

# ELECTRONIC ARTS INC

## FORM 10-Q (Quarterly Report)

Filed 8/6/2007 For Period Ending 6/30/2007

|             |                                                              |
|-------------|--------------------------------------------------------------|
| Address     | 209 REDWOOD SHORES PARKWAY<br>REDWOOD CITY, California 94065 |
| Telephone   | 650-628-1500                                                 |
| CIK         | 0000712515                                                   |
| Industry    | Software & Programming                                       |
| Sector      | Technology                                                   |
| Fiscal Year | 03/31                                                        |

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended June 30, 2007**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 0-17948**

**ELECTRONIC ARTS INC.**

*( Exact name of registrant as specified in its charter )*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**94-2838567**

*(I.R.S. Employer  
Identification No.)*

**209 Redwood Shores Parkway  
Redwood City, California**

*(Address of principal executive offices)*

**94065**

*(Zip Code)*

**(650) 628-1500**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

As of August 2, 2007, there were 311,938,373 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

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**ELECTRONIC ARTS INC.**  
**FORM 10-Q**  
**FOR THE PERIOD ENDED JUNE 30, 2007**

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## PART I – FINANCIAL INFORMATION

### Item 1. Condensed Consolidated Financial Statements (Unaudited)

#### ELECTRONIC ARTS INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

| (Unaudited)<br>(In millions, except par value data)                                                              | June 30,<br>2007       | March 31,<br>2007 (a)  |
|------------------------------------------------------------------------------------------------------------------|------------------------|------------------------|
| <b>ASSETS</b>                                                                                                    |                        |                        |
| Current assets:                                                                                                  |                        |                        |
| Cash and cash equivalents                                                                                        | \$ 663                 | \$ 1,371               |
| Short-term investments                                                                                           | 1,526                  | 1,264                  |
| Marketable equity securities                                                                                     | 660                    | 341                    |
| Receivables, net of allowances of \$176 and \$214, respectively                                                  | 123                    | 256                    |
| Inventories                                                                                                      | 74                     | 62                     |
| Deferred income taxes, net                                                                                       | 97                     | 84                     |
| Other current assets                                                                                             | 252                    | 219                    |
| Total current assets                                                                                             | 3,395                  | 3,597                  |
| Property and equipment, net                                                                                      | 494                    | 484                    |
| Investments in affiliates                                                                                        | 33                     | 6                      |
| Goodwill                                                                                                         | 736                    | 734                    |
| Other intangibles, net                                                                                           | 196                    | 210                    |
| Deferred income taxes, net                                                                                       | 66                     | 25                     |
| Other assets                                                                                                     | 105                    | 90                     |
| <b>TOTAL ASSETS</b>                                                                                              | <b><u>\$ 5,025</u></b> | <b><u>\$ 5,146</u></b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                      |                        |                        |
| Current liabilities:                                                                                             |                        |                        |
| Accounts payable                                                                                                 | \$ 119                 | \$ 180                 |
| Accrued and other current liabilities                                                                            | 415                    | 814                    |
| Deferred net revenue (packaged goods and digital content)                                                        | 68                     | 32                     |
| Total current liabilities                                                                                        | 602                    | 1,026                  |
| Income tax obligations                                                                                           | 283                    | —                      |
| Deferred income taxes, net                                                                                       | 7                      | 8                      |
| Other liabilities                                                                                                | 80                     | 80                     |
| Total liabilities                                                                                                | 972                    | 1,114                  |
| Commitments and contingencies (See Note 9)                                                                       |                        |                        |
| Stockholders' equity:                                                                                            |                        |                        |
| Preferred stock, \$0.01 par value. 10 shares authorized                                                          | —                      | —                      |
| Common stock, \$0.01 par value. 1,000 shares authorized; 312 and 311 shares issued and outstanding, respectively | 3                      | 3                      |
| Paid-in capital                                                                                                  | 1,480                  | 1,412                  |
| Retained earnings                                                                                                | 2,209                  | 2,323                  |
| Accumulated other comprehensive income                                                                           | 361                    | 294                    |
| Total stockholders' equity                                                                                       | 4,053                  | 4,032                  |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                | <b><u>\$ 5,025</u></b> | <b><u>\$ 5,146</u></b> |

See accompanying Notes to Condensed Consolidated Financial Statements.

(a) Derived from audited financial statements.

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### ELECTRONIC ARTS INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| (Unaudited)<br>(In millions, except per share data) | Three Months Ended<br>June 30, |                |
|-----------------------------------------------------|--------------------------------|----------------|
|                                                     | 2007                           | 2006           |
| Net revenue                                         | \$ 395                         | \$ 413         |
| Cost of goods sold                                  | <u>166</u>                     | <u>168</u>     |
| Gross profit                                        | 229                            | 245            |
| Operating expenses:                                 |                                |                |
| Marketing and sales                                 | 82                             | 77             |
| General and administrative                          | 71                             | 59             |
| Research and development                            | 250                            | 216            |
| Amortization of intangibles                         | 7                              | 6              |
| Restructuring charges                               | <u>2</u>                       | <u>6</u>       |
| Total operating expenses                            | <u>412</u>                     | <u>364</u>     |
| Operating loss                                      | (183)                          | (119)          |
| Interest and other income, net                      | <u>27</u>                      | <u>21</u>      |
| Loss before benefit from income taxes               | (156)                          | (98)           |
| Benefit from income taxes                           | <u>(24)</u>                    | <u>(17)</u>    |
| Net loss                                            | <u>\$ (132)</u>                | <u>\$ (81)</u> |
| Net loss per share:                                 |                                |                |
| Basic and Diluted                                   | \$ (0.42)                      | \$ (0.26)      |
| Number of shares used in computation:               |                                |                |
| Basic and Diluted                                   | 311                            | 306            |

See accompanying Notes to Condensed Consolidated Financial Statements.

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### ELECTRONIC ARTS INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| (Unaudited)<br>(In millions)                                                | Three Months Ended<br>June 30, |                 |
|-----------------------------------------------------------------------------|--------------------------------|-----------------|
|                                                                             | 2007                           | 2006            |
| <b>OPERATING ACTIVITIES</b>                                                 |                                |                 |
| Net loss                                                                    | \$ (132)                       | \$ (81)         |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                |                 |
| Depreciation, amortization and accretion                                    | 36                             | 35              |
| Stock-based compensation                                                    | 28                             | 37              |
| Change in assets and liabilities:                                           |                                |                 |
| Receivables, net                                                            | 138                            | 159             |
| Inventories                                                                 | (10)                           | 3               |
| Other assets                                                                | (45)                           | 12              |
| Accounts payable                                                            | (74)                           | (50)            |
| Accrued and other liabilities                                               | (133)                          | (142)           |
| Deferred income taxes, net                                                  | (36)                           | (11)            |
| Deferred net revenue (packaged goods and digital content)                   | 36                             | —               |
| Net cash used in operating activities                                       | <u>(192)</u>                   | <u>(38)</u>     |
| <b>INVESTING ACTIVITIES</b>                                                 |                                |                 |
| Capital expenditures                                                        | (14)                           | (38)            |
| Purchase of marketable equity securities and investments in affiliates      | (277)                          | —               |
| Proceeds from maturities and sales of short-term investments                | 641                            | 196             |
| Purchase of short-term investments                                          | <u>(897)</u>                   | <u>(147)</u>    |
| Net cash provided by (used in) investing activities                         | <u>(547)</u>                   | <u>11</u>       |
| <b>FINANCING ACTIVITIES</b>                                                 |                                |                 |
| Proceeds from issuance of common stock                                      | 18                             | 37              |
| Excess tax benefit from stock-based compensation                            | 8                              | 4               |
| Repayment of note assumed in connection with acquisition                    | <u>—</u>                       | <u>(14)</u>     |
| Net cash provided by financing activities                                   | <u>26</u>                      | <u>27</u>       |
| Effect of foreign exchange on cash and cash equivalents                     | 5                              | 6               |
| Increase (decrease) in cash and cash equivalents                            | (708)                          | 6               |
| Beginning cash and cash equivalents                                         | 1,371                          | 1,242           |
| Ending cash and cash equivalents                                            | 663                            | 1,248           |
| Short-term investments                                                      | <u>1,526</u>                   | <u>983</u>      |
| Ending cash, cash equivalents and short-term investments                    | <u>\$ 2,189</u>                | <u>\$ 2,231</u> |
| <b>Supplemental cash flow information:</b>                                  |                                |                 |
| Cash paid during the period for income taxes                                | <u>\$ 24</u>                   | <u>\$ 27</u>    |
| <b>Non-cash investing activities:</b>                                       |                                |                 |
| Change in unrealized gains on investments, net                              | <u>\$ 66</u>                   | <u>\$ 6</u>     |

See accompanying Notes to Condensed Consolidated Financial Statements.

**ELECTRONIC ARTS INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**(1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION**

We develop, market, publish and distribute interactive software games that are playable by consumers on video game consoles (such as the Sony PlayStation<sup>®</sup> 2 and PLAYSTATION<sup>®</sup> 3, Microsoft Xbox 360<sup>™</sup> and Nintendo Wii<sup>™</sup>), personal computers, mobile platforms (including cellular handsets and handheld game players such as the PlayStation<sup>®</sup> Portable (“PSP<sup>™</sup>”) and the Nintendo DS<sup>™</sup>) and online (over the Internet and other proprietary online networks). Some of our games are based on content that we license from others (e.g., Madden NFL Football, Harry Potter and FIFA Soccer), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims<sup>™</sup> and Need for Speed<sup>™</sup>). Our goal is to publish titles with mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game “franchises” that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (e.g., Madden NFL Football, NCAA<sup>®</sup> Football and FIFA Soccer), wholly-owned properties that can be successfully sequeled (e.g., The Sims, Need for Speed and Battlefield) and titles based on long-lived literary and/or movie properties (e.g., Lord of the Rings and Harry Potter).

The Condensed Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal recurring accruals unless otherwise indicated) that, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The preparation of these Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the amounts reported in these Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates. The results of operations for the current interim periods are not necessarily indicative of results to be expected for the current year or any other period.

Certain prior-year amounts have been reclassified to conform to the fiscal 2008 presentation.

These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2007, as filed with the United States Securities and Exchange Commission (“SEC”) on May 30, 2007.

**(2) FISCAL YEAR AND FISCAL QUARTER**

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ended March 31, 2008 and 2007 contain 52 weeks and end on March 29, 2008 and March 31, 2007, respectively. Our results of operations for the fiscal quarters ended June 30, 2007 and 2006 contain 13 weeks and ended on June 30, 2007 and July 1, 2006, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

**(3) FINANCIAL INSTRUMENTS**

***Marketable Equity Securities***

Our investments in marketable equity securities consist of investments in common stock of publicly traded companies.

In May 2007, we entered into a licensing agreement with and made a strategic equity investment in The9 Limited (“The9”), a leading online game operator in China. We purchased approximately 15 percent of the outstanding common shares (representing 15 percent of the voting rights at that time) of The9 for approximately \$167 million. Our agreement with The9 requires us to hold these common shares until May 2008. The licensing agreement gives The9 exclusive publishing rights for EA SPORTS<sup>™</sup> FIFA Online in mainland China. As of June 30, 2007, our ownership and voting right percentage remained unchanged.

In April 2007, we expanded our commercial agreements with, and made strategic equity investments in, Neowiz Corporation and a related online gaming company, Neowiz Games. Based in Korea, Neowiz is an online media and gaming company with

which we partnered in 2006 to launch *EA SPORTS FIFA Online* in Korea. We purchased 15 percent of the then-outstanding common shares (representing 15 percent of the voting rights at that time) of Neowiz Corporation and 15 percent of the outstanding common shares (representing 15 percent of the voting rights at the time) of Neowiz Games, for approximately \$83 million. We refer to Neowiz Corporation and Neowiz Games collectively as “Neowiz”. As of June 30, 2007, we owned approximately 15 percent of the outstanding common shares (representing 15 percent of the voting rights) of Neowiz. As discussed below, we also purchased preferred shares of Neowiz which we classified as investments in affiliates on our Condensed Consolidated Balance Sheets.

***Investments in Affiliates***

In April 2007, we also purchased all of the outstanding preferred shares of Neowiz for approximately \$27 million. The preferred shares, which do not have any voting rights, are convertible into approximately 4 percent of the outstanding common shares of Neowiz (representing 4 percent of the voting rights at the time) after a period of 12 months. We account for our investment in Neowiz under the cost method as prescribed by Accounting Principles Board Opinion (“APB”) No. 18, as amended “*The Equity Method of Accounting for Investments in Common Stock*”.

**(4) GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill information is as follows (in millions):

|          | As of<br>March 31,<br>2007 | Goodwill<br>Acquired | Effects of<br>Foreign<br>Currency<br>Translation | As of<br>June 30,<br>2007 |
|----------|----------------------------|----------------------|--------------------------------------------------|---------------------------|
| Goodwill | \$ 734                     | \$ —                 | \$ 2                                             | \$ 736                    |

Finite-lived intangibles consist of the following (in millions):

|                                   | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Other  | Other<br>Intangibles,<br>Net |
|-----------------------------------|-----------------------------|-----------------------------|--------|------------------------------|
| <b>As of June 30, 2007</b>        |                             |                             |        |                              |
| Developed and Core Technology     | \$ 183                      | \$ (71)                     | \$ —   | \$ 112                       |
| Carrier Contracts and Related     | 85                          | (24)                        | —      | 61                           |
| Trade Name                        | 44                          | (24)                        | —      | 20                           |
| Subscribers and Other Intangibles | 16                          | (12)                        | (1)    | 3                            |
| Total                             | \$ 328                      | \$ (131)                    | \$ (1) | \$ 196                       |
| <b>As of March 31, 2007</b>       |                             |                             |        |                              |
| Developed and Core Technology     | \$ 183                      | \$ (62)                     | \$ —   | \$ 121                       |
| Carrier Contracts and Related     | 85                          | (19)                        | —      | 66                           |
| Trade Name                        | 44                          | (24)                        | —      | 20                           |
| Subscribers and Other Intangibles | 16                          | (12)                        | (1)    | 3                            |
| Total                             | \$ 328                      | \$ (117)                    | \$ (1) | \$ 210                       |

Amortization of intangibles for the three months ended June 30, 2007 and 2006 was \$14 million (of which \$7 million was recognized as cost of goods sold) and \$12 million (of which \$6 million was recognized as cost of goods sold), respectively. Finite-lived intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from two to twelve years. As of June 30, 2007 and March 31, 2007, the weighted-average remaining useful life for finite-lived intangible assets was approximately 6.3 years.

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As of June 30, 2007, future amortization of finite-lived intangibles that will be recorded in cost of goods sold and operating expenses is estimated as follows (in millions):

|                              |               |
|------------------------------|---------------|
| Fiscal Year Ending March 31, |               |
| 2008 (remaining nine months) | \$ 38         |
| 2009                         | 41            |
| 2010                         | 34            |
| 2011                         | 29            |
| 2012                         | 9             |
| Thereafter                   | 45            |
| Total                        | <u>\$ 196</u> |

### (5) RESTRUCTURING CHARGES

Restructuring information as of June 30, 2007 was as follows (in millions):

|                               | Fiscal 2006 International<br>Publishing Reorganization |                        |             | Fiscal 2006, 2004, 2003<br>and 2002 Restructurings |                        |              |
|-------------------------------|--------------------------------------------------------|------------------------|-------------|----------------------------------------------------|------------------------|--------------|
|                               | Workforce                                              | Facilities-<br>related | Other       | Workforce                                          | Facilities-<br>related | Total        |
| Balances as of March 31, 2006 | \$ 1                                                   | \$ 8                   | \$ 2        | \$ 3                                               | \$ 7                   | \$ 21        |
| Charges to operations         | 10                                                     | 1                      | 4           | —                                                  | —                      | 15           |
| Charges utilized in cash      | (11)                                                   | —                      | (5)         | (3)                                                | (7)                    | (26)         |
| Balances as of March 31, 2007 | —                                                      | 9                      | 1           | —                                                  | —                      | 10           |
| Charges to operations         | 2                                                      | —                      | —           | —                                                  | —                      | 2            |
| Charges utilized in cash      | (1)                                                    | —                      | (1)         | —                                                  | —                      | (2)          |
| Balances as of June 30, 2007  | <u>\$ 1</u>                                            | <u>\$ 9</u>            | <u>\$ —</u> | <u>\$ —</u>                                        | <u>\$ —</u>            | <u>\$ 10</u> |

#### *Fiscal 2006 International Publishing Reorganization*

In November 2005, we announced plans to establish an international publishing headquarters in Geneva, Switzerland. Through the quarter ended September 30, 2006, we relocated certain employees to our new facility in Geneva, closed certain facilities in the United Kingdom, and made other related changes in our international publishing business.

Since the inception of the restructuring plan, through June 30, 2007, we have incurred restructuring charges of approximately \$31 million, of which \$15 million was for employee-related expenses, \$9 million for the closure of certain United Kingdom facilities, and \$7 million in other costs in connection with our international publishing reorganization. The restructuring accrual of \$10 million as of June 30, 2007 is expected to be utilized by March 2017. This accrual is included in other accrued expenses presented in Note 7 of the Notes to Condensed Consolidated Financial Statements.

In connection with our fiscal 2006 international publishing reorganization, in fiscal 2008, we expect to incur between \$5 million and \$10 million of restructuring costs. Overall, including charges incurred through June 30, 2007, we expect to incur between \$50 million and \$55 million of restructuring costs in connection with our fiscal 2006 international publishing reorganization, substantially all of which will result in cash expenditures by 2017. These restructuring costs will consist primarily of employee-related relocation assistance (approximately \$30 million), facility exit costs (approximately \$15 million), as well as other reorganization costs (approximately \$7 million).

### (6) ROYALTIES AND LICENSES

Our royalty expenses consist of payments to (1) content licensors, (2) independent software developers, and (3) co-publishing and distribution affiliates. License royalties consist of payments made to celebrities, professional sports organizations, movie studios and other organizations for our use of their trademarks, copyrights, personal publicity rights, content and/or other intellectual property. Royalty payments to independent software developers are payments for the development of intellectual

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property related to our games. Co-publishing and distribution royalties are payments made to third parties for the delivery of product.

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally in connection with the development of a particular product and, therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally amortized to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of goods sold.

Our contracts with some licensors include minimum guaranteed royalty payments which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Minimum royalty payment obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of June 30, 2007 and March 31, 2007, approximately \$17 million and \$9 million, respectively, of minimum guaranteed royalty obligations had been recognized in each period and are included in the royalty-related assets and liabilities tables below.

Each quarter, we also evaluate the future realization of our royalty-based assets as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. In either case, we rely on estimated revenue to evaluate the future realization of prepaid royalties and commitments. If actual sales or revised revenue estimates fall below the initial revenue estimate, then the actual charge taken may be greater in any given quarter than anticipated. During the three months ended June 30, 2007, we recognized impairment charges of less than \$1 million. We had no impairments during the three months ended June 30, 2006.

