. Mr. Firestone and Mr. Dollarhide's

17 unsupported statements at the Phase I trial that the 18 pages of source code attached to the

18 copyright application was not the entire authorization source code, which in fact

19 comprised between several hundred to a thousand pages of code,[15] was not sufficient to

20 discharge the Nelcela Parties' Rule 26(e)(1)(A) disclosure obligation. Once the Nelcela

21 Parties became aware that their authorization system was at issue, regardless of whether

22 that occurred prior to or at the Phase I Final Pretrial Conferences, there can be no

23 question that the Nelcela Parties' initial Rule 26(a) disclosures and responses to the Joint

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26   [15]In addition, those statements appears to have been incorrect. At the Phase II Final Pretrial Conference, Mr. Harris, despite stating in his motion that the Nelcela Authorization
27 Code "was several [hundred] pages," stated that "[t]he authorization code itself is these two binders that look to be about three-quarters of an inch thick, maybe 180 pages, something
28 like that." (Dkt. #682, p. 59).

1   Parties interrogatories were incomplete. That is, of course, unless "the additional or

2   corrective information has not otherwise been made known to the other parties during the

3   discovery process or in writing[.]" Fed.R.Civ.P. 26(e)(1)(A). Thus, the Nelcela Parties'

4   disclosure obligation was discharged only if information concerning the Nelcela

5   Authorization System was made known to the other parties. Only 18 pages of

6   authorization source code was made known to the Joint Parties, through their own effort.

7   If the Nelcela Authorization System was in fact larger than those 18 pages, then the

8   Nelcela Parties had an obligation to disclose that fact under Rule 26(e). And by failing to

9   disclose that the Nelcela Authorization System was larger than those 18 pages – to the

10 tune of hundreds of pages larger – until the fifth day of the Phase I trial, the Nelcela

11 Parties clearly violated Rule 26. Looking back, it appears the Court would have been

12 well within its authority to strike Mr. Dollarhide's answers and prevent Mr. Firestone

13 from engaging in any line of questioning regarding the alleged full extent of the Nelcela

14 Authorization System.

15   More importantly, simply eliciting testimony that the Nelcela Authorization

16 System source code was larger than the 18 pages of code attached to the copyright

17 application does not sufficiently "make known to the other parties" either the existence or

18 nature of the Nelcela Authorization System. The Nelcela Parties did not present any of

19 the alleged authorization code apart from the 18 pages of code attached to the copyright

20 application at the Phase I trial. Nor did they make known the location of the entire source

21 code. The mere declaration that there was additional authorization source code other than

22 what had been obtained by the POST Parties did not somehow shift the disclosure

23 obligation to the Joint Parties to request the entire Nelcela Authorization System source

24 code. This is especially true in light of the fact that Mr. Firestone explicitly averred to the

25 Joint Parties and the Court prior to the Phase I trial that the 18 pages of source code

26 attached to the Nelcela Authorization System copyright application was the authorization

27 system.

28

1   In any event, contrary to the Nelcela Parties contention, the Lexcel Parties did in

2   fact request the Nelcela Authorization System source code during the Phase II discovery

3   in this case. (Dkt. #614; Dkt. #674, p.6). The Lexcel Parties specifically requested "[a]ll

4   documents and communications, *including source code*, relating to the customization

5   and/or modification, at any time, of Nelcela Software by any person and/or of the Lexcel

6   Software by any of the Nelcela Defendants." (Id., Exh. 10, p.2) (emphasis added). And

7   the Nelcela Parties responded that "*[t]here is no additional source code to provide . . .*

8   beyond what has already been produced in this litigation." (Id.) (emphasis added). Thus,

9   there can be no doubt that the Nelcela Parties failed to disclose the Nelcela Authorization

10   System as now presented in Trial Exhibits 1006 and 1007 in violation of Federal Rule of

11   Civil Procedure 26(e).

12   However, "[t]he information may be introduced if the parties' failure to disclose

13   the required information is substantially justified or harmless." Yeti by Molly, 259 F.3d

14   at 1106 (citing Fed.R.Civ.P. 37(c)(1)). As in Yeti by Molly, neither of those exceptions

15   apply here. The only justifications offered by the Nelcela Parties are that throughout

16   most of Phase I they believed that their authorization system was not at issue, and that the

17   Joint Parties did not request their entire authorization system source code during Phase

18   II.[16] As discussed in detail above, both of those justifications fail; and to the extent the

19   former has any merit, the Nelcela Parties's response to the Lexcel Parties' Phase II

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21   [16]The Nelcela Parties also point to the fact that none of the Joint Parties ever produced
     their entire authorization system. First, however, the Nelcela Parties' disclosure obligations
22   are automatic and not contingent on the Joint Parties' compliance with its disclosure
     requirements. Fed.R.Civ.P. 26. Second, the Lexcel Parties' entire authorization source code
23   is not required for the Phase II jury to conduct their intrinsic analysis of the parties' software.
     The Phase II jury need only determine two things: (1) whether the protectable elements in
24   the Lexcel Parties' merchant and authorization systems, already identified by the Joint Parties
     at Dkt. #555 and discussed by the Court in its February 2, 2009 order on analytical
25   dissection, are virtually identical to those elements in the Nelcela Parties' software (Dkt.
     #652, p.2); and (2) whether the alleged protectable elements copied by the Nelcela Parties
26
27   are qualitatively and quantitatively insignificant to the Nelcela Parties' merchant and
28   authorization systems as a whole (id., pp. 2-3).

