

1 REGINALD D. STEER (SBN 056324)
 rsteer@akingump.com
 2 MARIA ELLINIKOS (SBN 235528)
 mellinikos@akingump.com
 3 **AKIN GUMP STRAUSS HAUER & FELD LLP**
 580 California, 15th Floor
 4 San Francisco, California 94104-1036
 Telephone: (415) 765-9500
 5 Facsimile: (415) 765-9501

6 EDWARD P. LAZARUS (SBN 212658)
 elazarus@akingump.com
 7 STEPHEN MICK (SBN 131569)
 smick@akingump.com
 8 MICHAEL SMALL (SBN 222768)
 msmall@akingump.com
 9 **AKIN GUMP STRAUSS HAUER & FELD LLP**
 2029 Century Park East, Suite 2400
 10 Los Angeles, California 90067-3012
 Telephone: (310) 229-1000
 11 Facsimile: (310) 229-1001

WILLIAM SLOAN COATS (SBN 94864)
 wcoats@whitecase.com
 MARK WEINSTEIN (SBN 193043)
 mweinstein@whitecase.com
 MARK F. LAMBERT (SBN 197410)
 mlambert@whitecase.com
WHITE & CASE LLP
 3000 El Camino Real
 5 Palo Alto Square, 9th Floor
 Palo Alto, California 94306
 Telephone: (650) 213-0300
 Facsimile: (650) 213-8158

12 Attorneys for Defendant and Counterclaimant
 13 DVD COPY CONTROL ASSOCIATION, INC.

14 UNITED STATES DISTRICT COURT
 15 NORTHERN DISTRICT OF CALIFORNIA

16 REALNETWORKS, INC., a Washington
 Corporation; and REALNETWORKS HOME
 17 ENTERTAINMENT, INC., a Delaware
 corporation,
 18
 Plaintiffs,
 19
 v.
 20 DVD COPY CONTROL ASSOCIATION, INC., a
 21 Delaware nonprofit corporation, et al.
 22 Defendants.
 23 And Related Counterclaims.

Case No. C08 04548 MHP;
 C08 04719 MHP

**OPPOSITION OF DVD COPY CONTROL
 ASSOCIATION, INC. TO PLAINTIFFS'
 MOTION TO DISMISS SECOND
 COUNTERCLAIM**

Before: Hon. Marilyn Hall Patel
Dept: Courtroom 15
Date: February 23, 2009
Time: 2:00 p.m.

24
 25 AND RELATED CASES

1 **I. INTRODUCTION**

2 DVD Copy Control Association, Inc. (“DVD CCA”) has asserted counterclaims against
 3 RealNetworks, Inc. and RealNetworks Home Entertainment, Inc. (collectively, “Real”) for breach of
 4 contract (First Claim for Relief) and breach of the implied covenant of good faith and fair dealing
 5 (Second Claim for Relief). Answer of DVD CCA to Amended Complaint for Declaratory Relief;
 6 Counterclaims (Dkt. No. 96; “DVD CCA Counterclaims”). Real’s motion to dismiss does not
 7 challenge the adequacy of the breach of contract counterclaim. It addresses only the claim for breach
 8 of the implied covenant of good faith and fair dealing. Real’s motion to dismiss that claim has no basis
 9 in California law and should be denied.

10 Ignoring iron-clad California precedent recognizing an implied covenant of good faith and fair
 11 dealing in “every contract,” Real argues that there is no implied covenant in its contract with DVD
 12 CCA because the agreement is a standard license that DVD CCA does not negotiate with individual
 13 licensees. Motion to Dismiss DVD CCA’s Second Counterclaim at 1 (Dkt. No. 98). Real’s argument
 14 is both wrong and radical in its implications. Real cites no authority (and DVD CCA is aware of none)
 15 that supports the notion that a uniform and non-discriminatory contract like the agreement between
 16 DVD CCA and Real (the “Agreement”)¹ can have no implied covenant of good faith and fair dealing.
 17 Under Real’s theory, a party that accepts and enjoys the benefits of a standard license, but then works
 18 assiduously to undermine the fundamental purposes of that license, cannot be sued for breaching the
 19 implied covenant simply because there was no negotiation between the licensee and licensor. This is
 20 true under Real’s theory even if, as DVD CCA alleges here, the licensee fully understood – and
 21 intentionally disregarded to the licensor’s detriment – the licensor’s stated purposes in offering the
 22
 23