The current and long-term portions of prepaid royalties and minimum guaranteed royalty-related assets, included in other current assets and other assets, consisted of (in millions):

|                        | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 |
|------------------------|---------------------------|----------------------------|
| Other current assets   | \$ 109                    | \$ 69                      |
| Other assets           | 45                        | 40                         |
| Royalty-related assets | <u>\$ 154</u>             | <u>\$ 109</u>              |

At any given time, depending on the timing of our payments to our co-publishing and/or distribution affiliates, content licensors and/or independent software developers, we recognize unpaid royalty amounts owed to these parties as either accounts payable or accrued liabilities. The current and long-term portions of accrued royalties, included in accrued and other current liabilities as well as other liabilities, consisted of (in millions):

|                                       | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 |
|---------------------------------------|---------------------------|----------------------------|
| Accrued and other current liabilities | \$ 89                     | \$ 91                      |
| Other liabilities                     | 10                        | 3                          |
| Royalty-related liabilities           | <u>\$ 99</u>              | <u>\$ 94</u>               |

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In addition, as of June 30, 2007, we were committed to pay approximately \$1,514 million to content licensors and co-publishing and/or distribution affiliates, but performance remained with the counterparty (i.e., delivery of the product or content or other factors) and such commitments were therefore not recorded in our Condensed Consolidated Financial Statements. See Note 9 of the Notes to Condensed Consolidated Financial Statements.

### (7) BALANCE SHEET DETAILS

#### *Inventories*

Inventories as of June 30, 2007 and March 31, 2007 consisted of (in millions):

|                                                    | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 |
|----------------------------------------------------|---------------------------|----------------------------|
| Raw materials and work in process                  | \$ 10                     | \$ 1                       |
| Finished goods (including manufacturing royalties) | 64                        | 61                         |
| Inventories                                        | <u>\$ 74</u>              | <u>\$ 62</u>               |

A significant amount of our inventory balance relates to our distribution business in Switzerland.

#### *Property and Equipment, Net*

Property and equipment, net, as of June 30, 2007 and March 31, 2007 consisted of (in millions):

|                                          | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 |
|------------------------------------------|---------------------------|----------------------------|
| Computer equipment and software          | \$ 575                    | \$ 555                     |
| Buildings                                | 206                       | 194                        |
| Leasehold improvements                   | 114                       | 110                        |
| Office equipment, furniture and fixtures | 72                        | 70                         |
| Land                                     | 66                        | 65                         |
| Warehouse equipment and other            | 10                        | 10                         |
| Construction in progress                 | 19                        | 10                         |
|                                          | <u>1,062</u>              | <u>1,014</u>               |
| Less accumulated depreciation            | (568)                     | (530)                      |
| Property and equipment, net              | <u>\$ 494</u>             | <u>\$ 484</u>              |

Depreciation expense associated with property and equipment amounted to \$30 million for the three months ended June 30, 2007 and \$23 million for the three months ended June 30, 2006.

**Accrued and Other Current Liabilities**

Accrued and other current liabilities as of June 30, 2007 and March 31, 2007 consisted of (in millions):

|                                       | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 |
|---------------------------------------|---------------------------|----------------------------|
| Other accrued expenses                | \$ 158                    | \$ 152                     |
| Accrued royalties                     | 89                        | 91                         |
| Accrued compensation and benefits     | 88                        | 206                        |
| Deferred net revenue (other)          | 57                        | 58                         |
| Accrued value added taxes             | 21                        | 23                         |
| Accrued income taxes                  | 2                         | 284                        |
| Accrued and other current liabilities | <u>\$ 415</u>             | <u>\$ 814</u>              |

Deferred net revenue (other), includes the deferral of subscription revenue, deferrals related to our Switzerland distribution business, advertising revenue, licensing arrangements and other revenue for which revenue recognition criteria has not been met.

**Deferred Net Revenue (Packaged Goods and Digital Content)**

Deferred net revenue (packaged goods and digital content) was \$68 million as of June 30, 2007 and \$32 million as of March 31, 2007. Deferred net revenue (packaged goods and digital content), includes the deferral of (1) the total revenue from the sale of certain online-enabled packaged goods and PC digital downloads for which we are not able to objectively determine the fair value of the online service we provide in connection with the sale of the software, and (2) revenue from the sale of certain incremental content related to our core subscription services playable only online, which are types of “micro-transactions”. We recognize revenue from sales of online-enabled software products for which we are not able to objectively determine the fair value of the online service on a straight-line basis over an estimated six month period beginning in the month after shipment.

**(8) INCOME TAXES**

In February 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation (“FIN”) No. 48, “*Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109*”, that clarifies the accounting and recognition for income tax positions taken or expected to be taken in our tax returns. On May 2, 2007, the FASB issued FASB Staff Position (“FSP”) FIN 48-1, “*Definition of Settlement in FASB Interpretation No. 48*”, which amends FIN No. 48 to provide guidance on how an entity should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The term “effectively settled” replaces the term “ultimately settled” when used to describe recognition, and the terms “settlement” or “settled” replace the terms “ultimate settlement” or “ultimately settled” when used to describe measurement of a tax position under FIN No. 48. FSP FIN 48-1 clarifies that a tax position can be effectively settled upon the completion of an examination by a taxing authority without being legally extinguished. For tax positions considered effectively settled, an entity would recognize the full amount of tax benefit, even if the tax position is not considered more likely than not to be sustained based solely on the basis of its technical merits and the statute of limitations remains open. We adopted FIN No. 48 and FSP FIN 48-1 on April 1, 2007, and recognized the cumulative effect of a change in accounting principle by recognizing a decrease in the liability for unrecognized tax benefits of \$18 million, with a corresponding increase to beginning retained earnings. We also recognized an additional decrease in the liability for unrecognized tax benefits of \$14 million with a corresponding increase in beginning paid-in capital related to the tax benefits of employee stock options. The total liability for gross unrecognized tax benefits included in our Condensed Consolidated Balance Sheet as of April 1, 2007, in non-current other liabilities was \$283 million. Of this amount, \$41 million of liabilities would be offset by prior cash deposits to tax authorities for issues pending resolution. Approximately \$239 million of the consolidated worldwide liability for unrecognized tax benefits would affect our effective tax rate if recognized upon resolution of the uncertain tax positions. The liability for unrecognized tax benefits increased by approximately \$2 million during the three months ended June 30, 2007.

Interest and penalties related to estimated obligations for tax positions taken in our tax returns are recognized in income tax expense in our Condensed Consolidated Statements of Operations. As of April 1, 2007, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns and included in non-current other liabilities was approximately \$42 million. Approximately \$4 million of accrued interest expense related to estimated obligations for unrecognized tax benefits was expensed during the three months ended June 30, 2007.

We have historically presented our estimated liability for unrecognized tax benefits as a current liability. FIN No. 48, requires liabilities for unrecognized tax benefits to be classified based on whether it is expected payment will be made within the next 12 months. That is, amounts expected to be paid within the next 12 months are to be classified as a current liability and all other amounts are to be classified as a non-current liability. In addition, we have historically presented our estimated state, local and interest liabilities net of the estimated benefit we expect to receive from deducting such payments on future tax returns (i.e., on a “net” basis). FIN No. 48 requires this estimated benefit to be classified as a deferred tax asset instead of a reduction of the overall liability (i.e., on a gross basis).

We file income tax returns in the U.S., including various state and local jurisdictions. Our subsidiaries file tax returns in various foreign jurisdictions, including Canada, France, Germany, Switzerland and the United Kingdom. The Internal Revenue Service (“IRS”) has completed its examination of our federal income tax returns through fiscal year 2003. To date, the IRS has proposed, and we have agreed to, certain adjustments to our tax returns. The effects of these adjustments have been considered in estimating our future obligations for unrecognized tax benefits and are not expected to have a material impact on our financial position or results of operations. We have not agreed to certain other proposed adjustments for fiscal years 1997 through 2003, and those issues are pending resolution by the Appeals section of the IRS. Furthermore, the IRS has commenced an examination of our fiscal year 2004 and 2005 tax returns. We are also under income tax examination in Canada for fiscal years 2004 and 2005. We remain subject to income tax examination in Canada for fiscal years after 1999, in France, Germany, and the United Kingdom for fiscal years after 2003, and in Switzerland for fiscal years after 2006.

The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. While it is reasonably possible that some of the issues in the IRS and Canadian examinations could be resolved in the next 12 months, at this stage of the process it is not practicable to estimate a range of the potential change in the underlying unrecognized tax benefits.

With respect to our projected annual effective income tax rate at the end of each quarter prior to the end of a fiscal year, we are required to make a projection of several items, including our projected mix of full-year income in each jurisdiction in which we operate and the related income tax expense in each jurisdiction. While this projection is inherently uncertain, for fiscal 2008, our projected tax rate is unusually volatile and subject to significantly greater variation because relatively small changes in our forecasted profitability for fiscal 2008 can significantly affect our projected annual effective tax rate. As such, as of the end of the first quarter of fiscal 2008, we believe our tax rate for the three months ended June 30, 2007 is currently the most reliable estimate of our annual effective tax rate for fiscal 2008. Accordingly, the effective income tax rate reflected in our financial statements for the three months ended June 30, 2007 reflects only our estimated tax position for the three months ended June 30, 2007. The final effective income tax rate for the fiscal year will likely be different from the tax rate in effect for the three months ended June 30, 2007 and could be considerably higher or potentially lower, as it will be particularly dependent on our profitability for the year. As is the case for fiscal 2008, during fiscal 2007 our projected tax rate was unusually volatile. As such, as of the end of the first quarter of fiscal 2007, because relatively small changes in our forecasted profitability for fiscal 2007 could have significantly affected our projected annual effective tax rate, our quarterly tax rate was the most reliable estimate of our effective tax rate. Accordingly, the effective income tax rate reflected in our financial statements for the first quarter of fiscal 2007 reflected only our estimated tax benefit for the quarter.

## **(9) COMMITMENTS AND CONTINGENCIES**

### ***Lease Commitments and Residual Value Guarantees***

We lease certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We are required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and will be required to pay any increases over the base year of these expenses on the remainder of our facilities.

In February 1995, we entered into a build-to-suit lease (“Phase One Lease”) with a third-party lessor for our headquarters facilities in Redwood City, California (“Phase One Facilities”). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is

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not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of \$132 million. In the event of a sale to a third party, if the sale price is less than \$132 million, we will be obligated to reimburse the difference between the actual sale price and \$132 million, up to a maximum of \$117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with Statement of Financial Accounting Standard ("SFAS") No. 13, "Accounting for Leases", as amended.

In December 2000, we entered into a second build-to-suit lease ("Phase Two Lease") with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property ("Phase Two Facilities"). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.

Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of \$115 million. In the event of a sale to a third party, if the sale price is less than \$115 million, we will be obligated to reimburse the difference between the actual sale price and \$115 million, up to a maximum of \$105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its lenders through July 2007. On May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of June 30, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

The two lease agreements with Keybank National Association described above require us to maintain certain financial covenants as shown below, all of which we were in compliance with as of June 30, 2007.

| Financial Covenants                  | Requirement              |         | Actual as of<br>June 30, 2007 |
|--------------------------------------|--------------------------|---------|-------------------------------|
| Consolidated Net Worth (in millions) | equal to or greater than | \$2,430 | \$ 4,053                      |
| Fixed Charge Coverage Ratio          | equal to or greater than | 3.00    | 4.20                          |
| Total Consolidated Debt to Capital   | equal to or less than    | 60%     | 5.7%                          |
| Quick Ratio — Q1 & Q2                | equal to or greater than | 1.00    | 6.57                          |
| Q3 & Q4                              | equal to or greater than | 1.75    | N/A                           |

### ***Development, Celebrity, League and Content Licenses: Payments and Commitments***

The products we produce in our studios are designed and created by our employee designers, artists, software programmers and by non-employee software developers ("independent artists" or "third-party developers"). We typically advance development funds to the independent artists and third-party developers during development of our games, usually in installment payments

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made upon the completion of specified development milestones. Contractually, these payments are generally considered advances against subsequent royalties on the sales of the products. These terms are set forth in written agreements entered into with the independent artists and third-party developers.

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, UEFA and FAPL (Football Association Premier League Limited) (professional soccer); NASCAR (stock car racing); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players' Association (professional hockey); Warner Bros. (Harry Potter, Batman and Superman); New Line Productions and Saul Zaentz Company (The Lord of the Rings); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football, basketball and baseball); Simco (Def Jam); Viacom Consumer Products (The Godfather); ESPN (content in EA SPORTS™ games); Twentieth Century Fox Licensing and Merchandising (The Simpsons); and Marvel Entertainment, Inc. (Marvel character fighting games). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

The following table summarizes our minimum contractual obligations and commercial commitments as of June 30, 2007 (in millions):

| Fiscal Year<br>Ending March 31, | Contractual Obligations |                                                      |               | Commercial<br>Commitments                         | Total           |
|---------------------------------|-------------------------|------------------------------------------------------|---------------|---------------------------------------------------|-----------------|
|                                 | Leases <sup>(1)</sup>   | Developer/<br>Licensor<br>Commitments <sup>(2)</sup> | Marketing     | Letter of Credit,<br>Bank and<br>Other Guarantees |                 |
| 2008 (remaining nine months)    | \$ 44                   | \$ 173                                               | \$ 63         | \$ 5                                              | \$ 285          |
| 2009                            | 56                      | 205                                                  | 40            | —                                                 | 301             |
| 2010                            | 39                      | 165                                                  | 31            | —                                                 | 235             |
| 2011                            | 27                      | 264                                                  | 32            | —                                                 | 323             |
| 2012                            | 24                      | 62                                                   | 17            | —                                                 | 103             |
| Thereafter                      | 46                      | 662                                                  | 169           | —                                                 | 877             |
| <b>Total</b>                    | <b>\$ 236</b>           | <b>\$ 1,531</b>                                      | <b>\$ 352</b> | <b>\$ 5</b>                                       | <b>\$ 2,124</b> |

- (1) Lease commitments include contractual rental commitments of \$15 million under real estate leases for unutilized office space resulting from our restructuring activities. These amounts, net of estimated future sub-lease income, were expensed in the periods of the related restructuring and are included in our accrued and other current liabilities reported on our Condensed Consolidated Balance Sheets as of June 30, 2007. See Note 5 of the Notes to Condensed Consolidated Financial Statements.
- (2) Developer/licensor commitments include \$17 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Condensed Consolidated Balance Sheets as of June 30, 2007 because payment is not contingent upon performance by the developer or licensor.

The amounts represented in the table above reflect our minimal cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be expensed in our Condensed Consolidated Financial Statements.

Also, as discussed in Note 8 of the Notes to Condensed Consolidated Financial Statements, we adopted the provisions of FIN No. 48. As of April 1, 2007, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$318 million, of which approximately \$41 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

***Legal proceedings***

We are subject to claims and litigation arising in the ordinary course of business. We believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would not have a material adverse effect on our consolidated financial position or results of operations.

***Director Indemnity Agreements***

We have entered into indemnification agreements with each of the members of our Board of Directors at the time they joined the Board to indemnify them to the extent permitted by law against any and all liabilities, costs, expenses, amounts paid in settlement and damages incurred by the directors as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors are sued or charged as a result of their service as members of our Board of Directors.

**(10) STOCK-BASED COMPENSATION**

We are required to estimate the fair value of share-based payment awards on the date of grant. We recognize compensation costs for stock-based payment transactions to employees based on their grant-date fair value over the service period for which such awards are expected to vest. The fair value of restricted stock units is determined based on the quoted price of our common stock on the date of grant. The fair value of stock options and stock purchase rights granted pursuant to our employee stock purchase plan (“ESPP”) is determined using the Black-Scholes valuation model. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the expected term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We estimated the following key assumptions for the Black-Scholes valuation calculation:

- *Risk-free interest rate* . The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.
- *Expected volatility* . We use a combination of historical stock price volatility and implied volatility computed based on the price of options publicly traded on our common stock for our expected volatility assumption.
- *Expected term* . The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.
- *Expected dividends* .

The assumptions used in the Black-Scholes valuation model to value our option grants were as follows:

|                             | Stock Option Grants<br>Three Months Ended<br>June 30, |           |
|-----------------------------|-------------------------------------------------------|-----------|
|                             | 2007                                                  | 2006      |
| Risk-free interest rate     | 5.0 - 5.1%                                            | 5.1%      |
| Expected volatility         | 31 - 37%                                              | 35 - 53%  |
| Weighted-average volatility | 32%                                                   | 48%       |
| Expected term               | 4.4 years                                             | 5.7 years |
| Expected dividends          | None                                                  | None      |

Employee stock-based compensation expense recognized during the three months ended June 30, 2007 and 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.

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The following table summarizes stock-based compensation expense resulting from stock options, restricted stock, restricted stock units and our employee stock purchase plan included in our Condensed Consolidated Statements of Operations (in millions):

|                                              | Three Months Ended<br>June 30, |              |
|----------------------------------------------|--------------------------------|--------------|
|                                              | 2007                           | 2006         |
| Cost of goods sold                           | \$ —                           | \$ —         |
| Marketing and sales                          | 4                              | 5            |
| General and administrative                   | 8                              | 11           |
| Research and development                     | 16                             | 21           |
| Stock-based compensation expense             | 28                             | 37           |
| Benefit from income taxes                    | (5)                            | (8)          |
| Stock-based compensation expense, net of tax | <u>\$ 23</u>                   | <u>\$ 29</u> |

As of June 30, 2007, our total unrecognized compensation cost related to stock options was \$206 million and is expected to be recognized over a weighted-average service period of 2.5 years. As of June 30, 2007, our total unrecognized compensation cost related to restricted stock and restricted stock units (collectively referred to as “restricted stock rights”) was \$117 million and is expected to be recognized over a weighted-average service period of 2.2 years.

The following table summarizes our stock option activity for the three months ended June 30, 2007:

|                                                    | Options<br>(in thousands) | Weighted-<br>Average<br>Exercise Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic Value<br>(in millions) |
|----------------------------------------------------|---------------------------|----------------------------------------|---------------------------------------------------------------------|-----------------------------------------------|
| Outstanding as of March 31, 2007                   | 35,864                    | \$ 40.75                               |                                                                     |                                               |
| Activity for the three months ended June 30, 2007: |                           |                                        |                                                                     |                                               |
| Granted                                            | 4,359                     | 49.92                                  |                                                                     |                                               |
| Exercised                                          | (720)                     | 24.00                                  |                                                                     |                                               |
| Forfeited, cancelled or expired                    | (654)                     | 52.97                                  |                                                                     |                                               |
| Outstanding as of June 30, 2007                    | <u>38,849</u>             | <u>\$ 41.88</u>                        | <u>6.51</u>                                                         | <u>\$ 428</u>                                 |
| Exercisable as of June 30, 2007                    | <u>23,672</u>             | <u>\$ 34.89</u>                        | <u>5.03</u>                                                         | <u>\$ 413</u>                                 |

The weighted-average grant-date fair value of stock options granted during the three months ended June 30, 2007 and 2006 was \$17.19 and \$24.85, respectively.

The following table summarizes our restricted stock rights activity for the three months ended June 30, 2007:

|                                                    | Restricted<br>Stock Rights<br>(in thousands) | Weighted-<br>Average Grant<br>Date Fair Value |
|----------------------------------------------------|----------------------------------------------|-----------------------------------------------|
| Balance as of March 31, 2007                       | 2,134                                        | \$ 52.62                                      |
| Activity for the three months ended June 30, 2007: |                                              |                                               |
| Granted                                            | 907                                          | 50.03                                         |
| Vested                                             | (1)                                          | 49.90                                         |
| Forfeited                                          | (70)                                         | 52.55                                         |
| Balance as of June 30, 2007                        | <u>2,970</u>                                 | <u>\$ 51.83</u>                               |

The weighted-average grant date fair value of restricted stock rights is based on the quoted market value of our common stock on the date of grant. The weighted-average fair value of restricted stock rights granted during the three months ended June 30, 2007 and 2006 was \$50.03 and \$45.14, respectively.

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During the three months ended June 30, 2007, there were no shares issued under our Employee Stock Purchase Plan.

