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A Nintendo Labyrinth Filled With Lawyers, Not Dragons

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A flurry of lawsuits, started by a small American software developer, now surrounds the Nintendo Entertainment System, the best-selling toy in the United States last year.

At issue is whether the Atari Games Corporation can manufacture cartridges for use on the Nintendo system without permission from the Nintendo Company of Japan.

The Nintendo system, which consists of a control deck that plugs into a television set, went on sale in 1985 and in the last two years has exploded into a craze among young people. The games, played with a handheld "joystick" that manipulates on-screen images, generally feature hero figures who fight and finesse their way through treacherous medieval and futuristic kingdoms filled with fire-breathing dragons, hammer-swinging turtles and other unwholesome types.

What distinguishes them from an earlier generation of video games is their consistently challenging and complex nature.

The system has been so successful that Nintendo commands 75 to 80 percent of the home video game market. Atari Games also makes coin-operated video machines, and its subsidiary, Tengen Inc., has a tiny share of the video game software market with the games it made for the Nintendo system.

Atari Games and Tengen sued Nintendo in December under antitrust laws; Nintendo countersued for breach of contract and patent and trademark infringement. With legal maneuvering expected to continue through the summer and fall, the suits are scheduled to come to trial in November in United States District Court in San Francisco.

Nintendo argues that its success rests on complete control of the quality and manufacturing of software. It maintains that control through strict contracts with software companies that develop the games and by placing a "lockout" chip in its hardware that prevents all but Nintendo-authorized games from playing on the system. 'Not the Way Business Is Done'

Atari Games argues that Nintendo's high degree of control is tantamount to monopoly, and is suing Nintendo for antitrust violations.

"Let's say you buy a Ford, and the company says, 'If you buy a Ford automobile from us, you have to buy Ford gas,'" said Dennis Wood, a senior vice president of Atari Games. "That's not the way business is done."

The Atari Corporation, which makes home video game hardware and was once part of the same company as Atari Games, has also sued Nintendo for antitrust violations. The suit does not directly involve the question of what software can be used on the Nintendo system, and industry experts say the suit is of far less consequence than those involving Atari Games.

Nintendo officials defend their use of "closed architecture" on their hardware.

"It was the only way we could assure that there would be consistent, quality software," said Howard Lincoln, senior vice president of Nintendo. "We made a choice and it turns out that our choice was the correct one, to achieve the kind of success that we have."

Nintendo has young Americans and their parents by the millions streaming into toy stores to buy games like Super Mario Brothers II and Mike Tyson's Punchout. The games, which cost \$25 to \$40, typically sell out within days, sometimes minutes, after appearing on the shelves. The control deck costs about \$100.

Nintendo has also been shrewd in its marketing strategy. To head off consumer boredom, it has treated the games like movies, carefully monitoring their sales and pulling them from the market at the first indication of a slowdown. It also publishes a magazine about the system, and its circulation is more than a million. The magazine offers tips on playing the games and profiles of teen-age Nintendo whizzes.

The payoff has been huge. The Nintendo system and games had sales of \$1.7 billion last year; sales for 1989 are estimated at \$2.6 billion. Struggle Began in 1987

The struggle between Atari Games and Nintendo began in 1987, shortly after Atari Games, based in Malpitas, Calif., established Tengen to become an authorized game developer for Nintendo.

The video games that play on Nintendo are created both by Nintendo itself and by 39 software development companies in the United States and Japan. The contracts with those companies specify the number of games they can develop each year and give Nintendo the right to reject any that do not meet its quality standards.

If Nintendo accepts the game, it manufactures the cartridges in Japan and then sells them to the developer, which in turn sells them to toy and computer stores.

But Tengen soon found that the demand for Nintendo games at stores it supplied far outstripped the relatively small quota of games that they say Nintendo allotted to them.

"We could only get less than 10 percent of our customers' demand," said Randy Broweleit, senior vice president for operations at Tengen. "They've created an illusion of a chip shortage. They are keeping supply low to keep prices high." 'Absolute Nonsense'

Nintendo officials vigorously deny that the chip shortage is an excuse.

"It's absolute nonsense that we've ever tried to control the quantity of cartridge allocations," Mr. Lincoln said. "We don't like to be in that position, and we've tried our best to be fair and equitable" to its licensees after the shortage developed.

Last year Atari engineers created software that circumvented Nintendo's lockout system, thus allowing Tengen games to play on the Nintendo system. Tengen then shipped the games to toy retailers around the United States.

Since Tengen began shipping its unauthorized cartridges late last year, Mr. Broweleit said, Tengen has increased its sales by 40 percent, and it hopes to double its yearly revenues, from \$35 million last year to \$70 million in 1989.

Atari says that to bypass the lockout chip it used "reverse engineering" that did not violate Nintendo's patent. The truth of this assertion is a major issue in the lawsuits.

Antitrust lawyers not involved in the matter said that at this stage it is not clear which side has the stronger case. They added that while a company with a 75 to 80 percent market share is generally presumed to be a monopoly, it is the use of monopoly power, not its simple existence, that is the issue.

Nintendo executives, as well as those of many software development companies still under contract, say that Nintendo's business strategy is not monopolistic, simply shrewd and effective.

The company's disciplined business strategy, they say, is the main reason for its enormous success, first in

Japan in the early 1980's, then in the United States. Lacking Discipline

American companies destroyed the \$3 billion-a-year home video business they had built in the early 1980's, Nintendo's defenders say, precisely because they lacked such discipline.

Instead, hoping to cash in on the boom, video game manufacturers flooded the market with cheap, poor-quality cartridges. Consumers grew disenchanted, and in 1985 only \$100 million worth of home video games were sold.

"Anyone in the Nintendo business who is rooting for Tengen doesn't understand the business," said Robert Holmes, chief operating officer for Acclaim, a Long Island-based company that develops Nintendo games. "Nintendo is trying to make this into a category, not a fad, where video gaming becomes another part of our entertainment life."

Mr. Broweleit said that Tengen, like the rest of the industry, had learned the lessons of the earlier bust, and that his company was determined not to glut the market.

Sean McGowan, a toy industry analyst for Balis Zorn Gerard, said Nintendo does intentionally keep its supply of game cartridges low to maintain interest in the games.

"The scarcer something is, the more status gets attached to having it," Mr. McGowan said. "You've got to keep them scarce. Toy companies realize this but rarely have the discipline to maintain that scarcity." Chip Shortage Called Real

Still, Mr. McGowan added, he believed that Nintendo was being truthful about its declaration of a chip shortage.

"Demand is far higher than they thought it would be, and they would like to see a lot more shipped," he said. "It's their strategy to undership demand, but this is ridiculous."

A verdict against Nintendo might prohibit the company's use of the lockout chip in its control decks, creating opportunities for any independent software developer who wished to create games for use on the Nintendo machine.

A verdict in favor of Nintendo would probably have a spillover effect into the personal computer industry, where it could have a chilling effect on the free flow of ideas and innovations that have characterized that market since its inception about a decade ago, software industry spokesmen say.

"We don't want any computer company to ever get the idea that what Nintendo is doing would be acceptable practice in the computer business," said Ken Wasch, executive director of the Software Publishers Association in Washington. "Software is an intellectual property that thrives in an unrestricted environment. No one in the world believes that any one company could come up with all the creative applications that a video game system could come up with."

Mr. Wasch said that the home video game industry should, ideally, follow the model of the personal computer industry, where computers can generally operate dozens of different brands of software, and manufacturers generally encourage as many software developers as possible to create programs compatible with their machines.