24 ¹ The “Agreement” between DVD CCA and Real comprises: (1) the CSS License Agreement,
 25 Version 1.2 and the CSS Specifications applicable to Real, which include (1) the Procedural
 26 Specifications; (2) the “CSS General Specifications” v. 1.10, November 1, 2000; (3) the “DVD Video
 27 Descrambler” v. 1.10, November 1, 2000; (3) the “Authenticator Module for CSS Decryption Module”
 28 version 1.10, November 1, 2000, and (4) the “Authenticator Module for DVD Drive” version 1.10,
 November 1, 2000. The CSS License Agreement v. 1.2, which defines the Agreement to include the
 CSS License Agreement and the CSS Specifications applicable to Real, is attached to Real’s Complaint
 For Declaratory Relief (“Complaint”) and referenced in Real’s Amended Complaint For Declaratory
 Relief (“Amended Complaint”), but constitutes only a part of the Agreement between the parties.
 DVD CCA Counterclaims, ¶ 9.

1 license. Neither case law nor common sense supports the granting of such immunity and thus
2 exempting standardized contracts from the universal rule that all contracts contain implied covenants
3 of good faith and fair dealing.

4 Real pleads for special treatment by trying to label its agreement with DVD CCA a contract of
5 adhesion. But the agreement is not an adhesion contract and, as especially pertinent to this motion, it
6 certainly cannot be deemed an adhesion contract at the pleading stage in light of the allegations in
7 DVD CCA's Counterclaims that businesses seeking a CSS License have the freedom and discretion to
8 select the type of Agreement they want, depending on their business needs and the type of DVD
9 products they plan to manufacture. Moreover, Real's argument for concluding that the contract is
10 adhesive, and hence no implied covenant of good faith and fair dealing arises and Real's interpretation
11 of the contract controls, depends on a determination of (1) Real's subjective interpretation of the
12 Agreement, and (2) whether that subjective interpretation was "reasonable" – two fact-intensive issues
13 that cannot possibly be resolved on a motion to dismiss. In any event, the pleadings have not placed
14 the entire Agreement before the Court at this juncture, and thus whether Real's interpretation should
15 control cannot be decided at this stage for that reason as well.

16 **II. ARGUMENT**

17 **A. The Covenant Of Good Faith And Fair Dealing Is Implied In Every Contract,** 18 **Including Licensing Agreements.**

19 Real admits that "a covenant of good faith and fair dealing is implied by law in every contract"
20 and that it exists "to prevent one contracting party from unfairly frustrating the other party's right to
21 receive the *benefits of the agreement actually made*," Motion to Dismiss at 2 (Dkt. No. 98), citing *Guz*
22 *v. Bechtel Nat'l Inc.*, 24 Cal. 4th 317, 349 (2000).

23 Because DVD CCA's position is that Real has frustrated DVD CCA's right to receive the
24 benefits of the CSS License Agreement, DVD CCA has alleged that Real has violated the covenant of
25 good faith and fair dealing.

26 Allegations of breach of the implied covenant of good faith and fair dealing are perfectly
27 appropriate in the licensing context. In licensing cases, the implied covenant of good faith and fair
28 dealing prohibits a licensee from taking advantage of the circumstances of the transaction to unfairly

