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9 Attorneys for Plaintiffs and Counterclaim Defendants  
 10 REALNETWORKS, INC. and REALNETWORKS  
 HOME ENTERTAINMENT, INC.  
 11

12 UNITED STATES DISTRICT COURT  
 13 NORTHERN DISTRICT OF CALIFORNIA  
 14

15 REALNETWORKS, INC., a Washington )  
 Corporation; and REALNETWORKS HOME )  
 16 ENTERTAINMENT, INC., a Delaware corporation, )  
 )  
 17 Plaintiffs, )  
 )  
 18 v. )  
 )  
 19 DVD COPY CONTROL ASSOCIATION, INC., a )  
 Delaware nonprofit corporation, DISNEY )  
 20 ENTERPRISES, INC., a Delaware corporation; )  
 PARAMOUNT PICTURES CORP., a Delaware )  
 21 corporation; SONY PICTURES ENTER., INC., a )  
 Delaware corporation; TWENTIETH CENTURY )  
 22 FOX FILM CORP., a Delaware corporation; NBC )  
 UNIVERSAL, INC., a Delaware corporation; )  
 23 WARNER BROS. ENTER. INC., a Delaware )  
 corporation; and VIACOM, Inc., a Delaware )  
 24 Corporation, )  
 )  
 25 Defendants. )

Case Nos. C08 04548 MHP;  
 C08 04719 MHP

**DECLARATION OF GORDON L.  
 KLEIN IN SUPPORT OF  
 REALNETWORKS, INC. AND  
 REALNETWORKS HOME  
 ENTERTAINMENT, INC.'S  
 OPPOSITION TO MOTION FOR  
 PRELIMINARY INJUNCTION**

Date: April 1, 2009  
 Time: 9:00 a.m.  
 Dept: 15

26 AND RELATED CASES )  
 27 )  
 28

1 I, Gordon L. Klein, declare as follows:

2 **I. PROFESSIONAL BACKGROUND**

3 1. I am a faculty member at UCLA's Anderson School of Management, where I  
4 have taught 11 accounting, tax, business law, and entrepreneurship courses in the undergraduate  
5 program and MBA Program since 1981. Specifically, I have taught small business management,  
6 profit forecasting, market segmentation, and business plan development in forecasting sales,  
7 incremental costs, consumer behavior, risk-adjusted discounting, and statistical analysis. I was a  
8 faculty member from 1987 to 2000 at UCLA's Law School, where I taught courses in  
9 accounting, taxation, and financial analysis. I taught similar courses as an Adjunct Professor in  
10 the LLM in Taxation Program at Loyola Law School in Los Angeles, California during fall 2001  
11 and 2002. I am a member of the California Bar (inactive), admitted in 1979, and a C.P.A.,  
12 certified in the state of Illinois in 1979. I have conducted executive education seminars in  
13 financial and tax aspects of business management to, among others, partners at  
14 PricewaterhouseCoopers, members of the German Bundestadt governing body, and the Finance  
15 Committee of the People's Republic of China. I have authored several books concerning  
16 managerial accounting, cost accounting, introductory accounting, managerial finance, and  
17 statistics, as identified in my curriculum vitae. I earned a B.B.A. from the University of  
18 Michigan Business School in 1976, graduating Phi Beta Kappa, and I earned a J.D. from the  
19 University of Michigan Law School in 1979. My curriculum vitae, including a list of my  
20 publications over the last ten years, is attached hereto as Exhibit 1.

21 2. I have served as an expert witness in various cases, including cases in Federal  
22 Court and in Los Angeles Superior Court, and I have served as a Superior Court referee in Los  
23 Angeles and Orange Counties in cases involving damages calculations. I have served as an  
24 expert in the area of damages in many cases, several of which involve media and consumer  
25 behavior, including *Redondo Beach v. Carpenter*, *Sharon Lechter v. Kiyosaki*, and *Digital*  
26 *Jukebox v. Anheuser Busch*. I have testified in several major matters that involve profit  
27 forecasting, including *Country Pine Finance v. Internal Revenue Service* and *Auerbach*

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1 *Associates v. Greg Daily*. A list of my expert testimony experience for the last four years is  
2 attached hereto as Exhibit 2.

## 3 **II. SCOPE OF WORK AND ANALYSIS**

4 3. I have been asked to address the Studios' claims that RealDVD's presence in the  
5 marketplace threatens immediate and irreparable harm to the Studios. Specifically, the Studios  
6 have asserted two broad forms of harm which they allege will arise from the sale of RealDVD:  
7 1) that RealDVD will economically harm the Studios' new and planned channels of distribution  
8 such as "Digital Copy," "Managed Copy," "Burn-to-DVD," via flash drives, and via stand-alone  
9 kiosks, by usurping these future sales opportunities, and 2) that RealDVD will reduce the  
10 Studios' DVD sales by encouraging piracy among consumers, including "rent-rip-return" and  
11 "borrow-rip-return" behavior, whereby consumers make permanent electronic copies of movies  
12 they borrow or rent.

