

1 Datel Holdings Ltd. v. Microsoft Corp., 712 F. Supp. 2d 974 (N.D. Cal. 2010)

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3 ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION TO DISMISS

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5 ELIZABETH D. LAPORTE, United States Magistrate Judge.

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7 Plaintiff Datel Holdings filed this action against Defendant Microsoft for violations of
... Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2, and Section 3 of the Clayton Act,
... 15 U.S.C. § 14, alleging that Defendant unlawfully monopolized the relevant markets for
... the Xbox 360 online video {979} game system and Xbox 360 accessories. ... On January 22,
... 2010, Defendant filed this motion to dismiss, which Plaintiff opposed. ... For the reasons
... stated at the hearing and in this Order, Defendant's motion is granted in part and denied
... in part.

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9 FACTS

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11 Plaintiff, a leading developer of video game enhancement products, develops and
... manufactures aftermarket products for the Xbox 360 video game system. Compl. ¶ 1. One of
... Plaintiff's leading products is a memory card for the Xbox known as the MAX Memory card.
... Id. Plaintiff's two gigabyte MAX Memory card retails for approximately \$39.99. Id.
... Defendant is the only other supplier of memory cards for the Xbox 360. Id. Defendant's
... memory card, which has only 512 megabytes of memory, also retails for approximately
... \$39.99. Id. {979}

12
13 Defendant released the Xbox in 2001, and launched the second generation console, Xbox 360,
... in 2005. Compl. ¶ 11. Various models of the Xbox 360 sell for \$199.99 to \$299.99. Id. In
... addition to the functionality of the Xbox 360, Defendant attracts customers with its Xbox
... Live program, which is a subscription-based online multiplayer gaming service. Id. ¶ 12.
... As of May 2009, Defendant reported more than 20 million active members of Xbox Live. Id.
... {979}

14
15 The Xbox 360 reached the market one year before Sony, Defendant's competitor, released its
... Playstation 3 in November 2006. Compl. ¶ 13. The Xbox 360 continues to control a larger
... share of the market than Sony's Playstation 3. Id. In January 2009, Defendant reported
... that total sales of Xbox 360 had reached 28 million, as compared to 20 million for
... Playstation 3. Id. In May 2009, Defendant's unit sales passed the 30 million mark for the
... Xbox 360, and analysts reported sales of 23 million for the Playstation 3. Id. {979}

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17 There is a considerable aftermarket for Xbox 360 accessories and add-ons, apart from Xbox
... 360 games. Compl. ¶ 14. Plaintiff, which has been developing and manufacturing electronics
... and video game console peripherals since the late 1980s, offers several aftermarket
... products for the Xbox 360:... (2) MAX Memory card (memory cards compatible with the Xbox
... 360 available in 2GB and 4GB versions); [...] {979}

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19 Plaintiff is the only source for Xbox 360-compatible memory cards other than Defendant
... itself. {980}

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23 On October 16, 2009, Defendant issued a notice to Xbox users through a blog entitled
... "Major Nelson." Compl. ¶ 20. The notice stated that when users receive a software update
... in the following week, unauthorized memory cards (such as Plaintiff's) would no longer
... work with the Xbox 360. Id. The blog suggested moving information from an unauthorized
... memory card to an authorized one. Id. {980}

24
25 Defendant informed Plaintiff that the disabling of third party memory cards was an
... unintentional effect of a software update. Compl. ¶ 21. Later, however, Defendant stated
... in an October 23, 2009 article that it goes to great lengths to protect the Xbox service
... from cheating that comes from use of unauthorized memory cards, and that use of those
... cards could cause compatibility and safety issues. Id. The move from unauthorized cards
... has created discussion online, and Plaintiff alleges that Defendant has not explained how
... a larger memory card promotes cheating, nor has it identified a compatibility or safety
... issue between a DMMC and an Xbox console. Id. Plaintiff alleges that Defendant's
... justification for disabling unauthorized memory cards based on cheating is a pretext, and
... that the true purpose behind disablement of the DMMCs is to exclude competition from the
... Xbox 360 aftermarket for memory cards and to force consumers to buy Defendant's memory
... cards. Id. ¶ 24. Plaintiff alleges that there is no benefit to consumers from Defendant's
... decision to target Plaintiff's product that will leave approximately 50,000 consumers with
... useless memory cards, and will forestall innovation and deprive consumers of the benefits
... of competition. Id. at ¶ 3. {980}

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27 [...]