1 disadvantage the licensor. Raymond T. Nimmer & Jeff Dodd, *Modern Licensing Law* § 12:34 (2008).
2 Courts have consistently applied this principle. *See Celador Int'l Ltd. v. Walt Disney Co.*, 347 F. Supp.
3 2d 846 (C.D. Cal. 2004) (denying licensee's motion to dismiss licensor's breach of the implied
4 covenant of good faith and fair dealing where licensor alleged that licensee intentionally sought to
5 frustrate licensor's enjoyment of its rights under the contract); *Marsu, B.V. v. Walt Disney Co.*, 185 F.3d
6 932, 936-38 (9th Cir. 1999) (although licensee met its express merchandising obligations to market
7 licensor's animated character, licensee violated implied covenant of good faith by consciously
8 choosing not to "do [the licensor] right," but instead devoting its attention and talent to promoting its
9 own profitable animated characters); *SAS Institute Inc. v. S & H Computer Systems, Inc.*, 605 F. Supp.
10 816 (M.D. Tenn. 1985) (licensee's reverse engineering and unauthorized copying of licensed computer
11 program violated licensee's implied covenant of good faith) (citing *County of Ventura v. Blackburn*,
12 362 F.2d 515 (9th Cir. 1966)) (affirming trial court ruling of breach of implied covenant of good faith,
13 where map maker licensor gave the licensee county the right to reproduce and sell his maps so long as
14 county affixed copyright notices to each map, and county failed to do so); *Emerson Radio Corp. v.*
15 *Orion Sales, Inc.*, 253 F.3d 159, 169-73 (3rd Cir. 2001) (denying summary judgment on implied
16 covenant claim, where licensee contracted to sell licensor's video products to Wal-Mart, but facts
17 suggested the licensee harbored "a secret intent to decimate Emerson's relationship with Wal-Mart").
18 Moreover, Real cites no authority for the proposition that the covenant of good faith and fair dealing is
19 not implied in contracts of adhesion.

20 **B. DVD CCA Has Alleged Sufficient Facts To State A Claim For Breach Of The**
21 **Implied Covenant Of Good Faith And Fair Dealing.**

22 As Real admits, all DVD CCA need allege to properly plead a claim for breach of the implied
23 covenant is that Real acted in bad faith to frustrate the benefits of the agreement actually made. DVD
24 CCA's pleading clearly alleges the benefits DVD CCA expected from the Agreement and Real's bad
25 faith. As in *Celador* and the other authorities involving breaches of license agreements, DVD CCA
26 has alleged specific acts that Real committed to frustrate DVD CCA's expected benefit of the contract;
27 namely, Real created the RealDVD and "New Platform" products to profit from allowing casual users
28 to make persistent, playable copies of DVDs whose contents are intended to be protected from copying

1 by CSS. Those allegations are more than sufficient to state a claim for breach of the implied covenant
2 of good faith and fair dealing.

3 As to the benefits DVD CCA expected from the Agreement, the CSS License Agreement
4 attached to Real's Complaint states that the primary objective of the CSS technology under the
5 Agreement is "to provide reasonable security for content on DVD Discs and thereby . . . to provide
6 protection for such copyrighted content against unauthorized consumer copying." Complaint, Exhibit
7 1 (CSS License Agreement, Version 1.2) at Recital A (Dkt. No. 2). In the Preliminary Statement to its
8 Counterclaims, DVD CCA clearly articulates the benefits under the Agreement that it expected in
9 exchange for making the CSS technology available to businesses interested in using it:

10 In exchange for this permission to use CSS, licensees would simply have to pay an
11 administrative fee and agree to observe detailed specifications for the decryption and
12 descrambling processes in order to achieve CSS's underlying goal of facilitating ready
13 playback of the DVD while preventing consumer copying of the underlying content.

14 DVD CCA Counterclaims at 2:23-26. And DVD CCA's Second Counterclaim alleges that it expected
15 its licensee, Real, to act "to prevent casual consumers from making unauthorized copies of DVD
16 content," by using the CSS technology "to produce devices" (i) "that require the physical presence of a
17 DVD in a playback device's disk drive when the device plays DVDs", and (ii) "that do not save
18 protected content . . . for subsequent playback without the DVD." DVD CCA Counterclaims, ¶ 27.
19 These expected benefits flow directly from the broader aim and requirements of the Agreement and the
20 CSS technology itself, as alleged in the counterclaim: prevention of unauthorized copying.