13 4. In addition, I understand that another RealNetworks product named "Facet" has  
14 been added to the case. I further understand that the Studios may claim harm from the presence  
15 of Facet in the market. To the extent that the Studios' claims with respect to Facet are analogous  
16 to their claims with respect to RealDVD, my opinions (expressed in detail below) apply to both  
17 products.

## 18 **III. ALLEGED DAMAGE TO NEW AND PLANNED CHANNELS OF 19 DISTRIBUTION**

20 5. The Studios assert that the presence of the RealDVD product in the marketplace  
21 will negatively impact the profits the Studios expect to earn on new and planned channels of  
22 distribution, including "Digital Copy," "Managed Copy," "Burn-to-DVD," sales made on flash  
23 drives, and sales made via stand-alone kiosks. Furthermore, the Studios allege that projecting  
24 profits from these products would be "premature" because the products are "too new to allow for  
25 a meaningful estimate of revenue to the Studios" and thus the harm would be irreparable.

26 6. To the extent that products or services have not been introduced into the  
27 marketplace, it is indeed difficult to quantify harm associated them. However, such an absence  
28 of meaningful data concerning prices, costs, and consumer demand often exists in lost profits

1 cases, including copyright and patent infringement, trade defamation, and intentional  
 2 interference with prospective economic advantage. I am unaware of any cases where an absence  
 3 of precise quantifiability was an adequate basis for demonstrating irreparable harm. Rather, in  
 4 my experience as a Superior Court Referee and expert witness, courts require only reasonable  
 5 certainty of estimation, not absolute certainty. Indeed, absolute precision in forecasting lost  
 6 profits and damages associated with a non-existent product would impose an essentially  
 7 impossible standard that few plaintiffs and damages experts could ever satisfy.

8 7. Nevertheless, it is my opinion that, to the extent damages exist, if at all, they can  
 9 be quantified by integrating the same four elements that frequently and recurrently are at issue  
 10 when estimating damages resulting from diverted sales. Those elements are:

- 11 (1) The differential in price received by a plaintiff between the lost product  
 12 sales and the actual product sales;
- 13 (2) The attendant costs associated with lost product sales and actual product  
 14 sales to compute lost profits;
- 15 (3) The size of the population subset that engages in behavior leading to  
 16 diverted sales; and
- 17 (4) The quantity of sales diverted by this population subset.

18 8. The price differential element can be determined by comparing the prices at  
 19 which the Studios sell or intend to offer these new and planned services to consumers, to the  
 20 prices the Studios actually receive on the products they sell instead, if any. The Studios' Mr.  
 21 Dunn, for example, discusses the price difference between copies of *What Happens in Vegas*  
 22 with and without Digital Copy—\$23.99 versus \$19.99, respectively.<sup>1</sup> Mr. Dunn also testified  
 23 that a plan entitled “DVD Managed Copy Service Proposal” suggested that the Managed Copy  
 24 service be offered at \$3 retail or \$1.43 for the content owners (i.e., the Studios).<sup>2</sup> I understand  
 25

26 <sup>1</sup> Declaration of Michael Dunn in support of *Ex Parte* Applications of Plaintiffs for  
 27 Temporary Restraining Order and Order to Show Cause re: Preliminary Injunction Thereof (“Dunn  
 Decl.”) at 7:16-19.

28 <sup>2</sup> Deposition of Michael Dunn (December 12, 2008) at 62-3.

1 from Larry Gerbrandt, an expert for RealNetworks, that the Studios likely possess robust data  
2 concerning the price at which they offer or intend to offer these new services. In addition, to the  
3 extent that the Studios are currently offering these new products for sale, I understand from Mr.  
4 Gerbrandt that the Studios likely receive detailed price information from their licensees, for  
5 example for movie downloads sold online. Moreover, services such as RoyaltySource collect  
6 publicly available data regarding license and royalty terms which may be helpful in estimating  
7 the price at which the Studios sell or plan to sell these new services.

8 9. The costs to the Studios associated with the sale or rental of new products can be  
9 readily determined. Detailed cost of goods sold data, as well as related costs, are required to be  
10 maintained under Generally Accepted Accounting Principles ("GAAP") and tax rules. To the  
11 extent that the Studios have begun selling these new products (as in the case of Digital Copy),  
12 these costs can be determined with the Studios' own data. It is my experience that publicly-held  
13 companies like the Studios customarily prepare detailed projections and feasibility studies before  
14 introducing new products. To the extent that new products have yet to be offered by the Studios,  
15 their attendant costs may be estimated by using data from such projections.