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29 Plaintiff alleges that Defendant's intention is to block the use of Plaintiff's
... competitive devices. Id. Plaintiff alleges that Defendant's update does not constitute an
... improvement of the product, but is instead an arbitrary contrivance intended to perpetuate
... Defendant's market power. Id. at ¶ 4. {980}

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31 RELEVANT MARKETS

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33 Plaintiff alleges that Defendant's anticompetitive conduct has affected two relevant
... product markets: (1) the aftermarket for accessories and add-ons specific to the Xbox
... brand; and (2) the primary market for video game systems that feature multiplayer online
... gaming in addition to personal gaming. Compl. ¶ 26.

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35 AFTERMARKET FOR XBOX 360 ACCESSORIES AND ADD-ONS ("AFTERMARKET")

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37 Plaintiff alleges that the Aftermarket is a relevant market that is wholly derivative of
... and dependent upon the primary market for the Xbox 360 gaming system. {981} Compl. ¶ 27.
... Plaintiff alleges that Defendant dominates this Aftermarket. Id. Defendant's add-ons are
... designed specifically for the Xbox 360 and are not interchangeable with products outside
... the Aftermarket. Id. ¶ 28. Plaintiff alleges that Defendant controls the Aftermarket, and
... has effected policies and practices designed to retain its control, including: (1) tying
... the sale of aftermarket accessories and add-ons to the sale of the Xbox 360 console; (2)
... erecting technological barriers to restrict the interoperability of third party
... accessories and add-ons; (3) using software updates to disable otherwise functional third
... party add-ons and accessories; and (4) using its special access to purchasers of an Xbox
... gaming system to promote its own add-ons and accessories and to advise customers against
... purchasing third party products. Id. ¶ 29.

38
39 Plaintiff alleges that the efficacy of Defendant's techniques is indicated by the fact
... that Plaintiff is the only firm that has been able to overcome Defendant's technical
... barriers and bring to market a competing memory card for the Xbox 360. Compl. ¶ 30.
... Plaintiff alleges that Defendant's market power in the Aftermarket derives from
... Defendant's control over the Xbox 360 hardware and software, and from its special access
... to purchasers of the gaming system, and does not derive from contractual rights that
... consumers knowingly and voluntarily gave Defendant at the time of purchase. Id. ¶ 31.
... Plaintiff alleges that market imperfections have prevented consumers from realizing the

39... impact that their choice in the primary market would have on their freedom in the
... Aftermarket. Id. ¶ 32 (for example, the presence of a USB port in the Xbox 360 console
... suggests to consumers that third party accessories and add-ons would be compatible and
... permissible).

40

41 Plaintiff alleges that Defendant misled customers into a reasonable belief at the time of
... purchasing an Xbox 360 console that third party accessories and add-ons are available.
... Compl. ¶ 33 (for example, Defendant's spokesperson stated that the Xbox 360 "also drives a
... ton of third-party spend," and noted the availability of "a lot of third party
... alternatives."). Plaintiff alleges that Defendant has touted its "accessories attach rate"
... as higher than any other manufacturer, including Sony. Id. ¶ 34. Defendant attributed this
... high rate to customer loyalty and trust. Id. However, Plaintiff alleges that the real
... reason is Defendant's anticompetitive conduct, including tying and predatory design, that
... drives the accessories attach rate. Id.

42

43 Plaintiff alleges that Defendant has used its power in the Aftermarket to charge
... supra-competitive prices. Compl. ¶ 35 (for example, although prices for memory cards in
... general have decreased steadily since 2005, Defendant's proprietary Xbox 360 memory card
... held steady at \$59.99 across a two-year period, until Plaintiff introduced its memory
... card, at which time Defendant reduced its price). Plaintiff alleges that even if there
... were meaningful competition in the primary market for multiplayer online dedicated gaming
... systems, that would not check Defendant's monopoly power in the Aftermarket due to: (1)
... the high switching costs associated with switching gaming systems; (2) the high
... information costs; (3) the large ratio of installed customer base relative to potential
... new customers; and (4) the substantial ability to exploit customers. Id. ¶ 36.

44

45 MULTIPLAYER ONLINE DEDICATED GAMING SYSTEMS MARKET ("ONLINE MARKET")

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47 The Multiplayer Online Dedicated Gaming Systems Market is a specific market for dedicated
... gaming systems with a meaningful capacity for online multiplayer gaming. Compl. ¶ 37.
... Plaintiff alleges that only two systems, the Xbox 360 and 982 *982 the Playstation 3,
... compete in the Online Market. Id. ¶ 37, 42.

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49 [...]