- 20 -

1 discovery request that there was in fact no additional source code is dispositive.[17]

2 Moreover, the Nelcela Parties citation to <u>Fonseca v. Sysco Food Servs. of Ariz., Inc.</u>, 374

3 F.3d 840, 846 (9th Cir. 2004), is inapposite. As distinguished by the court in <u>Hagan v.</u>

4 <u>California Forensic Medical Group</u>, 2009 WL 689740, at *3 (E.D. Cal. 2009), <u>Fonseca</u>,

5 involved a pro se plaintiff and held that the plaintiff's "late disclosure was . . . harmless,

6 because [Defendant] *had a copy* of the [challenged] declaration months before

7 [Plaintiff's] disclosure." 374 F.3d at 846 (emphasis added). Here, the Nelcela Parties do

8 not contend that the Joint Parties had a copy of the entire Nelcela Authorization System

9 source code at any time prior to its late disclosure.

10   The Nelcela Parties have also not shown that the delay was harmless. They assert

11 that they will suffer "great prejudice" if the Court were to exclude their entire

12 authorization system because "[i]n order for Nelcela to put on a proper defense, . . . [they]

13 must be permitted to show the jury the entirety of an Authorization System to show the

14 changes are not trivial" (Dkt. #661, p.5). And certainly that is a correct statement of the

15 law: if the Nelcela Parties are prevented from introducing their entire authorization

16 system, then in the event the Lexcel Parties are able to prove that virtually identical

17 copying took place, it appears that the Nelcela Parties would be unable to present

18 evidence (other than the 18 pages of authorization source code already disclosed) to show

19 that the elements copied are qualitatively and quantitatively insignificant to the Nelcela

20 Authorization System as a whole.

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24   [17]At the Phase II Final Pretrial Conference, Mr. Harris, appeared to contend that the reason he did not produce the entire Nelcela Authorization System source code in response

25 to the Lexcel Parties' Phase II discovery request was because he just recently discovered the source code in a box he had received from his co-counsel, Mr. Firestone and Ms. Manolio.

26 (Dkt. #662, pp. 54-55). That explanation does not excuse the Nelcela Parties' failure to disclose the requested information in light of the history of this litigation and the Nelcela

27 Parties' response to the Lexcel parties' discovery request that "[t]here is no additional source

28 code to provide."

1   But again, similar to the plaintiff in Yeti by Molly, the Lexcel Parties received

2   Trial Exhibits 1006 and 1007 only six weeks before they must litigate a complex

3   copyright action that has been drawn out in this Court since 2002. 259 F.3d at 1107. To

4   respond to this late disclosure, the Lexcel Parties would have to comb through

5   approximately hundreds of pages of written computer source code to determine whether

6   any of the code, apart from the 18 pages of code already disclosed, contain any of the

7   protectable elements identified by the Joint Partes.[18] But even Herculean efforts would

8   unlikely accomplish that task in the next two weeks. Moreover, if the Lexcel Parties

9   identified any similarities in the parties' authorization systems other than those identified

10   in the Joint Parties' List of Common Features and Elements (Dkt. #555), then the Court

11   might have to conduct analytic dissection of those additional elements, in which case it

12   would be impossible for the Phase II trial to proceed on schedule. The Court cannot find

13   that such delay is harmless.

14   "Courts have upheld the use of the [Rule 37(c)(1)] sanction even when a litigant's

15   entire cause of action or defense has been precluded." Yeti by Molly, 259 F.3d at 1106

16   (citing Ortiz-Lopez v. Sociedad Espanola de Auxilio Mutuo Y Beneficiencia De Puerto

17   Rico, 248 F.3d 29, 35 (1st Cir. 2001) (although the exclusion of an expert prevented

18   plaintiff from making a case and was "a harsh sanction to be sure," it was "nevertheless

19   within the wide latitude of" Rule 37(c)(1)). "Thus, even though [the Nelcela Parties]

20   never violated an explicit court order to produce the[ir] [authorization system] and even

21   absent a showing in the record of bad faith or willfulness, exclusion is an appropriate

22   remedy for failing to fulfill the required disclosure requirements of Rule 26(a)." Id. The

23   prejudice of which the Nelcela Parties complain is of their own making. Because of the

24   Nelcela Parties' multiple failures to disclose, as discussed above, the Court must grant the

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27   [18]Mr. Harris informed the Court at the Phase II Final Pretrial Conference that he does
     not possess the source code contained in Trial Exhibits 1006 and 1007 in machine-readable

28   format. (Dkt. #662, pp. 57-60).

1 Joint Parties' motion to exclude Trial Exhibits 1006 and 1007 pursuant to Federal Rule of
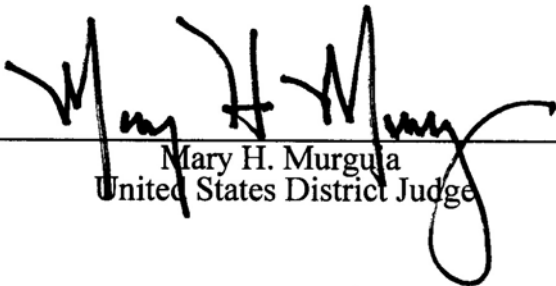
2 Civil Procedure 37(c)(1).

3   **Accordingly,**

4   **IT IS HEREBY ORDERED** granting MTSI's motion for partial reconsideration.

5 (Dkt. #662).

6   **IT IS FURTHER ORDERED** denying the Nelcela Parties' motion in limine to

7 exclude evidence of copyright ownership by MTSI. (Dkt. #645).

8   **IT IS FURTHER ORDERED** granting the Joint Parties' motion in limine to

9 exclude "Nelcela Authorization System" source code not timely produced. (Dkt. #649).

10   DATED this 24th day of July, 2009.

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      Mary H. Murguia
14   United States District Judge

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