At our Annual Meeting of Stockholders, held on July 26, 2007, our stockholders approved amendments to the 2000 Equity Incentive Plan to (a) increase the number of shares authorized for issuance under the Equity Plan by 9 million, (b) decrease by 4 million shares the limit on the total number of shares underlying awards of restricted stock and restricted stock units that may be granted under the Equity Plan — from 15 million to 11 million shares, and (c) revise the amount and nature of automatic initial and annual grants to our non-employee directors under the Equity Plan by adding restricted stock units and decreasing the size of stock option grants. Our stockholders also approved an amendment to the 2000 Employee Stock Purchase Plan to increase by 1.5 million the number of shares of common stock reserved for issuance under the Purchase Plan.

### (11) COMPREHENSIVE LOSS

We are required to classify items of other comprehensive income (loss) by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. Accumulated other comprehensive income primarily includes foreign currency translation adjustments, and the net-of-tax amounts for unrealized gains (losses) on investments and unrealized gains (losses) on derivatives designated as cash flow hedges.

The components of comprehensive loss for the three months ended June 30, 2007 and 2006 are summarized as follows (in millions):

|                                                                                                                                       | Three Months Ended<br>June 30, |         |
|---------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|---------|
|                                                                                                                                       | 2007                           | 2006    |
| Net loss                                                                                                                              | \$ (132)                       | \$ (81) |
| Other comprehensive income:                                                                                                           |                                |         |
| Change in unrealized gains on investments, net of tax expense of \$18 and \$0, respectively                                           | 48                             | 6       |
| Reclassification adjustment for gains realized on derivative instruments in net loss, net of tax expense of \$0 and \$0, respectively | (1)                            | —       |
| Foreign currency translation adjustments                                                                                              | 20                             | 18      |
| Total other comprehensive income                                                                                                      | 67                             | 24      |
| Total comprehensive loss                                                                                                              | \$ (65)                        | \$ (57) |

The foreign currency translation adjustments are not adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.

### (12) NET LOSS PER SHARE

As a result of our net loss for the three months ended June 30, 2007 and 2006, we have excluded certain stock awards from the diluted earnings per share calculation as their inclusion would have been antidilutive. Had we reported net income for these periods, an additional 7 million and 8 million shares of potential common stock equivalents would have been included in the number of shares used to calculate diluted earnings per share for the three months ended June 30, 2007 and 2006, respectively.

In addition, options to purchase 16 million and 19 million shares of common stock were excluded from the above computation of diluted shares for the three months ended June 30, 2007 and 2006, respectively, as their inclusion would have been antidilutive. For the three months ended June 30, 2007 and 2006, the weighted-average exercise price of these shares was \$54.69 and \$55.43, respectively.

### (13) SEGMENT INFORMATION

Our reporting segments are based upon: our internal organizational structure; the manner in which our operations are managed; the criteria used by our Chief Executive Officer, our chief operating decision maker, to evaluate segment performance; the availability of separate financial information; and overall materiality considerations.

We manage our business primarily based on geographical performance. Accordingly, our combined global publishing organizations represent our reportable segment, our Publishing segment, due to their similar economic characteristics, products and distribution methods. Publishing refers to the manufacturing, marketing, advertising and distribution of products developed or co-developed by us, or distribution of certain third-party publishers' products through our co-publishing and distribution program.

The following table summarizes the financial performance of our Publishing segment and a reconciliation of our Publishing segment's profit to our consolidated operating loss (in millions):

|                                                | Three Months Ended<br>June 30, |                 |
|------------------------------------------------|--------------------------------|-----------------|
|                                                | 2007                           | 2006            |
| Publishing segment:                            |                                |                 |
| Net revenue                                    | \$ 373                         | \$ 378          |
| Depreciation and amortization                  | (5)                            | (5)             |
| Other expenses                                 | (254)                          | (247)           |
| Publishing segment profit                      | 114                            | 126             |
| Reconciliation to consolidated operating loss: |                                |                 |
| Other:                                         |                                |                 |
| Net revenue                                    | 22                             | 35              |
| Depreciation and amortization                  | (39)                           | (30)            |
| Other expenses                                 | (280)                          | (250)           |
| Consolidated operating loss                    | <u>\$ (183)</u>                | <u>\$ (119)</u> |

Publishing segment profit differs from consolidated operating loss primarily due to the exclusion of (1) substantially all of our research and development expense, as well as certain corporate functional costs that are not allocated to the publishing organizations and (2) the deferral of certain net revenue related to packaged goods and digital content (see Note 7 of the Notes to Condensed Consolidated Financial Statements). Our Chief Executive Officer reviews assets on a consolidated basis and not on a segment basis.

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Information about our total net revenue by platform for the three months ended June 30, 2007 and 2006 is presented below (in millions):

|                                               | Three Months Ended<br>June 30, |               |
|-----------------------------------------------|--------------------------------|---------------|
|                                               | 2007                           | 2006          |
| <b>Consoles</b>                               |                                |               |
| PlayStation 2                                 | \$ 61                          | \$ 99         |
| Xbox 360                                      | 47                             | 61            |
| Wii                                           | 29                             | —             |
| PLAYSTATION 3                                 | 13                             | —             |
| Xbox                                          | 3                              | 23            |
| Nintendo GameCube                             | 1                              | 11            |
| Total Consoles                                | 154                            | 194           |
| <b>PC</b>                                     | 89                             | 66            |
| <b>Mobility</b>                               |                                |               |
| Cellular Handsets                             | 33                             | 33            |
| Nintendo DS                                   | 25                             | 8             |
| PSP                                           | 21                             | 37            |
| Game Boy Advance                              | 2                              | 7             |
| Total Mobility                                | 81                             | 85            |
| Co-publishing and Distribution                | 39                             | 42            |
| <b>Internet Services, Licensing and Other</b> |                                |               |
| Subscription Services                         | 23                             | 16            |
| Licensing, Advertising and Other              | 9                              | 10            |
| Total Internet Services, Licensing and Other  | 32                             | 26            |
| <b>Total Net Revenue</b>                      | <b>\$ 395</b>                  | <b>\$ 413</b> |

Information about our operations in North America, Europe and Asia for the three months ended June 30, 2007 and 2006 is presented below (in millions):

|                                         | North<br>America | Europe | Asia  | Total  |
|-----------------------------------------|------------------|--------|-------|--------|
| <b>Three months ended June 30, 2007</b> |                  |        |       |        |
| Net revenue from unaffiliated customers | \$ 163           | \$ 204 | \$ 28 | \$ 395 |
| Long-lived assets                       | 1,150            | 266    | 10    | 1,426  |
| <b>Three months ended June 30, 2006</b> |                  |        |       |        |
| Net revenue from unaffiliated customers | \$ 209           | \$ 169 | \$ 35 | \$ 413 |
| Long-lived assets                       | 1,060            | 212    | 12    | 1,284  |

No single customer represented more than 10 percent of total net revenue during the three months ended June 30, 2007. Our direct sales to Wal-Mart Stores, Inc. represented approximately 11 percent of total net revenue for the three months ended June 30, 2006.

### (14) IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, “*Fair Value Measurements*”. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be

separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, “ *The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115* ”. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. This Statement should not be applied retrospectively to fiscal years beginning prior to the effective date, except as permitted with early adoption. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Condensed Consolidated Financial Statements if we adopt. If we adopt SFAS No. 159, it could have a material impact on our Condensed Consolidated Financial Statements.

In June 2007, the FASB ratified the Emerging Issues Task Force’s (“EITF”) consensus conclusion on EITF 07-03, “ *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development* ”. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. We do not expect the adoption of EITF 07-03 to have a material impact on our Condensed Consolidated Financial Statements.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Electronic Arts Inc.:

We have reviewed the condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries (the Company) as of June 30, 2007, and the related condensed consolidated statements of operations and cash flows for the three-month periods ended June 30, 2007 and July 1, 2006. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of March 31, 2007, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for the year then ended (not presented herein); and in our report dated May 29, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of March 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

**KPMG LLP**

Mountain View, California  
August 6, 2007

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward looking. We use words such as "anticipate", "believe", "expect", "intend", "estimate" (and the negative of any of these terms), "future" and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed in this report under the heading "Risk Factors" in Part II, Item 1A, as well as in our Annual Report on Form 10-K for the fiscal year ended March 31, 2007 as filed with the Securities and Exchange Commission ("SEC") on May 30, 2007 and in other documents we have filed with the SEC.

### OVERVIEW

The following overview is a top-level discussion of our operating results as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers is important in order to understand our results for the three months ended June 30, 2007, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Risk Factors" and the Condensed Consolidated Financial Statements and related notes. Additional information can be found in the "Business" section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2007 as filed with the SEC on May 30, 2007 and in other documents we have filed with the SEC.

### **About Electronic Arts**

We develop, market, publish and distribute interactive software games that are playable by consumers on video game consoles (such as the Sony PlayStation<sup>®</sup> 2 and PLAYSTATION<sup>®</sup> 3, Microsoft Xbox 360<sup>™</sup> and Nintendo Wii<sup>™</sup>), personal computers, mobile platforms (including cellular handsets and handheld game players such as the PlayStation<sup>®</sup> Portable ("PSP<sup>™</sup>") and the Nintendo DS<sup>™</sup>) and online (over the Internet and other proprietary online networks). Some of our games are based on content that we license from others (e.g., Madden NFL Football, Harry Potter and FIFA Soccer), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims<sup>™</sup> and Need for Speed<sup>™</sup>). Our goal is to publish titles with mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game "franchises" that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (e.g., Madden NFL Football, NCAA<sup>®</sup> Football and FIFA Soccer), wholly-owned properties that can be successfully sequeled (e.g., The Sims, Need for Speed and Battlefield) and titles based on long-lived literary and/or movie properties (e.g., Lord of the Rings and Harry Potter).

### **Overview of Financial Results**

#### ***Special Note Regarding Deferred Net Revenue***

The ubiquity of high-speed Internet access and the integration of network connectivity into new generation game consoles are expected to increase demand for games with online-enabled features. To address this demand, many of our software products are developed with the ability to be connected to, and played via, the Internet. In order for consumers to participate in online communities and play against one another via the Internet, we (or through outsourced arrangements with third parties) maintain servers which support the various online services we provide to consumers such as matchmaking, roster updates, tournaments and player rankings. In situations where we do not separately sell these online services, we consider the sale of the software product as a "bundle" sale, or multiple element arrangement, in which we sell both the software product and the online service for one combined price.

Through fiscal 2007, for accounting purposes, vendor specific objective evidence of fair value existed for the online service. Accordingly, we allocated the revenue collected from the sale of the software product between the online service and the

software product and recognized the amounts allocated to each element separately. However, starting in fiscal 2008, for accounting purposes, the required vendor specific objective evidence of fair value does not exist for the online services related to certain of our online-enabled software products. This prevents us from allocating and recognizing revenue related to the software product and the online services separately. Accordingly, starting in fiscal 2008, we are recognizing all of the revenue from the sale of our online-enabled software products for the PC, PlayStation 2, PLAYSTATION 3 and the PSP on a deferred basis – over an estimated online service period, which we estimate to be six months beginning in the month after shipment. We anticipate that we will defer approximately \$350 to \$450 million in net revenue from the sale of these online-enabled software products from fiscal 2008 and into fiscal 2009. On a quarterly basis, this amount will vary significantly depending upon the timing of the release, sales volume, returns and price protection provided for these online-enabled software products. In addition, we expense the cost of goods sold related to these transactions during the period in which the product is delivered (rather than on a deferred basis), which inherently creates volatility in our reported gross margin percentages. As of June 30, 2007, we had an accumulated balance of \$68 million of deferred net revenue related to online-enabled packaged goods and digital content.

### **Three Months Ended June 30, 2007**

Total net revenue for the three months ended June 30, 2007 was \$395 million, down 4 percent as compared to the three months ended June 30, 2006. The impact of deferrals related to packaged goods and digital content for the three months ended June 30, 2007 decreased our reported net revenue by \$36 million. Net revenue was driven by sales of *Harry Potter and the Order of the Phoenix*<sup>™</sup>, *Command & Conquer 3 Tiberium Wars*<sup>™</sup>, *The Sims*<sup>™</sup> 2 Pets, *Need for Speed*<sup>™</sup> Carbon, and *The Sims*<sup>™</sup> 2. During the quarter, *Harry Potter and the Order of the Phoenix* sold over two million copies.

Net loss for the three months ended June 30, 2007 was \$132 million as compared to a net loss of \$81 million for the three months ended June 30, 2006. Diluted loss per share for the three months ended June 30, 2007 was \$0.42 as compared to a diluted loss per share of \$0.26 for the three months ended June 30, 2006. Net loss increased during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 due to (1) an \$18 million decrease in net revenue primarily as a result of the deferral of net revenue related to certain of our packaged goods and digital content sales in the amount of \$36 million, (2) an increase of \$18 million in personnel-related costs resulting from an increase in headcount, (3) an increase in external development costs of \$17 million due to a higher number of projects in development as compared to the prior year, and (4) an increase of \$10 million in facilities-related expenses to support our business.

During the three months ended June 30, 2007, we used \$192 million of cash from operating activities as compared to \$38 million for the three months ended June 30, 2006. The increase in cash used in operating activities for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 resulted primarily from (1) approximately \$90 million increase in annual bonus payments, (2) a \$26 million increase as a result of the timing of our royalty payments, and (3) an increase in operating expenses.

### **Management's Overview of Historical and Prospective Business Trends**

**Fiscal 2008 Reorganization.** In June 2007, we announced that we will organize our business into four divisions, which we call "Labels": EA SPORTS, EA Games, EA Casual Entertainment and The Sims. Each Label will operate with dedicated studio and publishing teams focused on consumer-driven priorities. The new structure is designed to streamline decision-making, improve global focus, and speed new ideas to the market.

**Transition to a New Generation of Consoles.** Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. Microsoft launched the Xbox 360 in November 2005, while Sony and Nintendo launched the PLAYSTATION 3 and the Wii, respectively, in November 2006. We have continued to develop and market new titles for prior-generation video game systems such as the PlayStation 2 while also making significant investments in products for the new systems. As the prior-generation systems reach the end of their life cycle and the installed base of the new systems continues to grow, our sales of video games for prior-generation systems will continue to decline as (1) we produce fewer titles for prior-generation systems, (2) consumers replace their prior-generation systems with the new systems, and/or (3) consumers reduce game software purchases for certain prior-generation consoles generally until they are able to purchase a new video game hardware system. This decline in prior-generation product sales could ultimately be greater or faster than we anticipate, and sales of products for the new platforms may be lower or increase more slowly than we anticipate. Moreover, we expect development costs for the new video game systems to be greater on a per-title basis than development costs for prior-generation video game systems.

We have incurred increased costs during this transition as we have continued to develop and market new titles for certain prior-generation video game platforms while also making significant investments in products for the new generation platforms. As a result of these factors, we expect research and development expenses to increase in fiscal 2008 as compared to fiscal 2007; however, we expect research and development expenses to decline as a percentage of net revenue in fiscal 2008 as compared to fiscal 2007.

*Investment in Online.* Today, we generate net revenue from a variety of online products and services, including casual games and downloadable content marketed under our Pogo brand, persistent state world games such as *Ultima Online*™ and *Dark Age of Camelot*®, PC-based downloadable content and online-enabled packaged goods. In addition, we are anticipating the release of *Warhammer*® *Online* which is currently in beta testing. As the nature of online game offerings expands and evolves, we anticipate long-term opportunities for growth in this area. For example, we expect that consumers will take advantage of the online connectivity of the new generation of consoles at a much higher rate than they have on prior-generation consoles, allowing more consumers to enhance their gameplay experience through multiplayer activity, community-building and downloading content. We plan to increase the amount of content available for download on the PC and consoles, increase the number of games with dynamic in-game advertising and to increase the number of PC-based games that can be downloaded digitally. In addition, we plan to expand our casual game offerings internationally and to invest in growing genres such as mid-session games. To further enhance our online offerings, we acquired Mythic Entertainment, Inc. (“Mythic”), a developer and publisher of massively multiplayer online role-playing games, in July 2006. We intend to make significant investments in online products, infrastructure and services and believe that online gameplay will become an increasingly important part of our business in the long term.

*Expansion of Mobile Platforms .* Advances in mobile technology have resulted in a variety of new and evolving platforms for on-the-go interactive entertainment that appeal to a broader demographic of consumers. Our efforts to capitalize on the growth in mobile interactive entertainment are focused in two broad areas – packaged goods games for handheld game systems and downloadable games for cellular handsets.

We have developed and published games for a variety of handheld platforms, including the Nintendo Game Boy and Game Boy Advance, for several years. The introductions of the Sony PSP and the Nintendo DS, with their enhanced graphics, deeper gameplay, and online functionality, provide a richer mobile gaming experience for consumers.

We expect sales of games for cellular handsets to continue to be an increasingly important part of our business worldwide. To accelerate our position in this growing segment, in February 2006, we acquired JAMDAT Mobile Inc., a global publisher of wireless games and other wireless entertainment applications.

As mobile technology continues to evolve and the installed base of both handheld game systems and game-enabled cellular phones continues to expand, we anticipate that sales of our titles for mobile platforms – for both handhelds and cellular handsets – will become an increasingly important part of our business.

*Acquisitions and Investments.* We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including acquisitions of companies, businesses, intellectual properties, and other assets. Since the beginning of fiscal 2007, we have completed several acquisitions and investments:

- In May 2007, we entered into a licensing agreement with and made a strategic equity investment in The9 Limited (“The9”), a leading online game operator in China. The licensing agreement gives The9 exclusive publishing rights for *EA SPORTS*™ *FIFA Online* in mainland China.
- In April 2007, we expanded our commercial agreements with and made strategic equity investments in Neowiz Corporation and a related online gaming company, Neowiz Games. Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA SPORTS FIFA Online* in Korea. We refer to Neowiz Corporation and Neowiz Games collectively as “Neowiz”.
- In October 2006, the remaining outstanding shares of Digital Illusions C.E. (“DICE”) were purchased, thereby completing the acquisition of the remaining minority interest of DICE.
- In July 2006, we acquired Mythic as part of our efforts to accelerate our growth in the massively multiplayer online role-playing market.

- In fiscal 2007, we also acquired SingShot Media, a San Francisco-based online karaoke community, as well as substantially all of the assets of Headgate Studios, a Utah-based developer with which we had partnered since 2000 to develop certain EA franchises, and Phenomic Game Development, a developer of real-time-strategy games based in Germany.

**International Operations and Foreign Currency Exchange Impact.** International sales are a fundamental part of our business. Net revenue from international sales accounted for approximately 59 percent of our total net revenue during the first three months of fiscal 2008 and approximately 49 percent of our total net revenue during the first three months of fiscal 2007. Our international net revenue was primarily driven by sales in Europe and, to a much lesser extent, in Asia. Year-over-year, foreign exchange rates had a favorable impact on our net revenue of \$14 million, or 3 percent, for the three months ended June 30, 2007. We believe that in order to succeed internationally, it is important to locally develop content that is specifically directed toward local cultures and consumers. As such, we expect to continue to devote resources to hiring local development talent and expanding our infrastructure, particularly in Asia.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, contingent assets and liabilities, and revenue and expenses during the reporting periods. The policies discussed below are considered by management to be critical because they are not only important to the portrayal of our financial condition and results of operations but also because application and interpretation of these policies requires both judgment and estimates of matters that are inherently uncertain and unknown. As a result, actual results may differ materially from our estimates.