21 Real's attempt to frame DVD CCA's implied covenant claim as imposing "additional
22 obligations based on contractual purposes with which Real did not agree" is incorrect, because Real's
23 obligation to manufacture products that do not enable consumers to make unauthorized copies of
24 DVDs, far from being "additional" to the Agreement, is absolutely fundamental according to DVD
25 CCA's allegations. See Raymond T. Nimmer & Jeff Dodd, *Modern Licensing Law* § 12:34 (2008)
26 (implied covenant of good faith is a general standard that "does not alter express contract terms or
27 provide additional terms," but refers to "an obligation of honesty in fact"). Indeed, as DVD CCA has
28 alleged, Real understood that to be the underlying purpose of CSS technology even before it decided to
enter into the Agreement licensing that technology. DVD CCA Counterclaims ¶ 26.

1 DVD CCA has also sufficiently alleged Real's bad faith acts that were intended to frustrate
2 DVD CCA's expected benefit. DVD CCA Counterclaims ¶¶ 26, 27; *see also id.*, Preliminary
3 Statement, at 3:4-15. DVD CCA alleges, among other things, that

- 4 • Real falsely justifies its subversion of the Agreement and its purposes;
- 5 • Real entered into the Agreement "with the intent of creating products that defied what it
6 knew to be DVD CCA's interpretation of the contractual requirements";
- 7 • Real's bad faith actions "achieved its objective: both Real DVD and the New Platform
8 implement CSS to copy CSS protected DVD content to a computer hard drive or other
9 storage media, thereby enabling a user to play back the DVD at a later time, without need
10 for the physical DVD itself"; and
- 11 • "Prior to entering into the Agreement, RealNetworks never communicated to DVD CCA
12 that it intended to construe the contract as allowing for the copying of DVD content to a
13 computer hard drive or other storage media for playback without the DVD."

14 By creating products that allow consumers to make unauthorized copies of DVD content in conscious
15 disregard of DVD CCA's understanding of the contract, Real engaged in paradigmatic bad faith
16 conduct. DVD CCA Counterclaims, ¶¶ 26, 27; Restatement (Second) of Contracts § 205 cmt. d
17 (1979) (even where a party thinks his conduct to be justified, "subterfuges and evasions violate the
18 obligation of good faith"; bad faith includes "evasion of the spirit of the bargain," and "willful
19 rendering of imperfect performance"). Thus, Real's effort to characterize this dispute as arising from a
20 failure to agree on terms has no support in the pleadings.

1 **C. DVD CCA’s Counterclaim Alleges Facts To Support The Conclusion That The**
 2 **Agreement Is Not A Contract Of Adhesion.**

3 Real argues that because the “CSS License Agreement”² is a contract of adhesion, Real’s
 4 interpretation controls the scope of the contract and by extension negates the existence of the implied
 5 covenant of good faith and fair dealing that DVD CCA alleges in the Counterclaims. Real is wrong.
 6 The Counterclaims allege that Real is a sophisticated business that entered into the Agreement with the
 7 benefit of legal counsel who advised it of the legal issues posed by its business plans under the CSS
 8 licensing structure and the Agreement. DVD CCA Counterclaims ¶¶ 13, 26. In light of these factual
 9 allegations, the Agreement cannot be deemed a contract of adhesion at the pleading stage. The cases
 10 cited by Real only reinforce the point. They involve contracts between parties of patently unequal
 11 bargaining strength, such as employer-employee agreements, insurance contracts, and standardized
 12 banking or credit card agreements. *See Intershop Commc’ns AG v. Martinez*, 104 Cal. App. 4th 191,
 13 201 (2002) (employee stock option exchange agreement); *Neal v. State Farm Ins. Co.*, 188 Cal. App.
 14 2d 690, 692 (1961) (employment contract); *Armendariz v. Foundation Health Psychcare Serv., Inc.*, 24
 15 Cal. 4th 83, 113 (2000) (employment contract); *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 817-18
 16 (1981) (mandatory union contract requiring arbitration before union board); *State Farm Fire and*
 17 *Casualty Co. v. Keenan*, 171 Cal. App. 3d 1 (1985) (insurance contract); *Badie v. Bank of America*, 67
 18 Cal. App. 4th 779 (1998) (account agreement between bank and credit card holders); and *Tahoe Nat’l*
 19 *Bank v. Phillips*, 4 Cal. 3d 11 (1971) (lending instrument between a bank and an individual). Real does
 20 not cite a single case holding an agreement between sophisticated businesses advised by legal counsel
 21 to be adhesive. On the pleadings here, there is no basis to conclude that DVD CCA has patently
 22 unequal bargaining power over Real.