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51 Plaintiff alleges that Defendant enjoys market power within the Online Market. Compl. ¶
... 43. Specifically, sales statistics reported by Defendant establish that the Xbox 360
... console has significantly more total unit sales than the Playstation 3 console. Id.
... Plaintiff alleges that Defendant's share of the Online Market was approximately 66% as of
... July 2009, and that in June 2009, the Xbox 360 outsold the Playstation 3 by approximately
... 1.5 to 1. Id. Plaintiff alleges that this disparity shows that Defendant's market
... dominance is continuing and stable. Id.

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55 LEGAL STANDARD

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59 REQUEST FOR JUDICIAL NOTICE

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63 Defendant seeks judicial notice of three documents: (1) the Xbox 360 "Limited Warranty and

63... Return Information," which includes the Xbox 360 software license; (2) the Xbox Live Terms
... of Use; and (3) a portion of the Xbox 360 console packaging. [...]

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67 The Court takes judicial notice of the existence and content of these documents, though
... not of their legal effect. {984}

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71 DISCUSSION

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73 1. FIRST CLAIM FOR VIOLATION OF SHERMAN ACT BASED ON AFTERMARKET FOR XBOX 360 ACCESSORIES
... AND ADD-ONS

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75 Plaintiff alleges that Defendant possesses substantial market power in the secondary
... Aftermarket, or that a dangerous probability exists that Defendant will gain such power,
... and that Defendant has deployed that power to charge customers supra-competitive prices in
... the Aftermarket.

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77 [...]

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79 Defendant argues that Plaintiff's first claim should be dismissed on the ground that
... Plaintiff has failed to plead a legally cognizable Aftermarket because Plaintiff cannot
... pursue antitrust claims based on a single-brand market. In general, single brand markets
... do not constitute a relevant market. ... However, there is an exception where aftermarket
... restrictions are not disclosed or agreed to by the customers at the time of purchase of a
... product or service from the primary market. See Eastman Kodak Co. v. Image Tech. Servs.,
... 504 U.S. 451, 112 S.Ct. 2072, 119 L.Ed.2d 265 (1992). {986}

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81 [...]

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83 Defendant argues that the Kodak exception does not apply because purchasers of the Xbox
... 360 knew and agreed at the time they purchased their systems that they could only use
... Defendant's authorized accessories with their systems. Thus, Defendant argues that its
... power in the market derives from contract, not from exclusionary conduct, so Eastman Kodak
... does not apply. ... The Newcal court stated:

84

85 The critical distinction between Eastman Kodak and the two circuit court opinions ... was
... that the Kodak customers did {987} not knowingly enter a contract that gave Kodak the
... exclusive right to provide parts and service for the life of the equipment. ... In In re
... Apple, the court stated: "Ultimately, the dispositive issue is whether Plaintiffs
... knowingly placed Defendants in a monopoly position in the alleged voice and data services
... aftermarket." Id. Therefore, to establish a single-brand aftermarket under Kodak and
... Newcal, the restriction in the aftermarket must not have been sufficiently disclosed to
... consumers in advance to enable them to bind themselves to the restriction knowingly and
... voluntarily.

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87 [...]

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89 Defendant argues that this case is more like Queen City Pizza, Forsyth, and Psystar, than
... Kodak, Newcal, and In re Apple, because Xbox purchasers knowingly gave Defendant the right
... to prohibit the use of unauthorized accessories through the warranty and software license
... that is included in the Xbox 360 packaging, as well as through the Xbox Live Terms of Use.

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91 The shrinkwrap license in the packaging states: "The software included in the Xbox product
... [Xbox 360 Video Game System or Xbox 360-compatible hardware accessories manufactured by or
... for Defendant whether included or purchased separately] is licensed to you, not sold. You
... are licensed to use such software only in your Xbox product and you may not reverse
... engineer it, except as expressly permitted by applicable law notwithstanding this
... limitation." Def.'s RJN Ex. A at 7.

92
93 This language, however, is arguably ambiguous. Further, it may not be applicable to using
... external accessories to boost memory, which may not involve a prohibited use of the
... software and does not constitute reverse engineering.

94
95 Defendant also points to the Xbox Live Terms of Use presented to consumers when they sign
... up for the service, which requires customers to "agree that you are using only authorized
... software and hardware to access the Service." Def.'s RJN Ex. B at 10. But this language is
... also arguably ambiguous in that use of accessories such as a memory card is not
... necessarily "using . . . software and hardware" to access the service. The Terms of Use
... also permit Defendant to, among other things, issue automatic software updates to prevent
... a customer from using unauthorized hardware peripheral devices. See *id.* at 10-11. However,
... this statement is somewhat ambiguous with respect to the meaning of peripheral device
... because the phrase is used earlier in the same paragraph to refer to devices used to log
... on to the Service, which may not include accessories such as memory cards. Further, the
... Terms of Use could not have informed a customer's purchasing decision because the Xbox
... Live is a separate optional service that a user may join after purchasing the Xbox 360.
... See Def.'s RJN Ex. C.