#### ***Revenue Recognition, Sales Returns, Allowances and Bad Debt Reserves***

We derive revenue principally from sales of interactive software games designed for play on video game consoles (such as the PLAYSTATION 3, Xbox 360 and Wii), PCs and mobile platforms including handheld game players (such as the Sony PSP and Nintendo DS), and cellular handsets. We evaluate the recognition of revenue based on the criteria set forth in Statement of Position ("SOP") 97-2, "Software Revenue Recognition", as amended by SOP 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions" and Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition". We evaluate revenue recognition using the following basic criteria and recognize revenue when all four of the following criteria are met:

- *Evidence of an arrangement* . Evidence of an agreement with the customer that reflects the terms and conditions to deliver products must be present in order to recognize revenue.
- *Delivery* . Delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have been transferred to the customer. For online game services, delivery is considered to occur as the service is provided.
- *Fixed or determinable fee* . If a portion of the arrangement fee is not fixed or determinable, we recognize revenue as the amount becomes fixed or determinable.
- *Collection is deemed probable* . We conduct a credit review of each customer involved in a significant transaction to determine the creditworthiness of the customer. Collection is deemed probable if we expect the customer to be able to pay amounts under the arrangement as those amounts become due. If we determine that collection is not probable, we recognize revenue when collection becomes probable (generally upon cash collection).

Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report in each period. For example, for multiple element arrangements, we must make assumptions and judgments in order to: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine whether vendor-specific objective evidence of fair value ("VSOE") exists for each undelivered element; and (4) allocate the total price among the various elements we must deliver. Changes to any of these assumptions or judgments, or changes to the elements in a software arrangement, could cause a material increase or decrease in the amount of revenue that

we report in a particular period. For example, some of our packaged goods products are sold with online services. Prior to fiscal 2008, we were able to determine VSOE for the online services to be delivered; therefore, we were able to allocate the total price received from the combined product and online service sale between these two elements and recognize the related revenue separately. However, starting in fiscal 2008, VSOE does not exist for the online services to be delivered for certain platforms and all revenue from these transactions are recognized over the estimated online service period. More specifically, starting in fiscal 2008, we began to recognize the revenue from sales of certain online-enabled packaged goods on a straight-line basis over a six month period beginning in the month after shipment. Accordingly, this relatively small change (from having VSOE for online hosting services to no longer having VSOE) has had a significant effect on our reported results.

Determining whether a transaction constitutes an online game service transaction or a download of a product requires judgment and can be difficult. The accounting for these transactions is significantly different. Revenue from product downloads is recognized when the download occurs (assuming all other recognition criteria are met). Revenue from online game services is recognized as the services are rendered. If the service period is not defined, we recognize the revenue over the estimated service period. Determining the estimated service period is inherently subjective and is subject to regular revision based on historical online usage.

Product revenue, including sales to resellers and distributors (“channel partners”), is recognized when the above criteria are met. We reduce product revenue for estimated future returns, price protection, and other offerings, which may occur with our customers and channel partners. Price protection represents the right to receive a credit allowance in the event we lower our wholesale price on a particular product. The amount of the price protection is generally the difference between the old price and the new price. In certain countries, we have stock-balancing programs for our PC and video game system products, which allow for the exchange of these products by resellers under certain circumstances. It is our general practice to exchange products or give credits rather than to give cash refunds.

In certain countries, from time to time, we decide to provide price protection for both our PC and video game system products. When evaluating the adequacy of sales returns and price protection allowances, we analyze historical returns, current sell-through of distributor and retailer inventory of our products, current trends in retail and the video game segment, changes in customer demand and acceptance of our products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in high returns or higher price protection costs in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing products. For example, the risk of product returns and/or price protection for our products may continue to increase as the PlayStation 2 console moves through its lifecycle. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates changed, our returns and price protection reserves would change, which would impact the total net revenue we report. For example, if actual returns and/or price protection were significantly greater than the reserves we have established, our actual results would decrease our reported total net revenue. Conversely, if actual returns and/or price protection were significantly less than our reserves, this would increase our reported total net revenue. In addition, if our estimates of returns and price protection related to online-enabled packaged goods products change, the amount of net deferred revenue we recognize in the future would change.

Significant judgment is required to estimate our allowance for doubtful accounts in any accounting period. We determine our allowance for doubtful accounts by evaluating customer creditworthiness in the context of current economic trends and historical experience. Depending upon the overall economic climate and the financial condition of our customers, the amount and timing of our bad debt expense and cash collection could change significantly.

### ***Royalties and Licenses***

Our royalty expenses consist of payments to (1) content licensors, (2) independent software developers, and (3) co-publishing and distribution affiliates. License royalties consist of payments made to celebrities, professional sports organizations, movie studios and other organizations for our use of their trademarks, copyrights, personal publicity rights, content and/or other intellectual property. Royalty payments to independent software developers are payments for the development of intellectual property related to our games. Co-publishing and distribution royalties are payments made to third parties for the delivery of product.

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue. Significant judgment is required to estimate the effective royalty rate for a particular contract. Because the computation of effective royalty rates requires us to project future revenue, it is inherently subjective as our future revenue projections must anticipate a number of factors, including (1) the total number of titles subject to the contract, (2) the timing of the release of these titles, (3) the number of software units we expect to sell which can be impacted by a number of variables, including product quality and competition, and (4) future pricing. Determining the effective royalty rate for our titles is particularly challenging due to the inherent difficulty in predicting the popularity of entertainment products. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the royalty expense we recognize. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally made in connection with the development of a particular product and, therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally amortized to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of goods sold.

Our contracts with some licensors include minimum guaranteed royalty payments which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Minimum royalty payment obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of June 30, 2007 and March 31, 2007, approximately \$17 million and \$9 million, respectively, of minimum guaranteed royalty obligations had been recognized in each period.

Each quarter, we also evaluate the future realization of our royalty-based assets as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. In either case, we rely on estimated revenue to evaluate the future realization of prepaid royalties and commitments. If actual sales or revised revenue estimates fall below the initial revenue estimate, then the actual charge taken may be greater in any given quarter than anticipated. During the three months ended June 30, 2007, we recognized impairment charges of less than \$1 million. We had no impairments during the three months ended June 30, 2006.

### ***Valuation of Long-Lived Assets, including goodwill and other intangible assets***

We evaluate both purchased intangible assets and other long-lived assets in order to determine if events or changes in circumstances indicate a potential impairment in value exists. This evaluation requires us to estimate, among other things, the remaining useful lives of the assets and future cash flows of the business. These evaluations and estimates require the use of judgment. Our actual results could differ materially from our current estimates.

Under current accounting standards, we make judgments about the recoverability of purchased intangible assets and other long-lived assets whenever events or changes in circumstances indicate a potential impairment in the remaining value of the assets recorded on our Condensed Consolidated Balance Sheets. In order to determine if a potential impairment has occurred, management makes various assumptions about the future value of the asset by evaluating future business prospects and estimated cash flows. Our future net cash flows are primarily dependent on the sale of products for play on proprietary video game consoles, handheld game players, PCs, and cellular handsets (“platforms”). The sales of our products are affected by our ability to accurately predict which platforms and which products we develop will be successful. Also, our revenue and earnings are dependent on our ability to meet our product release schedules. Due to product sales shortfalls, we may not realize the future net cash flows necessary to recover our long-lived assets, which may result in an impairment charge being recorded in the future. There were no impairment charges recorded in the three months ended June 30, 2007. We recognized an insignificant amount of impairment during the three months ended June 30, 2006.

Statement of Financial Accounting Standard (“SFAS”) No. 142, “*Goodwill and Other Intangible Assets*” requires at least an annual assessment for impairment of goodwill by applying a fair-value-based test. A two-step approach is required to test goodwill for impairment for each reporting unit. The first step tests for impairment by applying fair value-based tests at the

reporting unit level. The second step (if necessary) measures the amount of impairment by applying fair value-based tests to individual assets and liabilities within each reporting unit. Application of the goodwill impairment test requires judgment, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated using a discounted cash flow methodology which requires significant judgment to estimate the future cash flows, determine the appropriate discount rates, growth rates and other assumptions. The determination of fair value for each reporting unit could be materially affected by changes in these estimates and assumptions which could trigger impairment. In fiscal 2007, we completed the first step of the annual goodwill impairment testing as of January 1, 2007 and found no indicators of impairment of our recorded goodwill. We did not recognize an impairment loss on goodwill in fiscal 2007, 2006 or 2005. Future impairment tests may result in a charge to earnings and there is a potential for a write-down of goodwill in connection with the annual impairment test.

### **Stock-Based Compensation**

We are required to estimate the fair value of share-based payment awards on the date of grant. The estimated fair value of stock options and stock purchase rights granted pursuant to our employee stock purchase plan ("ESPP") is determined using the Black-Scholes valuation model. The Black-Scholes valuation model requires us to make certain assumptions about the future. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We estimated the following key assumptions for the Black-Scholes valuation calculation:

- *Risk-free interest rate* . The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.
- *Expected volatility* . We use a combination of historical stock price volatility and implied volatility computed based on the price of options publicly traded on our common stock for our expected volatility assumption.
- *Expected term* . The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.
- *Expected dividends* .

Employee stock-based compensation expense was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates and an adjustment will be recognized at that time.

Changes to our underlying stock price, our assumptions used in the Black-Scholes option valuation calculation and our forfeiture rate as well as future grants of equity could significantly impact compensation expense to be recognized during fiscal 2008 and future periods.

We continue to recognize the remaining compensation expense for options granted prior to our adoption of SFAS No. 123 (revised 2004) ("SFAS No. 123(R)", "*Share-Based Payment*") using the accelerated approach over the requisite service period. However, in conjunction with our adoption of SFAS No. 123(R) in fiscal 2007, we changed our method of recognizing our stock-based compensation expense for post-adoption grants to the straight-line approach over the requisite service period.

### **Income Taxes**

We adopted Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 48, "*Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109*", in the first quarter of fiscal 2008. See Note 8 of the Notes to Condensed Consolidated Financial Statements.

In the ordinary course of our business, there are many transactions and calculations where the tax law and ultimate tax determination is uncertain. As part of the process of preparing our Condensed Consolidated Financial Statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate prior to the completion and filing of tax

returns for such periods. This process requires estimating both our geographic mix of income and our uncertain tax positions in each jurisdiction where we operate. These estimates involve complex issues and require us to make judgments, such as anticipating the positions that we will take on tax returns prior to our actually preparing the returns and the outcomes of disputes with tax authorities. The ultimate resolution of these issues frequently may take extended periods of time due to examinations by tax authorities and statutes of limitations. We are also required to make determinations of the need to record deferred tax liabilities and the recoverability of deferred tax assets. A valuation allowance is established to the extent recovery of deferred tax assets is not likely based on our estimation of future taxable income in each jurisdiction.

In addition, changes in our business, including acquisitions, changes in our international corporate structure, changes in the geographic location of business functions or assets, changes in the geographic mix and amount of income, as well as changes in our agreements with tax authorities, valuation allowances, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income can affect the overall effective income tax rate.

The calculation of our tax liabilities involves accounting for uncertainties in the application of complex tax rules, regulations and practices. As a result of the implementation of FIN No. 48, we recognize benefits for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition of a benefit (or the absence of a liability) by determining if the weight of available evidence indicates that it is more likely than not that the position taken will be sustained upon audit, including resolution of related appeals or litigation processes, if any. If it is not “more likely than not” that the position will be sustained, then we do not recognize any benefit for the position. If it is more likely than not that the position will be sustained, a second step in the process is required to estimate how much of the benefit we will ultimately receive. This second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50 percent likely of being realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on a number of factors including, but not limited to, changes in facts or circumstances, changes in tax law, new facts, correspondence with tax authorities during the course of an audit, effective settlement of audit issues, and commencement of new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period. As a result of the adoption of FIN No. 48, we expect our tax rate to be more volatile.

In order to estimate our annual effective tax rate, we are required to make a projection of several items, including our projected amount of full-year income in each jurisdiction in which we operate and the related income tax expense in each jurisdiction. While this projection is inherently uncertain, our estimated annual tax rate for fiscal 2008 is expected to be unusually volatile and subject to significantly greater variation because relatively small changes in our forecasted profitability and geographical mix of income for fiscal 2008 will significantly affect our estimated annual effective tax rate. As such, as of the end of the first quarter of fiscal 2008, we believe our quarterly tax rate is currently the most reliable estimate of our effective tax rate. Accordingly, the effective income tax rate reflected in our financial statements for the first quarter of fiscal 2008 reflects only our estimated tax liabilities and tax benefits for this quarter. The overall effective income tax rate for the fiscal year and subsequent quarters will likely be different from this quarter’s tax rate and could be considerably higher or potentially lower, depending on our profitability for the year.

## **RESULTS OF OPERATIONS**

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ended March 31, 2008 and 2007 contain 52 weeks and end on March 29, 2008 and March 31, 2007, respectively. Our results of operations for the fiscal quarters ended June 30, 2007 and 2006 contain 13 weeks and ended on June 30, 2007 and July 1, 2006, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

Beginning on April 1, 2006, we adopted SFAS No. 123(R) and applied the provisions of SAB No. 107, “*Share-Based Payment*”, to our adoption of SFAS No. 123(R). During the three months ended June 30, 2007, we recognized stock-based compensation of \$28 million, pre-tax, and \$23 million, net of tax. During the three months ended June 30, 2006, we recognized stock-based compensation of \$37 million, pre-tax, and \$29 million, net of tax. Stock-based compensation expense has been reflected in the respective functional line items on our Condensed Consolidated Statements of Operations.

**Net Revenue**

We derive net revenue principally from sales of interactive software games designed for play on video game consoles (such as the PlayStation 2, PLAYSTATION 3, Xbox 360 and Wii), PCs and handheld game players (such as the Sony PSP, Nintendo DS and Nintendo Game Boy Advance) and cellular handsets. We also derive net revenue from selling services in connection with some of our online games, programming third-party web sites with our game content, allowing other companies to manufacture and sell our products in conjunction with other products, and selling advertisements on our online web pages and in our games.

From a geographical perspective, our total net revenue for the three months ended June 30, 2007 and 2006 was as follows (in millions):

|                   | Three Months Ended June 30, |      |        |      | Increase /<br>(Decrease) | %<br>Change |
|-------------------|-----------------------------|------|--------|------|--------------------------|-------------|
|                   | 2007                        |      | 2006   |      |                          |             |
| North America     | \$ 163                      | 41%  | \$ 209 | 51%  | \$ (46)                  | (22%)       |
| Europe            | 204                         | 52%  | 169    | 41%  | 35                       | 21%         |
| Asia              | 28                          | 7%   | 35     | 8%   | (7)                      | (20%)       |
| International     | 232                         | 59%  | 204    | 49%  | 28                       | 14%         |
| Total Net Revenue | \$ 395                      | 100% | \$ 413 | 100% | \$ (18)                  | (4%)        |

Total net revenue for the three months ended June 30, 2007 was \$395 million, down 4 percent as compared to the three months ended June 30, 2006. Deferred net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by \$36 million <sup>(a)</sup> during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. From an operational perspective, the decrease was driven by (1) a \$38 million decrease in net revenue from sales of titles for the PlayStation 2 (of which \$8 million was deferred and will be recognized in future periods), (2) a \$20 million decrease in net revenue from sales of titles for the Xbox, and (3) a \$16 million decrease in net revenue from sales of titles for the PSP (of which \$9 million was deferred and will be recognized in future periods). These decreases were significantly offset by (1) \$29 million of net revenue from sales of titles for the Wii, which was initially released in November 2006, (2) an increase of \$23 million in net revenue from sales of titles for the PC (of which \$7 million was deferred and will be recognized in future periods), and (3) an increase of \$17 million in net revenue from sales of titles for the Nintendo DS.

(a) The deferral of \$36 million of net revenue, which will be recognized in future periods, consisted of (1) \$9 million of net revenue related to the PSP, (2) \$8 million of net revenue related to the PlayStation 2, (3) \$7 million of net revenue related to the PLAYSTATION 3, (4) \$7 million of net revenue related to the PC, (5) \$1 million of net revenue related to cellular handsets, and (6) \$4 million of other net revenue.

**North America**

For the three months ended June 30, 2007, net revenue in North America was \$163 million, driven by sales of *Harry Potter and the Order of the Phoenix*, *Command & Conquer 3 Tiberium Wars*, and Club Pogo subscription revenue.

Net revenue for the three months ended June 30, 2007 decreased 22 percent as compared to the three months ended June 30, 2006. Deferred net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by \$8 million <sup>(b)</sup> during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. From an operational perspective, the decrease was driven by (1) a \$27 million decrease in net revenue from sales of titles for the PlayStation 2 (of which \$2 million was deferred and will be recognized in future periods), (2) a \$16 million decrease in net revenue from sales of titles for the Xbox 360, and (3) a \$14 million decrease in net revenue from sales of titles for the Xbox. These decreases were partially offset by (1) \$13 million of net revenue from sales of titles for the Wii, and (2) a \$7 million increase in net revenue from sales of titles for the PC.

(b) The deferral of \$8 million of net revenue, which will be recognized in future periods, consisted of (1) \$3 million of net revenue related to the PSP, (2) \$2 million of net revenue related to the PlayStation 2, (3) \$1 million of net revenue related to cellular handsets, and (4) \$2 million of other net revenue.

We expect net revenue for North America to increase during fiscal 2008 as compared to fiscal 2007.

### Europe

For the three months ended June 30, 2007, net revenue in Europe was \$204 million, driven by sales of *Harry Potter and the Order of the Phoenix*, *Command & Conquer 3 Tiberium Wars*, and *The Sims 2*. We estimate that foreign exchange rates (primarily the Euro and the British pound sterling) increased reported net revenue by approximately \$13 million, or 8 percent, for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. Excluding the effect of foreign exchange rates, we estimate that net revenue increased by approximately \$43 million, or 25 percent, for the three months ended June 30, 2007.

Net revenue for the three months ended June 30, 2007 increased 21 percent as compared to the three months ended June 30, 2006. Deferred net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by \$21 million <sup>(c)</sup> during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. From an operational perspective, the increase was driven by (1) a \$20 million increase in net revenue from sales of titles for the PC (of which \$4 million was deferred and will be recognized in future periods), (2) \$15 million of net revenue from sales of titles for the Wii, and (3) a \$10 million increase in net revenue from sales of titles for the Nintendo DS. These increases were partially offset by an \$8 million decrease in net revenue from sales of titles for the PlayStation 2 (of which \$5 million was deferred and will be recognized in future periods).

<sup>(c)</sup> The deferral of \$21 million of net revenue, which will be recognized in future periods, consisted of (1) \$5 million of net revenue related to the PlayStation 2, (2) \$5 million of net revenue related to the PLAYSTATION 3, (3) \$4 million of net revenue related to the PC, (4) \$4 million of net revenue related to the PSP, and (5) \$3 million of other net revenue.

We expect net revenue for Europe to increase during fiscal 2008 as compared to fiscal 2007.

### Asia

For the three months ended June 30, 2007, net revenue in Asia was \$28 million, driven by sales of *Harry Potter and the Order of the Phoenix*, *Command & Conquer 3 Tiberium Wars* and *Medal of Honor Airborne* <sup>TM</sup>. We estimate that foreign exchange rates increased reported net revenue by approximately \$1 million, or 3 percent, for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. Excluding the effect of foreign exchange rates, we estimate that net revenue decreased by approximately \$1 million, or 3 percent, for the three months ended June 30, 2007.

Net revenue for the three months ended June 30, 2007 decreased 20 percent as compared to the three months ended June 30, 2006. Deferred net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by \$7 million <sup>(d)</sup> during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006.