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 25
 26 ² Real’s motion ignores that the Counterclaims allege that the contract between Real and DVD
 27 CCA – the Agreement – consists of the CSS License Agreement and the CSS Specifications applicable
 28 to the CSS Membership Categories that Real selected: the “DVD Video Descrambler” v. 1.10,
 November 1, 2000; (3) the “Authenticator Module for CSS Decryption Module” version 1.10,
 November 1, 2000, and (4) the “Authenticator Module for DVD Drive” version 1.10, November 1,
 2000. DVD CCA Counterclaims, ¶ 9.

D. Real’s Argument That No Implied Covenant Arises Because The Agreement Is Adhesive Is Fact-Bound And Cannot Be Decided On The Pleadings.

Real’s argument that the CSS License Agreement is adhesive and that its interpretation controls also fails because whether a contract is adhesive presents a “mixed question of law and fact” that is not properly resolved on a motion to dismiss. *Erickson v. Aetna Health Plans of California, Inc.*, 71 Cal. App. 4th 646, 653 (1999) (determination of contract of adhesion is a mixed question of law and fact) (citing *Woodard v. Southern Cal. Permanente Medical Group*, 171 Cal. App. 3d 656, 667 (1985)); *Durning v. First Boston Corp.*, 815 F.2d 1265, 1267-68 (9th Cir. 1987); *Bryant v. Mattel*, 573 F. Supp. 2d 1254, 1260 (C.D. Cal. 2007). To properly address this mixed question, “a court would have to consider the conditions under which the contract was negotiated and executed, including an assessment of the parties’ relative bargaining power.” *Erickson*, 71 Cal. App. 4th at 653. In the face of these precedents, Real seeks to support the proposition that the covenant of good faith and fair dealing alleged in the Counterclaims does not exist by making the factual assertion that the parties’ contract (the whole of which is not yet even before the Court) is ambiguous in some unspecified way and that Real’s interpretation of the “CSS License Agreement” is “reasonable” by dint of the statement of decision from the *Kaleidescape* case. Motion at 4. Real is mistaken on two grounds. First, as a threshold point, the *Kaleidescape* decision – a matter that is beyond the Counterclaims – deals with only a small subset of the contractual provisions on which the DVD CCA’s counterclaims here rest, Counterclaims ¶ 15, and does not purport to define the underlying purposes of the license agreement. Second, Real’s argument, if accepted, would transform the statement of decision in *Kaleidescape*, which is on appeal and thus presently has no binding effect,³ into a decision that is binding on DVD

³ Because the appeal is still pending, the trial court ruling in *Kaleidescape* is not a final judgment for purposes of California law regarding the application of the doctrines of res judicata and collateral estoppel to bar relitigation of claims and issues previously litigated and decided. *Franklin & Franklin v. 7-Eleven Owners For Fair Franchising*, 85 Cal. App. 4th 1168, 1174 (2000) (judgments on appeal are not final for purposes of preclusion doctrines under California law). California’s rules on those doctrines govern here because federal courts must apply state law principles to ascertain the preclusive effect of decisions rendered by courts of that state. *Intri-Plex Technologies, Inc. v. Crest Group, Inc.*, 499 F.3d 1048, 1052 (9th Cir. 2007).

1 CCA simply because Real claims it influenced Real's undisclosed state of mind at the time it entered
2 into its contract with DVD CCA. No authority supports Real's argument and Real cites none.