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97 Plaintiff argues that customers did not knowingly agree at the time of purchase that their
... use of aftermarket accessories would be restricted.

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99 [...]

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101 Plaintiff argues that the Warranty could not have been discovered by consumers until the
... box was opened, and that therefore, a consumer could not have knowingly and voluntarily
... accepted it prior to purchase. See *Opp.* at 7. The weight of authority, however, including
... in this district, is that shrinkwrap licenses are enforceable.

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103 [...]

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105 Plaintiff argues that Defendant's interpretation of the definition of "Xbox Product" in
... the Warranty is not reasonable. Xbox Product is defined as:

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107 either (1) the Microsoft Xbox 360 Video Game System console including the Microsoft
... software stored on the separate Xbox 360 hard disk and/or embedded in the microprocessors
... within the Xbox 360 console; or (2) Microsoft branded Xbox 360-compatible hardware
... accessories manufactured by or for Microsoft whether included with the console or
... purchased separately.

108
109 According to Plaintiff, only by reading the definition in the conjunctive can Defendant
... support the argument that the Warranty language prohibits unauthorized third party
... accessories. . . . At the very least, Plaintiff has shown an ambiguity in the relevant
... contract language which counsels against granting a motion to dismiss premised on
... Defendant's contested interpretation of the provision, which customers may not have
... understood.

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113 In the absence of a clearly binding contractual restriction on the market, Plaintiff
... points to the factors applied by the Newcal court to determine whether a consumer's
... selection of a brand in the market is the functional equivalent of a contractual
... commitment, or instead allows the plaintiff to pursue a claim based on a single-product
... aftermarket as in Kodak. ... Fourth, the complaint here, as in Newcal, alleges that
... Defendant's representations and market imperfections lead its customers to mistakenly
... believe that they will be free to shop in the Aftermarket despite their choice in the
... primary market. On balance, the Newcal factors weigh in favor of denying the motion to
... dismiss this claim. Viewing the allegations in the light most favorable to Plaintiff, and
... because contract ambiguities are interpreted against the drafter (see Cal.Civ.Code §
... 1654), shopping for competing products in the Aftermarket is not clearly precluded by any
... contractual provision into which customers knowingly and voluntarily entered. Therefore,
... Defendant's motion to dismiss the first claim is denied.

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115 2. SECOND CLAIM FOR VIOLATION OF SHERMAN ACT BASED ON MULTIPLAYER ONLINE DEDICATED GAMING
... SYSTEMS MARKET

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119 3. THIRD CLAIM FOR VIOLATION OF SHERMAN ACT BASED ON TYING

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123 Here, Plaintiff alleges that Defendant's share of the Online Market was approximately 66%
... as of July 2009. ... Defendant allegedly ties the sale of Xbox 360 consoles to accessory
... products, including memory cards, by implementing the dashboard update that conditioned
... use of the Xbox 360 system on purchasing memory cards solely from Defendant.

124

125 Plaintiff alleges that the tying arrangement harms competition in the Aftermarket in many
... ways, including by ... "forcing consumers, who would otherwise prefer third-party
... accessories and add-ons for the Xbox 360, including the DMMCs and other Datel accessories,
... to nonetheless use Microsoft's accessories and add-ons." Plaintiff alleges that ... the
... tying arrangement affects a substantial volume of interstate commerce. Accordingly, to the
... extent that there is a lower threshold to support the market power requirement for
... purposes of a tying claim, Plaintiff has met that threshold.

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127 [...]

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129 Viewing the allegations in the light most favorable to Plaintiff, Plaintiff has adequately
... pled a per se tying claim. For all of the reasons stated above, Defendant's motion to
... dismiss Plaintiff's tying claim based on the viability of the primary market is denied.

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133 4. FOURTH AND FIFTH CLAIMS FOR UNFAIR COMPETITION

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135 [...] Because at least one of Plaintiff's Sherman Act claims survive dismissal,
... Plaintiff's unfair competition claims also survive.

136

137 CONCLUSION

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139 Defendant's motion to dismiss is granted in part with leave to amend and denied in part.

139... [...]

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141 IT IS SO ORDERED.