<sup>(d)</sup> The deferral of \$7 million of net revenue, which will be recognized in future periods, consisted of (1) \$3 million of net revenue related to the PLAYSTATION 3, (2) \$2 million of net revenue related to the PC, (3) \$1 million of net revenue related to the PlayStation 2, and (4) \$1 million of net revenue related to the PSP.

We expect net revenue for Asia to increase slightly during fiscal 2008 as compared to fiscal 2007.

### Cost of Goods Sold

Cost of goods sold for our packaged-goods business consists of (1) product costs, (2) certain royalty expenses for celebrities, professional sports and other organizations and independent software developers, (3) manufacturing royalties, net of volume discounts and other vendor reimbursements, (4) expenses for defective products, (5) write-offs of post-launch prepaid royalty costs, (6) amortization of certain intangible assets, (7) personnel-related costs, and (8) distribution costs. We generally recognize volume discounts when they are earned from the manufacturer (typically in connection with the achievement of unit-based milestones), whereas other vendor reimbursements are generally recognized as the related revenue is recognized. Cost of goods sold for our online products consists primarily of data center and bandwidth costs associated with hosting our web sites, credit card fees and royalties for use of third-party properties. Cost of goods sold for our web site advertising business primarily consists of ad-serving costs.

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Costs of goods sold for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | % of Net<br>Revenue | June 30,<br>2006 | % of Net<br>Revenue | % Change | Change as a<br>% of Net<br>Revenue |
|------------------|---------------------|------------------|---------------------|----------|------------------------------------|
| \$ 166           | 42.0%               | \$ 168           | 40.7%               | (1.2%)   | 1.3%                               |

During the three months ended June 30, 2007, as a percentage of total net revenue, cost of goods sold increased primarily as a result of the deferral of \$36 million in net revenue related to certain online-enabled packaged goods and digital content with no corresponding deferral in cost of goods sold. Overall, cost of goods sold as a percentage of total net revenue increased by approximately 4 percent in the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 due to our net revenue deferral.

As a percentage of total net revenue, the increase to cost of goods sold was partially offset by lower royalty costs as a result of (1) lower royalty rates on sales of titles shipped in the first quarter of the current year versus titles shipped in the first quarter of the prior year and (2) lower royalty costs associated with our cellular handset business. We estimate that royalty costs as a percentage of total net revenue decreased by approximately 3 percent during the three months ended June 30, 2007 as compared to the three months ended June 30, 2006.

Although there can be no assurance, and our actual results could differ materially, in the short term we expect our gross margin as a percentage of total net revenue to decline in fiscal 2008 as compared to fiscal 2007 as a result of (1) increased deferred net revenue related to certain online-enabled packaged goods (we expense the cost of goods sold related to these transactions during the period in which the product is delivered) and (2) a higher mix of co-publishing and distribution net revenue that has a lower gross margin.

### **Marketing and Sales**

Marketing and sales expenses consist of personnel-related costs and advertising, marketing and promotional expenses, net of qualified advertising cost reimbursements from third parties.

Marketing and sales expenses for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | % of Net<br>Revenue | June 30,<br>2006 | % of Net<br>Revenue | \$ Change | % Change |
|------------------|---------------------|------------------|---------------------|-----------|----------|
| \$ 82            | 21%                 | \$ 77            | 19%                 | \$ 5      | 6%       |

Marketing and sales expenses increases by \$5 million for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. The increase was primarily due to an increase of \$4 million in personnel-related costs primarily resulting from an increase in headcount of 18 percent.

We expect marketing and sales expenses to increase in absolute dollars in fiscal 2008 as compared to fiscal 2007 primarily due to higher advertising and marketing activity to support our titles.

### **General and Administrative**

General and administrative expenses consist of personnel and related expenses of executive and administrative staff, fees for professional services such as legal and accounting, and allowances for doubtful accounts.

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General and administrative expenses for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | % of Net<br>Revenue | June 30,<br>2006 | % of Net<br>Revenue | \$ Change | % Change |
|------------------|---------------------|------------------|---------------------|-----------|----------|
| \$ 71            | 18%                 | \$ 59            | 14%                 | \$ 12     | 20%      |

General and administrative expenses increased by \$12 million for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 primarily due to increases in contracted services associated with systems initiatives and professional services of \$7 million and facilities-related expenses of \$5 million to support our business.

We expect general and administrative expenses to increase in absolute dollars in fiscal 2008 as compared to fiscal 2007 primarily due to an increase in personnel-related costs.

### **Research and Development**

Research and development expenses consist of expenses incurred by our production studios for personnel-related costs, contracted services, equipment depreciation and any impairment of prepaid royalties for pre-launch products. Research and development expenses for our online business include expenses incurred by our studios consisting of direct development and related overhead costs in connection with the development and production of our online games. Research and development expenses also include expenses associated with the development of web site content, network infrastructure direct expenses, software licenses and maintenance, and network and management overhead.

Research and development expenses for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | % of Net<br>Revenue | June 30,<br>2006 | % of Net<br>Revenue | \$ Change | % Change |
|------------------|---------------------|------------------|---------------------|-----------|----------|
| \$ 250           | 63%                 | \$ 216           | 52%                 | \$ 34     | 16%      |

Research and development expenses increased by \$34 million for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. The increase was primarily due to (1) an increase of \$17 million in external development costs primarily due to a higher number of projects in development as compared to the prior year, (2) an increase of \$13 million in personnel-related costs, primarily due to a 16 percent increase in headcount as compared to prior year, and (3) an increase of \$5 million in facilities-related expenses in support of our research and development functions worldwide.

We expect research and development expenses to increase in absolute dollars in fiscal 2008 as compared to fiscal 2007 primarily to support our development of titles for the new generation of consoles.

### **Restructuring Charges**

Restructuring charges for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | % of Net<br>Revenue | June 30,<br>2006 | % of Net<br>Revenue | \$ Change | % Change |
|------------------|---------------------|------------------|---------------------|-----------|----------|
| \$ 2             | 1%                  | \$ 6             | 1%                  | \$ (4)    | (67%)    |

During the three months ended June 30, 2007, we incurred approximately \$2 million of employee-related restructuring expenses in connection with our fiscal 2006 international publishing reorganization. During the three months ended June 30, 2006, restructuring charges were approximately \$6 million of which \$4 million was for employee-related expenses and \$2 million in other costs in connection with our fiscal 2006 international publishing reorganization.

In connection with our fiscal 2006 international publishing reorganization, in fiscal 2008, we expect to incur between \$5 million and \$10 million of restructuring costs. Overall, including charges incurred through June 30, 2007, we expect to incur between \$50 million and \$55 million of restructuring costs in connection with our fiscal 2006 international publishing reorganization,

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substantially all of which will result in cash expenditures by 2017. These restructuring costs will consist primarily of employee-related relocation assistance (approximately \$30 million), facility exit costs (approximately \$15 million), as well as other reorganization costs (approximately \$7 million).

### **Interest and Other Income, Net**

Interest and other income, net, for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | % of Net<br>Revenue | June 30,<br>2006 | % of Net<br>Revenue | \$ Change | % Change |
|------------------|---------------------|------------------|---------------------|-----------|----------|
| \$ 27            | 7%                  | \$ 21            | 5%                  | \$ 6      | 29%      |

For the three months ended June 30, 2007, interest and other income, net, increased by \$6 million, or 29 percent, as compared to the three months ended June 30, 2006 primarily due to an increase of \$7 million in interest income as a result of higher yields on our cash, cash equivalent and short-term investment balances.

### **Income Taxes**

Benefit from income taxes for the three months ended June 30, 2007 and 2006 were as follows (in millions):

| June 30,<br>2007 | Effective<br>Tax Rate | June 30,<br>2006 | Effective<br>Tax Rate | % Change |
|------------------|-----------------------|------------------|-----------------------|----------|
| \$ 24            | 15.1%                 | \$ 17            | 17.6%                 | 41%      |

Our effective income tax rates were 15.1 percent and 17.6 percent for the three months ended June 30, 2007 and 2006, respectively. Because relatively small changes in our forecasted profitability for fiscal 2008 can significantly affect our estimated annual effective tax rate, we believe our quarterly tax benefit rate of 15.1 percent is currently the most reliable estimate of our effective tax benefit rate. Accordingly, our quarterly tax rate for the three months ended June 30, 2007 and the remainder of fiscal 2008 largely depend on our profitability and could fluctuate significantly. In addition, our effective income tax rates for the remainder of fiscal 2008 and future periods will depend on a variety of factors. For example, changes in our business, including acquisitions and intercompany transactions (for example, the acquisition of and intercompany transactions relating to both Mythic and DICE) in prior years, changes in our international structure, changes in the geographic location of business functions or assets, changes in the geographic mix of income, as well as changes in, or termination of, our agreements with tax authorities, valuation allowances, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income or loss can affect the overall effective income tax rate for the remainder of fiscal 2008 and future periods. We incur certain tax expenses that do not decline proportionately with declines in our pre-tax consolidated income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

We historically have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. Although we repatriated funds under the American Jobs Creation Act of 2004 in fiscal 2006, we currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States.

### **Impact of Recently Issued Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, “*Fair Value Measurements*”. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our Condensed Consolidated Financial Statements.

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In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment of FASB Statement No. 115*”. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. This Statement should not be applied retrospectively to fiscal years beginning prior to the effective date, except as permitted with early adoption. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Condensed Consolidated Financial Statements if we adopt. If we adopt SFAS No. 159, it could have a material impact on our Condensed Consolidated Financial Statements.

In June 2007, the FASB ratified the Emerging Issues Task Force’s (“EITF”) consensus conclusion on EITF 07-03, “*Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development*”. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. We do not expect the adoption of EITF 07-03 to have a material impact on our Condensed Consolidated Financial Statements.

## LIQUIDITY AND CAPITAL RESOURCES

| (In millions)                | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 | Increase/<br>(Decrease) |
|------------------------------|---------------------------|----------------------------|-------------------------|
| Cash and cash equivalents    | \$ 663                    | \$ 1,371                   | \$ (708)                |
| Short-term investments       | 1,526                     | 1,264                      | 262                     |
| Marketable equity securities | 660                       | 341                        | 319                     |
| Total                        | <u>\$ 2,849</u>           | <u>\$ 2,976</u>            | <u>\$ (127)</u>         |
| Percentage of total assets   | 57%                       | 58%                        |                         |

| (In millions)                                           | June 30,<br>2007 | June 30,<br>2006 | Decrease        |
|---------------------------------------------------------|------------------|------------------|-----------------|
| Cash used in operating activities                       | \$ (192)         | \$ (38)          | \$ (154)        |
| Cash provided by (used in) investing activities         | (547)            | 11               | (558)           |
| Cash provided by financing activities                   | 26               | 27               | (1)             |
| Effect of foreign exchange on cash and cash equivalents | 5                | 6                | (1)             |
| Net increase (decrease) in cash and cash equivalents    | <u>\$ (708)</u>  | <u>\$ 6</u>      | <u>\$ (714)</u> |

### Changes in Cash Flow

During the three months ended June 30, 2007, we used \$192 million of cash from operating activities as compared to \$38 million for the three months ended June 30, 2006. The increase in cash used in operating activities for the three months ended June 30, 2007 as compared to the three months ended June 30, 2006 resulted primarily from (1) approximately \$90 million increase in annual bonus payments, (2) a \$26 million increase as a result of the timing of our royalty payments, and (3) an increase in operating expenses. We expect cash provided by operating activities to increase in fiscal 2008 as compared to fiscal 2007.

For the three months ended June 30, 2007, we generated \$641 million of cash proceeds from maturities and sales of short-term investments and \$18 million in proceeds from sales of common stock through our stock-based compensation plans. Our primary

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use of cash in non-operating activities consisted of \$897 million used to purchase short-term investments and \$277 million used to purchase marketable equitable securities and investments in affiliates.

### ***Short-term investments and marketable equity securities***

Due to our mix of fixed and variable rate securities, our short-term investment portfolio is susceptible to changes in short-term interest rates. As of June 30, 2007, our short-term investments had gross unrealized gains of less than \$1 million, or less than 1 percent of the total in short-term investments, and gross unrealized losses of approximately \$3 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs. Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains or losses. However, as of June 30, 2007, we had no intention of selling any short-term investments that had an unrealized loss.

Marketable equity securities increased to \$660 million as of June 30, 2007, from \$341 million as of March 31, 2007. This increase was primarily due to (1) our \$167 million investment in The9, (2) our \$83 million common stock investment in Neowiz, and (3) increases in the fair value of our investments in The9 of \$41 million and Ubisoft Entertainment of \$27 million. In addition, we made a \$27 million preferred stock investment in Neowiz which is classified as an investment in affiliates on our Condensed Consolidated Balance Sheets.

### ***Receivables, net***

Our gross accounts receivable balances were \$299 million and \$470 million as of June 30, 2007 and March 31, 2007, respectively. The decrease in our accounts receivable balance was primarily due to lower sales volumes in the first quarter of fiscal 2008 as compared to the fourth quarter of fiscal 2007 and the collection of receivables from the fourth quarter of fiscal 2007, which was expected as we traditionally have lower sales during our first fiscal quarter as compared to our fourth fiscal quarter. We expect our accounts receivable balance to increase during the three months ending September 30, 2007 based on our seasonal product release schedule. Reserves for sales returns, pricing allowances and doubtful accounts decreased in absolute dollars from \$214 million as of March 31, 2007 to \$176 million as of June 30, 2007. Reserves remained flat at 8 percent as a percentage of trailing nine month net revenue for both June 30, 2007 and March 31, 2007. We believe these reserves are adequate based on historical experience and our current estimate of potential returns, pricing allowances and doubtful accounts.

### ***Inventories***

Inventories increased to \$74 million as of June 30, 2007, from \$62 million as of March 31, 2007 primarily as a result of an inventory build-up related to *NCAA<sup>®</sup> Football 08* in anticipation of the post-quarter release. Other than *NCAA Football 08* and *Harry Potter and the Order of the Phoenix*, no single title represented more than \$5 million of inventory as of June 30, 2007.

### ***Other current assets***

Other current assets increased to \$252 million as of June 30, 2007, from \$219 million as of March 31, 2007, primarily due to an increase in prepaid royalties.

### ***Accounts payable***

Accounts payable decreased to \$119 million as of June 30, 2007, from \$180 million as of March 31, 2007, primarily due to lower marketing and advertising expenses during first quarter of fiscal 2008 as compared to the fourth quarter of fiscal 2007 related to the seasonality of our business.

### ***Accrued and other current liabilities***

Our accrued and other current liabilities decreased to \$415 million as of June 30, 2007 from \$814 million as of March 31, 2007. The decrease was primarily due to (1) \$283 million of current income taxes accrued being reclassified to long-term tax obligations as a result of our adoption of FIN No. 48 (see Note 8 of the Notes to Condensed Consolidated Financial

Statements), and (2) payments of \$127 million related to our fiscal 2007 bonus made during the three months ended June 30, 2007.

### ***Deferred income taxes, net***

Our net deferred income tax asset position increased by \$55 million as of June 30, 2007 as compared to March 31, 2007 primarily due to increases of (1) \$25 million in deferred tax assets resulting from the tax benefit we recognized related to our operating loss during the three months ended June 30, 2007, (2) \$6 million in deferred tax assets related to stock-based compensation, and (3) \$36 million in deferred tax assets related to the adoption of FIN No. 48. These increases were partially offset by increases in deferred tax liabilities of \$17 million related to the unrealized gains on investments which were recognized in accumulated other comprehensive income on our Condensed Consolidated Balance Sheets.

### ***Financial Condition***

We believe that existing cash, cash equivalents, short-term investments and cash generated from operations will be sufficient to meet our operating requirements for at least the next twelve months, including working capital requirements, capital expenditures, and potential future acquisitions or strategic investments. We may choose at any time to raise additional capital to strengthen our financial position, facilitate expansion, pursue strategic acquisitions and investments or to take advantage of business opportunities as they arise. There can be no assurance, however, that such additional capital will be available to us on favorable terms, if at all, or that it will not result in substantial dilution to our existing stockholders.

The loan financing arrangements supporting our Redwood City headquarters leases with Keybank National Association, described in the “Off-Balance Sheet Commitments” section below, are scheduled to expire in July 2008. Upon expiration of the financing, we may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor’s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the leases will terminate. Upon expiration of the leases, we may purchase the facilities for \$247 million, or arrange for a sale of the facilities to a third party. In the event of a sale to a third party, if the sale price is less than \$247 million, we will be obligated to reimburse the difference between the actual sale price and \$247 million, up to maximum of \$222 million, subject to certain provisions of the leases.

As of June 30, 2007, approximately \$1,010 million of our cash, cash equivalents, short-term investments and marketable equity securities that was generated from operations was domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we would accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

We have a “shelf” registration statement on Form S-3 on file with the SEC. This shelf registration statement, which includes a base prospectus, allows us at any time to offer any combination of securities described in the prospectus in one or more offerings up to a total amount of \$2 billion. Unless otherwise specified in a prospectus supplement accompanying the base prospectus, we would use the net proceeds from the sale of any securities offered pursuant to the shelf registration statement for general corporate purposes, including for working capital, financing capital expenditures, research and development, marketing and distribution efforts and, if opportunities arise, for acquisitions or strategic alliances. Pending such uses, we may invest the net proceeds in interest-bearing securities. In addition, we may conduct concurrent or other financings at any time.

Our ability to maintain sufficient liquidity could be affected by various risks and uncertainties including, but not limited to, those related to customer demand and acceptance of our products on new platforms and new versions of our products on existing platforms, our ability to collect our accounts receivable as they become due, successfully achieving our product release schedules and attaining our forecasted sales objectives, the impact of competition, economic conditions in the United States and abroad, the seasonal and cyclical nature of our business and operating results, risks of product returns and the other risks described in the “Risk Factors” section, included in Part II, Item 1A of this report.

## Contractual Obligations and Commercial Commitments

### *Development, Celebrity, League and Content Licenses: Payments and Commitments*

The products we produce in our studios are designed and created by our employee designers, artists, software programmers and by non-employee software developers (“independent artists” or “third-party developers”). We typically advance development funds to the independent artists and third-party developers during development of our games, usually in installment payments made upon the completion of specified development milestones. Contractually, these payments are generally considered advances against subsequent royalties on the sales of the products. These terms are set forth in written agreements entered into with the independent artists and third-party developers.

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, UEFA and FAPL (Football Association Premier League Limited) (professional soccer); NASCAR (stock car racing); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players’ Association (professional hockey); Warner Bros. (Harry Potter, Batman and Superman); New Line Productions and Saul Zaentz Company (The Lord of the Rings); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football, basketball and baseball); Simco (Def Jam); Viacom Consumer Products (The Godfather); ESPN (content in EA SPORTS™ games); Twentieth Century Fox Licensing and Merchandising (The Simpsons); and Marvel Entertainment, Inc. (Marvel character fighting games). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

The following table summarizes our minimum contractual obligations and commercial commitments as of June 30, 2007, and the effect we expect them to have on our liquidity and cash flow in future periods (in millions):

| Fiscal Year<br>Ending March 31, | Contractual Obligations |                                                      |               | Commercial<br>Commitments                         | Total           |
|---------------------------------|-------------------------|------------------------------------------------------|---------------|---------------------------------------------------|-----------------|
|                                 | Leases <sup>(1)</sup>   | Developer/<br>Licensor<br>Commitments <sup>(2)</sup> | Marketing     | Letter of Credit,<br>Bank and<br>Other Guarantees |                 |
| 2008 (remaining nine months)    | \$ 44                   | \$ 173                                               | \$ 63         | \$ 5                                              | \$ 285          |
| 2009                            | 56                      | 205                                                  | 40            | —                                                 | 301             |
| 2010                            | 39                      | 165                                                  | 31            | —                                                 | 235             |
| 2011                            | 27                      | 264                                                  | 32            | —                                                 | 323             |
| 2012                            | 24                      | 62                                                   | 17            | —                                                 | 103             |
| Thereafter                      | 46                      | 662                                                  | 169           | —                                                 | 877             |
| Total                           | <u>\$ 236</u>           | <u>\$ 1,531</u>                                      | <u>\$ 352</u> | <u>\$ 5</u>                                       | <u>\$ 2,124</u> |

<sup>(1)</sup> See discussion on operating leases in the “Off-Balance Sheet Commitments” section below for additional information.