3 In yet another gambit, Real would have this Court determine at this stage that Real genuinely
4 held a different interpretation of the language of the license agreement than the interpretation it
5 allegedly knew DVD CCA to hold (as opposed to a manufactured construction created to justify its
6 conduct). Counterclaims ¶ 26.⁴ But this presents just another variation of the same problem. Matters
7 beyond the Counterclaims concerning the circumstances in which the Agreement was entered, the
8 subjective intent of the parties, the relative bargaining strength of the parties, or other factual matters
9 suggested by Real cannot properly be considered in the context of a motion to dismiss. It is black-
10 letter law that a motion to dismiss may not argue, and the court cannot consider, factual disputes, or
11 evidence outside of the counterclaims. *Bryant v. Mattel*, 573 F. Supp. 2d 1254, 1260 (C.D. Cal. 2007);
12 *see also* 5B Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* ("Wright &
13 Miller") § 1356 (3d ed. 2004) (Federal Rule 12(b)(6) motion serves to "test the formal sufficiency of
14 the statement of the claim for relief; the motion is not a procedure for resolving a contest between the
15 parties about the facts or the substantive merits of the plaintiff's case"). Real's motion violates these
16 fundamental principles. Real's assertions as to its state of mind and other factual assertions regarding
17 the supposed adhesive nature of the Agreement upon which Real's motion depends are contradicted in
18 the Counterclaims, which allege that Real freely entered into the Agreement, did so knowing DVD
19 CCA's interpretation of it and did not disclose its intention to assert an interpretation completely
20 contrary to DVD CCA's. Consequently, Real's motion to dismiss is improper.

21 **E. The Entire Agreement Is Not Yet Before The Court.**

22 Real's argument that its interpretation controls also fails because only part of the Agreement is
23 attached to the pleadings, and none of it is attached to the Counterclaims. Real's First Amended
24 Complaint references only the CSS License Agreement document – one of five documents comprising
25 the Agreement between the parties. *See* DVD CCA Counterclaims ¶ 9. Any asserted contractual
26

27 _____
28 ⁴ To the extent Real suggests that DVD CCA's counterclaims admit that Real held such a
genuine and inconsistent interpretation, Real has simply misconstrued the pleadings.

1 interpretation, regardless of the party advancing it, must be evaluated in accordance with fundamental
 2 principles of contract interpretation under California law. Chief among these principles is the
 3 requirement that “[t]he whole of a contract is to be taken together, so as to give effect to every part, if
 4 reasonably practicable, each clause helping to interpret the other.” CAL. CIV. CODE § 1641 (West
 5 2001). The whole Agreement is not before the Court, and even if it were, the Court could not properly
 6 resolve competing interpretations in the context of a motion to dismiss and the necessary absence of
 7 evidence beyond the pleadings. *City of Chino v. Jackson*, 97 Cal. App. 4th 377, 383-84 (2002) (“First,
 8 the [trial] court provisionally receives (without actually admitting) all credible evidence concerning the
 9 parties’ intentions to determine ‘ambiguity’, i.e., whether the language is ‘reasonably susceptible’ to
 10 the interpretation urged by a party”), quoting *Winet v. Price*, 4 Cal. App. 4th 1159, 1165-66 (1992),
 11 (additional citation omitted); see also *Intel Corp. v. Via Technologies, Inc.*, 319 F.3d 1357, 1363, 1368
 12 (Fed. Cir. 2003) (court interpreted language against drafter only after interpreting the language of the
 13 agreement “insofar as possible,” and only after determining that “as to the critical terms the agreement
 14 is indeed ambiguous”). Whatever Real’s purported contractual interpretation may be, it is plainly at
 15 odds with the interpretation DVD CCA asserts, and which Real knew DVD CCA asserted at the
 16 time the contract was made. This Court cannot resolve the dispute over the contract and its
 17 interpretation on the basis of a pleading motion such as this.

18 **III. CONCLUSION**

19 For the foregoing reasons, DVD CCA respectfully submits that Real’s motion to dismiss the
 20 Second Counterclaim should be denied.

21 Dated: February 2, 2009

Respectfully submitted,

AKIN GUMP STRAUSS HAUER & FELD LLP

WHITE & CASE LLP

26 By _____ /s/

27 Reginald D. Steer
 Attorneys for Defendant
 DVD COPY CONTROL ASSOCIATION, INC.