16 10. The quantity of RealDVD licensees can also be readily determined; it is my  
17 understanding that RealNetworks tracks each RealDVD download, including both paid  
18 subscriptions and unpaid trial subscriptions. Again, RealNetworks, a publicly-traded company,  
19 is required to maintain records of these sales under GAAP and tax rules; similarly, RealNetworks  
20 will also be required to maintain records of Facet sales.

21 11. Lastly, to the extent that consumers use RealDVD and/or Facet to copy traditional  
22 DVDs rather than purchase the products the Studios are offering or intending to offer, this  
23 number can be determined, if it is even material, by using well-established analytical techniques.  
24 I am aware that the Studios have commissioned studies by outside consultants on consumer  
25 behavior, including LEK, Solutions Research Group, and Futuresource Consulting. I have also  
26 reviewed or am aware of marketing and consumer behavior studies conducted by third parties  
27 such as Kagan SNL, PricewaterhouseCoopers, NPD, and others. Finally, it is my experience that  
28 market surveys can be designed and used to effectively estimate consumer behavior, including

1 the use of products and their features. While such surveys should be treated with caution and  
2 only relied upon if they are methodologically sound, sound surveys can be constructed to  
3 estimate potential damages, if any, that would arise from RealDVD or Facet sales.

#### 4 **IV. ALLEGED DAMAGES ARISING FROM PIRACY**

5 12. The Studios also claim that RealDVD will encourage piracy, including an  
6 increase in the “rent-rip-return” and “borrow-rip-return” behaviors described above, and result in  
7 lower DVD sales. It is my opinion that, to the extent damages exist, if at all, they can be  
8 quantified by integrating the same four elements discussed above.

9 13. One, the price differential element can be determined by comparing the price at  
10 which the Studios sell DVDs to the price earned by the Studios from additional rentals of DVDs,  
11 if any. In his TRO declaration, Mr. Dunn asserts that DVDs were sold at “an average price of  
12 \$18.50” and DVDs were rented at “an average price of \$3.25.”<sup>3</sup> I note that while the retail prices  
13 identified by Mr. Dunn are not a measure of the different prices collected by the Studios, these  
14 retail prices can be readily converted into the Studios’ wholesale prices using data that the  
15 Studios customarily maintain in the ordinary course of business and are required to report under  
16 applicable SEC and tax rules. Moreover, I have reviewed or am aware of data collected by third  
17 parties, such as RoyaltySource and Kagan, which may be helpful in estimating the price at which  
18 the Studios sell or rent DVDs.

19 14. Two, as with the Studios’ nascent or planned distribution methods, the costs to the  
20 Studios associated with the sale or rental of a DVD can be readily determined. Detailed cost of  
21 goods sold data, as well as related costs, are required to be maintained under GAAP and tax  
22 rules. In addition, in my experience, publicly-held companies such as the Studios customarily  
23 prepare detailed product-by-product cost analyses, both on a historical and on a forecasting, or  
24 so-called *pro forma*, basis. Additionally, Mr. Gerbrandt observes that the Studios often track  
25 cost data in order to comply with profit sharing agreements, and receive detailed cost data from  
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27 <sup>3</sup> Dunn Decl. at 9:1-2.  
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1 licensees. Finally, Mr. Gerbrandt notes that the Studios regularly prepare "Ultimates," detailed  
2 reports which contain, among other data, cost information.

3 15. Three, as discussed above, the quantity of RealDVD licensees can also be readily  
4 determined since RealNetworks tracks each RealDVD download, including both paid  
5 subscriptions and unpaid trial subscriptions. Again, RealNetworks, a publicly-traded company,  
6 is required to maintain records of these sales under GAAP and tax rules. Similarly,  
7 RealNetworks will also be required to maintain records of Facet sales.

8 16. Four, the displacement of DVD sales by consumers renting or borrowing rather  
9 than buying DVDs can be determined, if material, by well-established analytical techniques used  
10 by the Studios in internal marketing studies and financial analysis. I am also aware that the  
11 Studios and the MPAA have commissioned numerous studies by outside consultants on the  
12 scope and breadth of the impact of piracy worldwide. These include LEK, Solutions Research  
13 Group, and Futuresource Consulting. In my opinion, performing assessments of worldwide  
14 studio losses to piracy, and determining the amount of piracy on a country by country basis, is a  
15 far more difficult analytical challenge than estimating harm from the possible diversion of DVD  
16 sales by the use of RealDVD or Facet. This is especially true considering the required data,  
17 since the selling prices and rental prices of DVDs, the costs of production, and the number of  
18 RealDVD licensees and sales of Facet are readily known.

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