<sup>(2)</sup> Developer/licensor commitments include \$17 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Condensed Consolidated Balance Sheets as of June 30, 2007 because payment is not contingent upon performance by the developer or licensor.

The amounts represented in the table above reflect our minimal cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be expensed in our Condensed Consolidated Financial Statements.

Lease commitments include contractual rental commitments of \$15 million under real estate leases for unutilized office space resulting from our restructuring activities. These amounts, net of estimated future sub-lease income, were expensed in the periods of the related restructuring and are included in our accrued and other current liabilities reported on our Condensed Consolidated Balance Sheets as of June 30, 2007. See Note 5 of the Notes to Condensed Consolidated Financial Statements.

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Also, as discussed in Note 8 of the Notes to Condensed Consolidated Financial Statements, we adopted the provisions of FIN No. 48. As of April 1, 2007, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$318 million, of which approximately \$41 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

**OFF-BALANCE SHEET COMMITMENTS**

***Lease Commitments and Residual Value Guarantees***

We lease certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We are required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and will be required to pay any increases over the base year of these expenses on the remainder of our facilities.

In February 1995, we entered into a build-to-suit lease (“Phase One Lease”) with a third-party lessor for our headquarters facilities in Redwood City, California (“Phase One Facilities”). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of \$132 million. In the event of a sale to a third party, if the sale price is less than \$132 million, we will be obligated to reimburse the difference between the actual sale price and \$132 million, up to a maximum of \$117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor’s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with SFAS No. 13, “*Accounting for Leases*”, as amended.

In December 2000, we entered into a second build-to-suit lease (“Phase Two Lease”) with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property (“Phase Two Facilities”). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.

Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of \$115 million. In the event of a sale to a third party, if the sale price is less than \$115 million, we will be obligated to reimburse the difference between the actual sale price and \$115 million, up to a maximum of \$105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its lenders through July 2007. On May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor’s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of June 30, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

The two lease agreements with Keybank National Association described above require us to maintain certain financial covenants as shown below, all of which we were in compliance with as of June 30, 2007.

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| Financial Covenants                  |         | Requirement              | Actual as of<br>June 30, 2007 |         |
|--------------------------------------|---------|--------------------------|-------------------------------|---------|
| Consolidated Net Worth (in millions) |         | equal to or greater than | \$2,430                       | \$4,053 |
| Fixed Charge Coverage Ratio          |         | equal to or greater than | 3.00                          | 4.20    |
| Total Consolidated Debt to Capital   |         | equal to or less than    | 60%                           | 5.7%    |
| Quick Ratio —                        | Q1 & Q2 | equal to or greater than | 1.00                          | 6.57    |
|                                      | Q3 & Q4 | equal to or greater than | 1.75                          | N/A     |

### ***Legal Proceedings***

We are subject to claims and litigation arising in the ordinary course of business. We believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would not have a material adverse effect on our consolidated financial position or results of operations.

### ***Director Indemnity Agreements***

We have entered into indemnification agreements with each of the members of our Board of Directors at the time they joined the Board to indemnify them to the extent permitted by law against any and all liabilities, costs, expenses, amounts paid in settlement and damages incurred by the directors as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors are sued or charged as a result of their service as members of our Board of Directors.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**MARKET RISK**

We are exposed to various market risks, including changes in foreign currency exchange rates, interest rates and market prices. Market risk is the potential loss arising from changes in market rates and market prices. We employ established policies and practices to manage these risks. Foreign exchange option and forward contracts are used to hedge anticipated exposures or mitigate some existing exposures subject to foreign exchange risk as discussed below. We have not historically, nor do we currently, hedge our short-term investment portfolio. We do not consider our cash and cash equivalents to be exposed to significant interest rate risk because our cash and cash equivalent portfolio consists of highly liquid investments with original maturities of three months or less. We also do not currently hedge our market price risk relating to our equity investments. Further, we do not enter into derivatives or other financial instruments for trading or speculative purposes.

***Foreign Currency Exchange Rate Risk***

*Cash Flow Hedging Activities* . From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing option contracts that generally have maturities of 15 months or less. These transactions are designated and qualify as cash flow hedges. The derivative assets associated with our hedging activities are recorded at fair value in other current assets in our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity and subsequently reclassified into net revenue or operating expenses, as appropriate in the period when the forecasted transaction is recorded. The ineffective portion of gains or losses resulting from changes in fair value, if any, is reported in each period in interest and other income, net, in our Condensed Consolidated Statements of Operations. Our hedging programs reduce, but do not entirely eliminate, the impact of currency exchange rate movements in revenue and operating expenses. As of June 30, 2007, we had foreign currency option contracts to purchase approximately \$29 million in foreign currencies and to sell approximately \$346 million of foreign currencies. As of June 30, 2007, these foreign currency option contracts outstanding had a total fair value of \$3 million, included in other current assets.

*Balance Sheet Hedging Activities* . We use foreign exchange forward contracts to mitigate foreign currency risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The forward contracts generally have a contractual term of three months or less and are transacted near month-end. Our foreign exchange forward contracts are not designated as hedging instruments under SFAS No. 133 and are accounted for as derivatives whereby the fair value of the contracts are reported as other current assets or other current liabilities in our Condensed Consolidated Balance Sheets, and gains and losses from changes in fair value are reported in interest and other income, net. The gains and losses on these forward contracts generally offset the gains and losses on the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. As of June 30, 2007, we had forward foreign exchange contracts to purchase and sell approximately \$155 million in foreign currencies. Of this amount, \$107 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$13 million to sell foreign currencies in exchange for British pound sterling and \$35 million to purchase foreign currencies in exchange for U.S. dollars. The fair value of our forward contracts was immaterial as of June 30, 2007.

The counterparties to these forward and option contracts are creditworthy multinational commercial banks; therefore, the risk of counterparty nonperformance is not considered to be material.

Notwithstanding our efforts to mitigate some foreign currency exchange rate risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of June 30, 2007, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would result in a potential loss in fair value of our option contracts of \$3 million in both scenarios. A hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would result in potential losses on our forward contracts of \$14 million and \$21 million, respectively, as of June 30, 2007. This sensitivity analysis assumes a parallel adverse shift in foreign currency exchange rates, which do not always move in the same direction. Actual results may differ materially.

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We manage our interest rate risk by maintaining an investment portfolio generally consisting of debt instruments of high credit quality and relatively short maturities. Additionally, the contractual terms of the securities do not permit the issuer to call, prepay or otherwise settle the securities at prices less than the stated par value of the securities. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.

As of June 30, 2007 and March 31, 2007, our short-term investments were classified as available-for-sale and, consequently, recorded at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of any tax effects, in stockholders' equity. Our portfolio of short-term investments consisted of the following investment categories, summarized by fair value as of June 30, 2007 and March 31, 2007 (in millions):

|                              | As of<br>June 30,<br>2007 | As of<br>March 31,<br>2007 |
|------------------------------|---------------------------|----------------------------|
| Commercial paper             | \$ 725                    | \$ 574                     |
| Corporate bonds              | 300                       | 226                        |
| U.S. agency securities       | 296                       | 264                        |
| Asset-backed securities      | 129                       | 108                        |
| U.S. Treasury securities     | 76                        | 92                         |
| Total short-term investments | <u>\$ 1,526</u>           | <u>\$ 1,264</u>            |

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. At any time, a sharp change in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in fair value in our short-term investment portfolio as of June 30, 2007, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ("BPS"), 100 BPS, and 150 BPS.

| (In millions)                | Valuation of Securities Given<br>an Interest Rate Decrease of X<br>Basis Points |                 |                 | Fair Value<br>as of<br>June 30,<br>2007 | Valuation of Securities Given<br>an Interest Rate Increase of X<br>Basis Points |                 |                 |
|------------------------------|---------------------------------------------------------------------------------|-----------------|-----------------|-----------------------------------------|---------------------------------------------------------------------------------|-----------------|-----------------|
|                              | (150 BPS)                                                                       | (100 BPS)       | (50 BPS)        |                                         | 50 BPS                                                                          | 100 BPS         | 150 BPS         |
| Commercial paper             | \$ 727                                                                          | \$ 726          | \$ 725          | \$ 725                                  | \$ 723                                                                          | \$ 722          | \$ 722          |
| Corporate bonds              | 306                                                                             | 305             | 303             | 300                                     | 297                                                                             | 296             | 294             |
| U.S. agency securities       | 304                                                                             | 301             | 298             | 296                                     | 293                                                                             | 290             | 287             |
| Asset-backed securities      | 132                                                                             | 131             | 130             | 129                                     | 129                                                                             | 128             | 127             |
| U.S. Treasury securities     | 79                                                                              | 78              | 77              | 76                                      | 76                                                                              | 75              | 74              |
| Total short-term investments | <u>\$ 1,548</u>                                                                 | <u>\$ 1,541</u> | <u>\$ 1,533</u> | <u>\$ 1,526</u>                         | <u>\$ 1,518</u>                                                                 | <u>\$ 1,511</u> | <u>\$ 1,504</u> |

**Market Price Risk**

The value of our equity investments in publicly traded companies are subject to market price volatility. As of June 30, 2007 and March 31, 2007, our marketable equity securities were classified as available-for-sale and, consequently, were recorded in our Condensed Consolidated Balance Sheets at fair market value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of any tax effects, in stockholders' equity. The fair value of our marketable equity securities was \$660 million and \$341 million as of June 30, 2007 and March 31, 2007, respectively.

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At any time, a sharp change in market prices in our investments in marketable equity securities could have a significant impact on the fair value of our investments. The following table presents hypothetical changes in the fair value of our marketable equity securities as of June 30, 2007, arising from changes in market prices plus or minus 25 percent, 50 percent and 75 percent.

| (In millions)                | Valuation of Securities Given<br>an X Percentage Decrease<br>in Each Stock's Market Price |        |        | Fair Value<br>as of<br>June 30,<br>2007 | Valuation of Securities Given<br>an X Percentage Increase<br>in Each Stock's Market Price |        |          |
|------------------------------|-------------------------------------------------------------------------------------------|--------|--------|-----------------------------------------|-------------------------------------------------------------------------------------------|--------|----------|
|                              | (75%)                                                                                     | (50%)  | (25%)  |                                         | 25%                                                                                       | 50%    | 75%      |
| Marketable equity securities | \$ 165                                                                                    | \$ 330 | \$ 495 | \$ 660                                  | \$ 825                                                                                    | \$ 990 | \$ 1,155 |

**Item 4. Controls and Procedures**

***Definition and limitations of disclosure controls***

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial and Administrative Officer, as appropriate to allow timely decisions regarding required disclosure. Our management evaluates these controls and procedures on an ongoing basis.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. These limitations include the possibility of human error, the circumvention or overriding of the controls and procedures and reasonable resource constraints. In addition, because we have designed our system of controls based on certain assumptions, which we believe are reasonable, about the likelihood of future events, our system of controls may not achieve its desired purpose under all possible future conditions. Accordingly, our disclosure controls and procedures provide reasonable assurance, but not absolute assurance, of achieving their objectives.

***Evaluation of disclosure controls and procedures***

Our Chief Executive Officer and our Chief Financial and Administrative Officer, after evaluating the effectiveness of our disclosure controls and procedures, believe that as of the end of the period covered by this report, our disclosure controls and procedures were effective in providing the requisite reasonable assurance that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial and Administrative Officer, as appropriate to allow timely decisions regarding the required disclosure.

***Changes in internal control over financial reporting***

We have implemented a new set of financial information systems and processes designed to help us accurately process, prepare, report and analyze the significant amount of net revenue from online-enabled packaged goods and digital content we will recognize on a deferred basis. During the quarter ended June 30, 2007, no other changes occurred in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

We are subject to claims and litigation arising in the ordinary course of business. We believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would not have a material adverse effect on our consolidated financial position or results of operations.

### Item 1A. Risk Factors

Our business is subject to many risks and uncertainties, which may affect our future financial performance. If any of the events or circumstances described below occurs, our business and financial performance could be harmed, our actual results could differ materially from our expectations and the market value of our stock could decline. The risks and uncertainties discussed below are not the only ones we face. There may be additional risks and uncertainties not currently known to us or that we currently do not believe are material that may harm our business and financial performance.

**Our business is highly dependent on the success and availability of video game hardware systems manufactured by third parties, as well as our ability to develop commercially successful products for these systems.**

We derive most of our revenue from the sale of products for play on video game hardware systems (which we also refer to as “platforms”) manufactured by third parties, such as Sony’s PlayStation 2 and PLAYSTATION 3, Microsoft’s Xbox 360 and Nintendo’s Wii. The success of our business is driven in large part by the commercial success and adequate supply of these video game hardware systems, our ability to accurately predict which systems will be successful in the marketplace, and our ability to develop commercially successful products for these systems. We must make product development decisions and commit significant resources well in advance of anticipated product ship dates. A platform for which we are developing products may not succeed or may have a shorter life cycle than anticipated. If consumer demand for the systems for which we are developing products are lower than our expectations, our revenue will suffer, we may be unable to fully recover the investments we have made in developing our products, and our financial performance will be harmed. Alternatively, a system for which we have not devoted significant resources could be more successful than we had initially anticipated, causing us to miss out on meaningful revenue opportunities.

**Our industry is cyclical and is beginning its next cycle. During the transition, consumers may be slower to adopt new video game systems than we anticipate, and our operating results may suffer and become more difficult to predict.**

Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. Microsoft launched the Xbox 360 in November 2005, while Sony and Nintendo launched the PLAYSTATION 3 and the Wii, respectively, in November 2006. We have continued to develop and market new titles for prior-generation video game systems such as the PlayStation 2 while also making significant investments in products for the new systems. As the prior-generation systems reach the end of their life cycle and the installed base of the new systems continues to grow, our sales of video games for prior-generation systems will continue to decline as (1) we produce fewer titles for prior-generation systems, (2) consumers replace their prior-generation systems with the new systems, and/or (3) consumers defer game software purchases until they are able to purchase a new video game hardware system. This decline in prior-generation product sales may be greater or faster than we anticipate, and sales of products for the new platforms may be lower or increase more slowly than we anticipate. Moreover, we expect development costs for the new video game systems to be greater on a per-title basis than development costs for prior-generation video game systems. As a result of these factors, during the next several quarters, we expect our operating results to be more volatile and difficult to predict, which could cause our stock price to fluctuate significantly.

**If we do not consistently meet our product development schedules, our operating results will be adversely affected.**

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring in the December quarter. In addition, we seek to release many of our products in conjunction with specific events, such as the release of a related movie or the beginning of a sports season or major sporting event. If we miss these key selling periods for any reason, including product delays or delayed introduction of a new platform for which we have developed products, our sales will suffer disproportionately. Likewise, if a key event to which our product release schedule is tied were to be delayed or cancelled, our sales would also suffer disproportionately. Our ability to meet product development schedules is affected by a

number of factors, including the creative processes involved, the coordination of large and sometimes geographically dispersed development teams required by the increasing complexity of our products and the platforms for which they are developed, and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back release dates. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, harm our profitability, and cause our operating results to be materially different than anticipated.

**Our business is intensely competitive and “hit” driven. If we do not continue to deliver “hit” products and services or if consumers prefer our competitors’ products or services over our own, our operating results could suffer.**

Competition in our industry is intense and we expect new competitors to continue to emerge in the United States and abroad. While many new products and services are regularly introduced, only a relatively small number of “hit” titles accounts for a significant portion of total revenue in our industry. Hit products or services offered by our competitors may take a larger share of consumer spending than we anticipate, which could cause revenue generated from our products and services to fall below expectations. If our competitors develop more successful products or services, offer competitive products or services at lower price points or based on payment models perceived as offering a better value proposition (such as pay-for-play or subscription-based models), or if we do not continue to develop consistently high-quality and well-received products and services, our revenue, margins, and profitability will decline.

**We are in the process of reorganizing our business and operating structure. We may encounter a variety of issues in connection with the reorganization that could negatively impact our operating results, financial condition and ability to report our financial results.**

In an effort to streamline our internal decision-making processes, improve our global focus, and accelerate the process of bringing new ideas to market, we have begun to reorganize our business into four major divisions, which we refer to as “Labels”: The Sims, EA Games, EA SPORTS, and EA Casual Entertainment. The reorganization will present a number of operational challenges, which, if not successfully managed, could cause our operating results to suffer in the near-term and/or delay or inhibit the anticipated benefits of the reorganization. Implementing any reorganization necessarily requires time and focus from all levels of the organization – time and focus that may be taken away from other business needs. For example, as our employees assume new responsibilities under the new structure, their responsibilities under the old structure may not be successfully re-assigned or adequately addressed, which could result in operational problems that negatively impact our financial condition and operating results. Similarly, as our employees’ roles and responsibilities change in a new structure, it is possible that we could experience a greater loss of key personnel than we have historically. Further, in connection with the reorganization, we anticipate that we will need to align some of our internal financial controls and procedures with our new organizational structure. Any delay or failure to align our internal controls over financial reporting could prevent us from reporting our financial results in a timely manner or lead to control deficiencies.

**Technology changes rapidly in our business and if we fail to anticipate or successfully implement new technologies or the manner in which people play our games, the quality, timeliness and competitiveness of our products and services will suffer.**

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must implement and take advantage of in order to make our products and services competitive in the market. Therefore, we usually start our product development with a range of technical development goals that we hope to be able to achieve. We may not be able to achieve these goals, or our competition may be able to achieve them more quickly and effectively than we can. In either case, our products and services may be technologically inferior to our competitors’, less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule of our products and services, then we may delay their release until these technology goals can be achieved, which may delay or reduce revenue and increase our development expenses. Alternatively, we may increase the resources employed in research and development in an attempt to accelerate our development of new technologies, either to preserve our product or service launch schedule or to keep up with our competition, which would increase our development expenses.

**The video game hardware manufacturers set the royalty rates and other fees that we must pay to publish games for their platforms, and therefore have significant influence on our costs. If one or more of these manufacturers adopt a different fee structure for future game consoles, our profitability will be materially impacted.**

In order to publish products for a video game system such as the Xbox 360, PLAYSTATION 3 or Wii, we must take a license from the manufacturer, which gives it the opportunity to set the fee structure that we must pay in order to publish games for that platform. Similarly, certain manufacturers have retained the flexibility to change their fee structures, or adopt different fee structures for online gameplay and other new features for their consoles. The control that hardware manufacturers have over the fee structures for their platforms and online access makes it difficult for us to predict our costs, profitability and impact on margins. Because publishing products for video game systems is the largest portion of our business, any increase in fee structures would significantly harm our ability to generate revenues and/or profits.

**The video game hardware manufacturers are among our chief competitors and frequently control the manufacturing of and/or access to our video game products. If they do not approve our products, we will be unable to ship to our customers.**

Our agreements with hardware licensors (such as Sony for the PLAYSTATION 3, Microsoft for the Xbox 360, and Nintendo for the Wii) typically give significant control to the licensor over the approval and manufacturing of our products, which could, in certain circumstances, leave us unable to get our products approved, manufactured and shipped to customers. These hardware licensors are also among our chief competitors. Generally, control of the approval and manufacturing process by the hardware licensors increases both our manufacturing lead times and costs as compared to those we can achieve independently. While we believe that our relationships with our hardware licensors are currently good, the potential for these licensors to delay or refuse to approve or manufacture our products exists. Such occurrences would harm our business and our financial performance.

We also require compatibility code and the consent of Microsoft, Sony and Nintendo in order to include online capabilities in our products for their respective platforms. As online capabilities for video game systems become more significant, Microsoft, Sony and Nintendo could restrict the manner in which we provide online capabilities for our products. If Microsoft, Sony or Nintendo refused to approve our products with online capabilities or significantly impacted the financial terms on which these services are offered to our customers, our business could be harmed.

**If we are unable to maintain or acquire licenses to intellectual property, we will publish fewer hit titles and our revenue, profitability and cash flows will decline. Competition for these licenses may make them more expensive and increase our costs.**

Many of our products are based on or incorporate intellectual property owned by others. For example, our EA SPORTS products include rights licensed from major sports leagues and players' associations. Similarly, many of our other hit franchises, such as The Godfather, Harry Potter and Lord of the Rings, are based on key film and literary licenses. Competition for these licenses is intense. If we are unable to maintain these licenses or obtain additional licenses with significant commercial value, our revenues and profitability will decline significantly. Competition for these licenses may also drive up the advances, guarantees and royalties that we must pay to the licensor, which could significantly increase our costs.

**Our business is subject to risks generally associated with the entertainment industry, any of which could significantly harm our operating results.**

Our business is subject to risks that are generally associated with the entertainment industry, many of which are beyond our control. These risks could negatively impact our operating results and include: the popularity, price and timing of our games and the platforms on which they are played; economic conditions that adversely affect discretionary consumer spending; changes in consumer demographics; the availability and popularity of other forms of entertainment; and critical reviews and public tastes and preferences, which may change rapidly and cannot necessarily be predicted.

**If we do not continue to attract and retain key personnel, we will be unable to effectively conduct our business.**

The market for technical, creative, marketing and other personnel essential to the development and marketing of our products and management of our businesses is extremely competitive. Our leading position within the interactive entertainment industry makes us a prime target for recruiting of executives and key creative talent. If we cannot successfully recruit and retain the

employees we need, or replace key employees following their departure, our ability to develop and manage our businesses will be impaired.

**If patent claims continue to be asserted against us, we may be unable to sustain our current business models or profits, or we may be precluded from pursuing new business opportunities in the future.**

Many patents have been issued that may apply to widely-used game technologies, or to potential new modes of delivering, playing or monetizing game software products. For example, infringement claims under many issued patents are now being asserted against interactive software or online game sites. Several such claims have been asserted against us. We incur substantial expenses in evaluating and defending against such claims, regardless of the merits of the claims. In the event that there is a determination that we have infringed a third-party patent, we could incur significant monetary liability and be prevented from using the rights in the future, which could negatively impact our operating results. We may also discover that future opportunities to provide new and innovative modes of game play and game delivery to consumers may be precluded by existing patents that we are unable to license on reasonable terms.

**Other intellectual property claims may increase our product costs or require us to cease selling affected products.**

Many of our products include extremely realistic graphical images, and we expect that as technology continues to advance, images will become even more realistic. Some of the images and other content are based on real-world examples that may inadvertently infringe upon the intellectual property rights of others. Although we believe that we make reasonable efforts to ensure that our products do not violate the intellectual property rights of others, it is possible that third parties still may claim infringement. From time to time, we receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether valid or not, may be time consuming and expensive to defend. Such claims or litigations could require us to stop selling the affected products, redesign those products to avoid infringement, or obtain a license, all of which would be costly and harm our business.

**From time to time we may become involved in other legal proceedings which could adversely affect us.**

We are currently, and from time to time in the future may become, subject to legal proceedings, claims, litigation and government investigations or inquiries, which could be expensive, lengthy, and disruptive to normal business operations. In addition, the outcome of any legal proceedings, claims, litigation, investigations or inquiries may be difficult to predict and could have a material adverse effect on our business, operating results, or financial condition.

**Our business, our products and our distribution are subject to increasing regulation of content, consumer privacy, distribution and online hosting and delivery in the key territories in which we conduct business. If we do not successfully respond to these regulations, our business may suffer.**

Legislation is continually being introduced that may affect both the content of our products and their distribution. For example, data and consumer protection laws in the United States and Europe impose various restrictions on our web sites. Those rules vary by territory although the Internet recognizes no geographical boundaries. Other countries, such as Germany, have adopted laws regulating content both in packaged games and those transmitted over the Internet that are stricter than current United States laws. In the United States, the federal and several state governments are continually considering content restrictions on products such as ours, as well as restrictions on distribution of such products. For example, recent legislation has been adopted in several states, and could be proposed at the federal level, that prohibits the sale of certain games (e.g., violent games or those with “M (Mature)” or “AO (Adults Only)” ratings) to minors. Any one or more of these factors could harm our business by limiting the products we are able to offer to our customers, by limiting the size of the potential market for our products, and by requiring costly additional differentiation between products for different territories to address varying regulations.

**If one or more of our titles were found to contain hidden, objectionable content, our business could suffer.**

Throughout the history of our industry, many video games have been designed to include certain hidden content and gameplay features that are accessible through the use of in-game cheat codes or other technological means that are intended to enhance the gameplay experience. However, in several recent cases, hidden content or features have been found to be included in other publishers’ products by an employee who was not authorized to do so or by an outside developer without the knowledge of the publisher. From time to time, some hidden content and features have contained profanity, graphic violence and sexually explicit or otherwise objectionable material. In a few cases, the Entertainment Software Ratings Board (“ESRB”) has reacted to

discoveries of hidden content and features by reviewing the rating that was originally assigned to the product, requiring the publisher to change the game packaging and/or fining the publisher. Retailers have on occasion reacted to the discovery of such hidden content by removing these games from their shelves, refusing to sell them, and demanding that their publishers accept them as product returns. Likewise, consumers have reacted to the revelation of hidden content by refusing to purchase such games, demanding refunds for games they've already purchased, and refraining from buying other games published by the company whose game contained the objectionable material.

We have implemented preventative measures designed to reduce the possibility of hidden, objectionable content from appearing in the video games we publish. Nonetheless, these preventative measures are subject to human error, circumvention, overriding, and reasonable resource constraints. If a video game we published were found to contain hidden, objectionable content, the ESRB could demand that we recall a game and change its packaging to reflect a revised rating, retailers could refuse to sell it and demand we accept the return of any unsold copies or returns from customers, and consumers could refuse to buy it or demand that we refund their money. This could have a material negative impact on our operating results and financial condition. In addition, our reputation could be harmed, which could impact sales of other video games we sell. If any of these consequences were to occur, our business and financial performance could be significantly harmed.

### **If we ship defective products, our operating results could suffer.**

Products such as ours are extremely complex software programs, and are difficult to develop, manufacture and distribute. We have quality controls in place to detect defects in the software, media and packaging of our products before they are released. Nonetheless, these quality controls are subject to human error, overriding, and reasonable resource constraints. Therefore, these quality controls and preventative measures may not be effective in detecting defects in our products before they have been reproduced and released into the marketplace. In such an event, we could be required to recall a product, or we may find it necessary to voluntarily recall a product, and/or scrap defective inventory, which could significantly harm our business and operating results.

### **Our international net revenue is subject to currency fluctuations.**

For the three months ended June 30, 2007, international net revenue comprised 59 percent of our total net revenue. We expect foreign sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. While we use foreign exchange forward contracts to mitigate some foreign currency risk associated with foreign currency denominated assets and liabilities (primarily certain intercompany receivables and payables) and, from time to time, foreign currency option contracts to hedge foreign currency forecasted transactions (primarily related to a portion of the revenue and expenses denominated in foreign currency generated by our operational subsidiaries), our results of operations, including our reported net revenue and net income, and financial condition would be adversely affected by unfavorable foreign currency fluctuations, particularly the Euro, British pound sterling and Canadian dollar.

### **Changes in our tax rates or exposure to additional tax liabilities could adversely affect our earnings and financial condition.**

We are subject to income taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, and, in the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain.

We are also required to estimate what our tax obligations will be in the future. Although we believe our tax estimates are reasonable, the estimation process and applicable laws are inherently uncertain, and our estimates are not binding on tax authorities. Our effective tax rate could be adversely affected by our profit level, by changes in our business or changes in our structure resulting from the reorganization of our business and operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws as well as other factors. Further, our tax determinations are regularly subject to audit by tax authorities and developments in those audits could adversely affect our income tax provision. Should our ultimate tax liability exceed our estimates, our income tax provision and net income or loss could be materially affected.

We incur certain tax expenses that do not decline proportionately with declines in our consolidated pre-tax income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax

income or loss than higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and various foreign jurisdictions. We are regularly under examination by tax authorities with respect to these non-income taxes. There can be no assurance that the outcomes from these examinations, changes in our business or changes in applicable tax rules will not have an adverse effect on our earnings and financial condition.

**Our reported financial results could be adversely affected by changes in financial accounting standards or by the application of existing or future accounting standards to our business as it evolves.**

As a result of the enactment of the Sarbanes-Oxley Act and the review of accounting policies by the SEC and national and international accounting standards bodies, the frequency of accounting policy changes may accelerate. For example, as discussed in Note 8 of the Notes to Condensed Consolidated Financial Statements, FIN No. 48 has affected the way we account for income taxes and may have a material impact on our financial results. Similarly, changes in accounting standards relating to stock-based compensation require us to recognize significantly greater expense than we had been recognizing prior to the adoption of the new standard. Likewise, policies affecting software revenue recognition have and could further significantly affect the way we account for revenue related to our products and services. For example, as our industry transitions to new video game hardware systems, we expect a more significant portion of our console and PC games will be online-enabled and, as a result, we will be required to recognize the related revenue over an extended period of time rather than at the time of sale. As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenue and taxes, could have a significant adverse effect on our reported results although not necessarily on our cash flows.

**We have begun the implementation of a new set of financial information systems in anticipation of a significant increase in deferred net revenue, which, if not completed in a successful and timely manner, could impede our ability to accurately process, prepare and analyze important financial data.**

We have begun to implement a new set of financial information systems and processes designed to help us accurately process, prepare and analyze the significant amount of net revenue from online-enabled packaged goods we expect to recognize on a deferred basis beginning in fiscal 2008. The successful implementation of these systems and processes entails a number of risks due to the complexity of the systems, the number of people affected company-wide, and the implementation process itself. While testing of these new systems and processes and training of employees are done in advance of implementation, there are inherent limitations in our ability to simulate a full-scale operating environment in advance of implementation. There can be no assurance that the implementation of these financial information systems and processes will not impede our ability to accurately and timely process, prepare and analyze the financial data we use in making operating decisions and which form the basis of the financial information we include in the periodic reports we file with the SEC.

**Changes in our worldwide operating structure or the adoption of new products and distribution models could have adverse tax consequences.**

As we expand our international operations, adopt new products and new distribution models, implement changes to our operating structure or undertake intercompany transactions in light of changing tax laws, expiring rulings, acquisitions and our current and anticipated business and operational requirements, our tax expense could increase. For example, in the fourth quarter of fiscal 2006, we repatriated \$375 million under the American Jobs Creation Act of 2004. As a result, we recognized an additional one-time tax expense in fiscal 2006 of \$17 million.

**The majority of our sales are made to a relatively small number of key customers. If these customers reduce their purchases of our products or become unable to pay for them, our business could be harmed.**

In the quarter ended June 30, 2007, over 63 percent of our U.S. sales were made to seven key customers. In Europe, our top ten customers accounted for approximately 29 percent of our sales in that territory during the three months ended June 30, 2007. No single customer represented more than 10 percent of total net revenue during the three months ended June 30, 2007. Though our products are available to consumers through a variety of retailers, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their

purchases or ceased to carry our products, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products. Additionally, our receivables from these large customers increase significantly in the December quarter as they stock up for the holiday selling season. Also, having such a large portion of our total net revenue concentrated in a few customers could reduce our negotiating leverage with these customers.

**Acquisitions, investments and other strategic transactions could result in operating difficulties, dilution to our investors and other negative consequences.**

We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including (i) acquisitions of companies, businesses, intellectual properties, and other assets, (ii) minority investments in strategic partners, and (iii) investments in new interactive entertainment businesses (for example, online and mobile games). Any of these strategic transactions could be material to our financial condition and results of operations. Although we regularly search for opportunities to engage in strategic transactions, we may not be successful in identifying suitable opportunities. We may not be able to consummate potential acquisitions or investments or an acquisition or investment may not enhance our business or may decrease rather than increase our earnings. In addition, the process of integrating an acquired company or business, or successfully exploiting acquired intellectual property or other assets, could divert a significant amount of our management's time and focus and may create unforeseen operating difficulties and expenditures. Additional risks we face include:

- The need to implement or remediate controls, procedures and policies appropriate for a public company in an acquired company that, prior to the acquisition, lacked these controls, procedures and policies,
- Cultural challenges associated with integrating employees from an acquired company or business into our organization,
- Retaining key employees from the businesses we acquire,
- The need to integrate an acquired company's accounting, management information, human resource and other administrative systems to permit effective management, and
- To the extent that we engage in strategic transactions outside of the United States, we face additional risks, including risks related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries.

Future acquisitions and investments could involve the issuance of our equity securities, potentially diluting our existing stockholders, the incurrence of debt, contingent liabilities or amortization expenses, write-offs of goodwill, intangibles, or acquired in-process technology, or other increased expenses, any of which could harm our financial condition. Our stockholders may not have the opportunity to review, vote on or evaluate future acquisitions or investments.

**Our products are subject to the threat of piracy by a variety of organizations and individuals. If we are not successful in combating and preventing piracy, our sales and profitability could be harmed significantly.**

In many countries around the world, more pirated copies of our products are sold than legitimate copies. Though we believe piracy has not had a material impact on our operating results to date, highly organized pirate operations have been expanding globally. In addition, the proliferation of technology designed to circumvent the protection measures we use in our products, the availability of broadband access to the Internet, the ability to download pirated copies of our games from various Internet sites, and the widespread proliferation of Internet cafes using pirated copies of our products, all have contributed to ongoing and expanding piracy. Though we take steps to make the unauthorized copying and distribution of our products more difficult, as do the manufacturers of consoles on which our games are played, these efforts may not be successful in controlling the piracy of our products. This could have a negative effect on our growth and profitability in the future.

**Our stock price has been volatile and may continue to fluctuate significantly.**

The market price of our common stock historically has been, and we expect will continue to be, subject to significant fluctuations. These fluctuations may be due to factors specific to us (including those discussed in the risk factors above as well as others not currently known to us or that we currently do not believe are material), to changes in securities analysts' earnings estimates or ratings, to our results or future financial guidance falling below our expectations and analysts' and investors' expectations, to factors affecting the computer, software, Internet, entertainment, media or electronics industries, or to national or international economic conditions.

**Item 6. Exhibits**

The following exhibits (other than exhibits 32.1 and 32.2, which are furnished with this report) are filed as part of, or incorporated by reference into, this report:

| <u>Exhibit<br/>Number</u> | <u>Title</u>                                                                                                                                                                                                |
|---------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1                      | Electronic Arts Inc. 2000 Equity Incentive Plan, as amended. (*)                                                                                                                                            |
| 10.2                      | Electronic Arts Inc. 2000 Employee Stock Purchase Plan, as amended. (*)                                                                                                                                     |
| 10.3                      | Electronic Arts Inc. Deferred Compensation Plan. (*)                                                                                                                                                        |
| 10.4                      | Offer Letter for Employment at Electronic Arts Inc. to Kathy Vrabeck, dated May 10, 2007. (*) (1)                                                                                                           |
| 10.5                      | Employment Agreement between Electronic Arts (Canada), Inc. and V. Paul Lee, dated June 18, 2007. (*) (2)                                                                                                   |
| 10.6                      | Offer Letter for Employment at Electronic Arts Inc. to Peter Moore, dated June 5, 2007. (*) (3)                                                                                                             |
| 10.7                      | Electronic Arts Inc. Executive Bonus Plan. (*) (4)                                                                                                                                                          |
| 15.1                      | Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm.                                                                                                                                |
| 31.1                      | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                              |
| 31.2                      | Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

Additional exhibits furnished with this report:

|      |                                                                                                                                                  |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------|
| 32.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                              |
| 32.2 | Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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\* Management contract or compensatory plan or arrangement.

- (1) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed June 6, 2007.
- (2) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed June 22, 2007.
- (3) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed July 17, 2007.
- (4) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed July 27, 2007.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ELECTRONIC ARTS INC.  
(Registrant)

/s/ Warren C. Jenson  
WARREN C. JENSON  
Executive Vice President,  
Chief Financial and Administrative Officer

DATED:  
August 6, 2007

**ELECTRONIC ARTS INC.  
FORM 10-Q  
FOR THE PERIOD ENDED JUNE 30, 2007**

**EXHIBIT INDEX**

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## ELECTRONIC ARTS INC.

## 2000 EQUITY INCENTIVE PLAN

## As Amended by the Stockholders on July 26, 2007

**1. PURPOSE.** The purpose of this Plan is to provide incentives to attract, retain and motivate eligible persons whose present and potential contributions are important to the success of the Company, its Parent and Subsidiaries by offering them an opportunity to participate in the Company's future performance through awards of Options, Restricted Stock, Restricted Stock Units, and Stock Appreciation Rights. Capitalized terms not defined in the text are defined in Section 24.

**2. SHARES SUBJECT TO THE PLAN.**

2.1 Number of Shares. Subject to Sections 2.2, 2.3 and 19, the aggregate number of Shares that have been reserved pursuant to this Plan is 76,400,000 Shares. Shares that are: (a) subject to issuance upon exercise of an Award but cease to be subject to such Award for any reason other than exercise of such Award; (b) subject to an Award granted hereunder but are forfeited; or (c) subject to an Award that otherwise terminates or is settled without Shares being issued shall revert to and again become available for issuance under the Plan. The following Shares shall not again become available for issuance under the Plan: (x) Shares that are not issued or delivered as a result of the net settlement of an Option or Stock Appreciation Right; (y) Shares that are used to pay the exercise price or withholding taxes related to an Award; or (z) Shares that are repurchased by the Company with the proceeds of an Option exercise. At all times the Company shall reserve and keep available a sufficient number of Shares as shall be required to satisfy the requirements of all outstanding Options and Stock Appreciation Rights granted under this Plan and all other outstanding but unvested Awards granted under this Plan.

2.2 Limitation on Number of Shares Subject to Restricted Stock Awards and Restricted Stock Unit Awards. The number of Shares that may be issued under Sections 6 and 7 of this Plan shall not exceed 11,000,000 in the aggregate.

2.3 Adjustment of Shares. In the event that the number of outstanding shares is changed by a stock dividend, recapitalization, stock split, reverse stock split, subdivision, combination, reclassification or similar change in the capital structure of the Company without consideration, then (a) the number of Shares reserved for issuance under this Plan, (b) the Exercise Prices of and number of Shares subject to outstanding Awards, and (c) the number of Shares associated with other outstanding Awards, will be proportionately adjusted, subject to any required action by the Board or the stockholders of the Company and compliance with applicable securities laws; provided, however, that fractions of a Share will not be issued but will either be replaced by a cash payment equal to the Fair Market Value of such fraction of a Share or will be rounded up to the nearest whole Share, as determined by the Committee.

**3. ELIGIBILITY.** ISOs (as defined in Section 5 below) may be granted only to employees (including officers and directors who are also employees) of the Company or of a Parent or Subsidiary of the Company. All other Awards may be granted to employees and directors of the Company or any Parent or Subsidiary of the Company. No person will be eligible to receive Awards covering more than 1,400,000 Shares in any calendar year under this Plan, of which no more than 400,000 Shares shall be covered by Awards of Restricted Stock or Restricted Stock Units, other than new employees of the Company or of a Parent or Subsidiary of the Company (including new employees who are also officers and directors of the Company or any Parent or Subsidiary of the Company), who are eligible to receive Awards covering up to a maximum of 2,800,000 Shares in the calendar year in which they commence their employment, of which no more than 800,000 Shares shall be covered by Awards of Restricted Stock or Restricted Stock Units. For purposes of these limits, each Restricted Stock Unit settled in Shares (but not those settled in cash), shall be deemed to cover one Share. A person may be granted more than one Award under this Plan.

#### **4. ADMINISTRATION.**

4.1 Committee Authority . This Plan will be administered by the Committee or by the Board acting as the Committee. Except for automatic grants to Outside Directors pursuant to Section 10 hereof, and subject to the general purposes, terms and conditions of this Plan, and to the direction of the Board, the Committee will have full power to implement and carry out this Plan. Except for automatic grants to Outside Directors pursuant to Section 10 hereof, the Committee will have the authority to:

- (a) construe and interpret this Plan, any Award Agreement and any other agreement or document executed pursuant to this Plan;
- (b) prescribe, amend and rescind rules and regulations relating to this Plan or any Award;
- (c) select persons to receive Awards;
- (d) determine the form and terms of Awards;
- (e) determine the number of Shares or other consideration subject to Awards;
- (f) determine whether Awards will be granted singly, in combination with, in tandem with, in replacement of, or as alternatives to, other Awards under this Plan or any other incentive or compensation plan of the Company or any Parent or Subsidiary of the Company;
- (g) grant waivers of Plan or Award conditions;
- (h) determine the vesting, exercisability and payment of Awards;
- (i) correct any defect, supply any omission or reconcile any inconsistency in this Plan, any Award or any Award Agreement;
- (j) determine whether an Award has been earned; and
- (k) make all other determinations necessary or advisable for the administration of this Plan.

4.2 Committee Discretion . Except for automatic grants to Outside Directors pursuant to Section 10 hereof, any determination made by the Committee with respect to any Award will be made in its sole discretion at the time of grant of the Award or, unless in contravention of any express term of this Plan or Award, at any later time, and such determination will be final and binding on the Company and on all persons having an interest in any Award under this Plan. The Committee may delegate to one or more officers of the Company the authority to (i) construe and interpret this Plan, any Award Agreement and any other agreement or document executed pursuant to this Plan, and (ii) grant an Award under this Plan to Participants who are not Insiders of the Company.

4.3 Section 162(m) . To the extent that Awards are granted hereunder as “performance-based compensation” within the meaning of Section 162(m) of the Code, the Plan shall be administered by a committee, which may be the Committee, of two or more “outside directors” within the meaning of Section 162(m) of the Code. For purposes of qualifying grants of Awards as “performance-based compensation” under Section 162(m) of the Code, the committee, in its discretion, may set restrictions based upon the achievement of performance goals. The performance goals shall be set by the committee on or before the latest date permissible to enable the Awards to qualify as “performance-based compensation” under Section 162(m) of the Code. In granting Awards that are intended to qualify under

Section 162(m) of the Code, the committee shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Awards under Section 162(m) of the Code (e.g., in determining the performance goals).

**5. OPTIONS.** The Committee may grant Options to eligible persons and will determine whether such Options will be Incentive Stock Options within the meaning of the Code (“**ISO**”) or Nonqualified Stock Options (“**NQSOs**”), the number of Shares subject to the Option, the Exercise Price of the Option, the period during which the Option may be exercised, and all other terms and conditions of the Option, subject to the following:

**5.1 Form of Option Grant.** Each Option granted under this Plan will be evidenced by an Award Agreement which will expressly identify the Option as an ISO or an NQSO (“**Stock Option Agreement**”), and, except as otherwise required by the terms of Section 10 hereof, will be in such form and contain such provisions (which need not be the same for each Participant) as the Committee may from time to time approve, and which will comply with and be subject to the terms and conditions of this Plan.

**5.2 Date of Grant.** The date of grant of an Option will be the date on which the Committee makes the determination to grant such Option, unless otherwise specified by the Committee. The Stock Option Agreement and a copy of this Plan will be delivered to the Participant within a reasonable time after the granting of the Option.

**5.3 Exercise Period; Performance Goals.**

(a) Options may be exercisable within the times or upon the events determined by the Committee as set forth in the Stock Option Agreement governing such Option; *provided, however*, that no Option will be exercisable after the expiration of ten (10) years from the date the Option is granted; and *provided, further*, that no ISO granted to a person who directly or by attribution owns more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or of any Parent or Subsidiary of the Company (“**Ten Percent Stockholder**”) will be exercisable after the expiration of five (5) years from the date the ISO is granted. The Committee also may provide for Options to become exercisable at one time or from time to time, periodically or otherwise, in such number of Shares or percentage of Shares as the Committee determines.

(b) Participant’s ability to exercise Options shall be subject to such restrictions, if any, as the Committee may impose. These restrictions may be based upon completion of a specified number of years of service with the Company or a Subsidiary or upon completion of the performance goals as set out in advance in the Participant’s individual Stock Option Agreement. Options may vary from Participant to Participant and between groups of Participants. Should the Committee elect to impose restrictions on an Option, the Committee shall: (a) determine the nature, length and starting date of any Performance Period for the Option; (b) select from among the Performance Factors to be used to measure performance goals, if any; and (c) determine the number of Shares subject to such Option. Prior to such Option becoming exercisable, the Committee shall determine the extent to which such Performance Factors have been met. Performance Periods may overlap and Participants may participate simultaneously with respect to Options that are subject to different Performance Periods and have different performance goals and other criteria.

**5.4 Exercise Price.** The Exercise Price of an Option will be determined by the Committee when the Option is granted and may be not less than 100% of the Fair Market Value of the Shares on the date of grant; provided that the Exercise Price of any ISO granted to a Ten Percent Stockholder will not be less than 110% of the Fair Market Value of the Shares on the date of grant. Payment for the Shares purchased may be made in accordance with Section 9 of this Plan.

**5.5 Method of Exercise.** Options may be exercised only by delivery to the Company of a written stock option exercise agreement (the “Exercise Agreement”) in a form approved by the Committee (which need not be the same for each Participant), stating the number of Shares being purchased, the restrictions imposed on the Shares purchased under such Exercise Agreement, if any, and

such representations and agreements regarding Participant's investment intent and access to information and other matters, if any, as may be required or desirable by the Company to comply with applicable securities laws, together with payment in full of the Exercise Price for the number of Shares being purchased.

5.6 Termination . Notwithstanding the exercise periods set forth in the Stock Option Agreement, exercise of an Option will always be subject to the following:

- (a) If the Participant is Terminated for any reason except death or Disability, then the Participant may exercise such Participant's Options only to the extent that such Options would have been exercisable upon the Termination Date no later than three (3) months after the Termination Date (or such shorter or longer time period not exceeding five (5) years as may be determined by the Committee, with any exercise beyond three (3) months after the Termination Date deemed to be an NQSO), but in any event, no later than the expiration date of the Options.
- (b) If the Participant is Terminated because of Participant's death or Disability (or the Participant dies within three (3) months after a Termination other than for Cause or because of Participant's Disability), then Participant's Options may be exercised only to the extent that such Options would have been exercisable by Participant on the Termination Date and must be exercised by Participant (or Participant's legal representative or authorized assignee) no later than twelve (12) months after the Termination Date (or such shorter or longer time period not exceeding five (5) years as may be determined by the Committee, with any such exercise beyond (a) three (3) months after the Termination Date when the Termination is for any reason other than the Participant's death or Disability, or (b) twelve (12) months after the Termination Date when the Termination is for Participant's death or Disability, deemed to be an NQSO), but in any event no later than the expiration date of the Options.
- (c) Notwithstanding the provisions in paragraph 5.6(a) above, if a Participant is terminated for Cause, neither the Participant, the Participant's estate nor such other person who may then hold the Option shall be entitled to exercise any Option with respect to any Shares whatsoever, after termination of service, whether or not after termination of service the Participant may receive payment from the Company or Subsidiary for vacation pay, for services rendered prior to termination, for services rendered for the day on which termination occurs, for salary in lieu of notice, or for any other benefits. In the event that the Committee has delegated to one or more officers of the Company the authority set forth in Section 4.2 above and Participant has been notified that such officer or officers has made a determination that Participant has been terminated for Cause, Participant shall have five (5) business days (measured from the date he or she was first notified of such determination) to appeal such determination to the Committee. If Participant appeals to the Committee in a timely manner, the Committee shall give the Participant an opportunity to present to the Committee evidence on his or her behalf. If the Committee has not delegated to one or more officers of the Company the authority set forth in Section 4.2, and the Committee makes such Cause determination itself, such decision shall be deemed final and unappealable. For the purpose of this paragraph, termination of service

shall be deemed to occur on the date when the Company or Subsidiary dispatches notice or advice to the Participant that his service is terminated.

5.7 Limitations on Exercise . The Committee may specify a reasonable minimum number of Shares that may be purchased on any exercise of an Option, provided that such minimum number will not prevent Participant from exercising the Option for the full number of Shares for which it is then exercisable.

5.8 Limitations on ISO . The aggregate Fair Market Value (determined as of the date of grant) of Shares with respect to which ISO are exercisable for the first time by a Participant during any calendar year (under this Plan or under any other incentive stock option plan of the Company, Parent or Subsidiary of the Company) will not exceed \$100,000. If the Fair Market Value of Shares on the date of grant with respect to which ISO are exercisable for the first time by a Participant during any calendar year exceeds \$100,000, then the Options for the first \$100,000 worth of Shares to become exercisable in such calendar year will be ISO and the Options for the amount in excess of \$100,000 that become exercisable in that calendar year will be NQSOs. In the event that the Code or the regulations promulgated thereunder are amended after the Effective Date of this Plan to provide for a different limit on the Fair Market Value of Shares permitted to be subject to ISO, such different limit will be automatically incorporated herein and will apply to any Options granted after the effective date of such amendment.

5.9 Modification, Extension or Renewal . The Committee may modify, extend or renew outstanding Options and authorize the grant of new Options, provided however, that (i) any such action may not, without the written consent of a Participant, impair any of such Participant's rights under any Option previously granted, (ii) any such action shall not extend the exercise period of the Option to a date later than the later of (a) the fifteenth day of the third month following the date on which the Option otherwise would have expired or (b) December 31 of the calendar year in which the Option would have otherwise expired, and (iii) the Committee may not reduce the Exercise Price of outstanding Options without the approval of the stockholders. Any outstanding ISO that is modified, extended, renewed or otherwise altered will be treated in accordance with Section 424(h) of the Code.

5.10 No Disqualification . Notwithstanding any other provision in this Plan, no term of this Plan relating to ISO will be interpreted, amended or altered, nor will any discretion or authority granted under this Plan be exercised, so as to disqualify this Plan under Section 422 of the Code or, without the consent of the Participant affected, to disqualify any ISO under Section 422 of the Code.

**6. RESTRICTED STOCK** . A Restricted Stock Award is an offer by the Company to grant or to sell to an eligible person Shares that are subject to restrictions. The Committee will determine to whom an offer will be made, the number of Shares the person may purchase, the price to be paid (the “ **Purchase Price** ”), if any, the restrictions to which the Shares will be subject, and all other terms and conditions of the Restricted Stock Award, subject to the following:

6.1 Form of Restricted Stock Award . All grants or purchases under a Restricted Stock Award made pursuant to this Plan will be evidenced by an Award Agreement (“ **Restricted Stock Purchase Agreement** ”) that will be in such form (which need not be the same for each Participant) as the Committee will from time to time approve, and will comply with and be subject to the terms and conditions of this Plan. The offer of Restricted Stock will be accepted by the Participant's execution and delivery of the Restricted Stock Purchase Agreement and full payment, if any, for the Shares to the Company within thirty (30) days, or such other date as may be set forth in the Restricted Stock Purchase Agreement, from the date the Restricted Stock Purchase Agreement is delivered to the person. If such person does not execute and deliver the Restricted Stock Purchase Agreement along with full payment, if any, for the Shares to the Company within thirty (30) days, or such other date as may be set forth in the Restricted Stock Purchase Agreement, then the offer will terminate, unless otherwise determined by the Committee.

6.2 Purchase Price . The Purchase Price of Shares sold pursuant to a Restricted Stock Award, if any, will be determined by the Committee on the date the Restricted Stock Award is granted. At the Committee's discretion, consideration for the Restricted Stock Award may be in the form of continued service to the Company or a Subsidiary. Payment of the Purchase Price may be made in accordance with Section 9 of this Plan.

6.3 Terms of Restricted Stock Awards . Restricted Stock Awards shall be subject to such restrictions as the Committee may impose. These restrictions may be based upon completion of a specified number of years of service with the Company or a Subsidiary or upon completion of the performance goals as set out in advance in the Participant's individual Restricted Stock Purchase Agreement. Restricted Stock Awards may vary from Participant to Participant and between groups of Participants. Prior to the grant of a Restricted Stock Award, the Committee shall: (a) determine the nature, length and starting date of any Performance Period for the Restricted Stock Award; (b) select from among the Performance Factors to be used to measure performance goals, if any; and (c) determine the number of Shares that may be awarded to the Participant. Prior to the payment of any Restricted Stock Award, the Committee shall determine the extent to which such Restricted Stock Award has been earned. Performance Periods may overlap and Participants may participate simultaneously with respect to Restricted Stock Awards that are subject to different Performance Periods and having different performance goals and other criteria.

6.4 Termination During Performance Period . If a Participant is Terminated during a Performance Period for any reason, then such Participant will be entitled to payment (whether in Shares, cash or otherwise) with respect to the Restricted Stock Award only to the extent earned as of the date of Termination in accordance with the Restricted Stock Purchase Agreement, unless the Committee determines otherwise in the case of a Participant who is not a "covered employee" for purposes of Section 162(m) of the Code in the year of Termination.

7. RESTRICTED STOCK UNITS . Each Restricted Stock Unit shall have a value equal to the Fair Market Value of a share of the Company's Common Stock. A Restricted Stock Unit does not constitute a share of, nor represent any ownership interest in, the Company. The Committee will determine the number of Restricted Stock Units granted to any eligible person; whether the Restricted Stock Units will be settled in Shares, in cash, or in a combination of the two; the price to be paid (the "**Purchase Price**"), if any, for any Shares issued pursuant to a Restricted Stock Unit; the restrictions to which the Restricted Stock Units will be subject, and all other terms and conditions of the Restricted Stock Units, subject to the following:

7.1 Form of Restricted Stock Unit Award . All Restricted Stock Units granted pursuant to this Plan will be evidenced by an Award Agreement ("**Restricted Stock Unit Agreement**") that will be in such form (which need not be the same for each Participant) as the Committee will from time to time approve, and will comply with and be subject to the terms and conditions of this Plan. The offer of Restricted Stock Units will be accepted by the Participant's execution and delivery of the Restricted Stock Unit Agreement within thirty (30) days, or such other date as may be set forth in the Restricted Stock Unit Agreement, from the date the Restricted Stock Unit Agreement is delivered to the person. If such person does not execute and deliver the Restricted Stock Unit Agreement within thirty (30) days, or such other date as may be set forth in the Restricted Stock Unit Agreement, then the offer will terminate, unless otherwise determined by the Committee.

7.2 Purchase Price . The Purchase Price of Shares sold pursuant to a Restricted Stock Unit, if any, will be determined by the Committee on the date the Restricted Stock Unit is granted. At the Committee's discretion, consideration for the Restricted Stock Unit may be in the form of continued service to the Company or a Subsidiary. Payment of the Purchase Price, if any, shall be made in accordance with Section 9 of this Plan when the Shares are issued.

7.3 Terms of Restricted Stock Units . Restricted Stock Units shall be subject to such restrictions as the Committee may impose. These restrictions may be based upon completion of a specified number of years of service with the Company or a Subsidiary or upon completion of the performance goals as set out in advance in the Participant's individual Restricted Stock Unit Agreement. Restricted Stock

Units may vary from Participant to Participant and between groups of Participants. Prior to the grant of Restricted Stock Units, the Committee shall: (a) determine the nature, length and starting date of any Performance Period for the Restricted Stock Unit; (b) select from among the Performance Factors to be used to measure performance goals, if any; and (c) determine the number of Restricted Stock Units that will be awarded to the Participant. Prior to the payment (whether in Shares, cash or otherwise) of any Restricted Stock Units, the Committee shall determine the extent to which such Restricted Stock Units have been earned. Performance Periods may overlap and Participants may participate simultaneously with respect to Restricted Stock Units that are subject to different Performance Periods and have different performance goals and other criteria.

**7.4 Termination During Performance Period.** If a Participant is Terminated during a Performance Period for any reason, then such Participant will be entitled to payment (whether in Shares, cash or otherwise) with respect to the Restricted Stock Units only to the extent earned as of the date of Termination in accordance with the Restricted Stock Unit Agreement, unless the Committee determines otherwise in the case of a Participant who is not a “covered employee” for purposes of Section 162(m) of the Code in the year of Termination.

**7.5 Payment When Restrictions Lapse.** The cash or Shares that a Participant is entitled to receive pursuant to a Restricted Stock Unit shall be paid or issued to the Participant when all applicable restrictions and other conditions applicable to the Restricted Stock Unit have lapsed or have been satisfied, unless the Restricted Stock Unit Agreement provides for a later settlement date in compliance with Section 409A of the Code.

**8. STOCK APPRECIATION RIGHTS.** The Committee may grant Stock Appreciation Rights or SARs to eligible persons and will determine the number of Shares subject to the SARs, the Exercise Price of the SARs, the period during which the SARs may be exercised, and all other terms and conditions of the SARs, subject to the following:

**8.1 Form of SAR Grant.** SARs granted under this Plan will be evidenced by an Award Agreement that will expressly identify the SARs as freestanding SARs (SARs granted independent of any other Option), tandem SARs (SARs granted in connection with an Option, or any portion thereof), or any combination thereof (“**SAR Agreement**”), and will be in such form and contain such provisions (which need not be the same for each Participant) as the Committee may from time to time approve, and which will comply with and be subject to the terms and conditions of this Plan.

**8.2 Date of Grant.** The date of grant of a SAR will be the date on which the Committee makes the determination to grant such SAR, unless otherwise specified by the Committee. The SAR Agreement and a copy of this Plan will be delivered to the Participant within a reasonable time after the granting of the SAR.

**8.3 Exercise Price and Other Terms.**

(a) The Committee, subject to the provisions of the Plan, shall have complete discretion to determine the terms and conditions of SARs granted under the Plan; *provided, however*, that no SAR will be exercisable after the expiration of ten (10) years from the date the SAR is granted; *provided, further*, that the Exercise Price for freestanding SARs shall be not less than one hundred percent (100%) of the Fair Market Value of a Share on the grant date. The Exercise Price for tandem SARs shall equal the Exercise Price of the related Option.

(b) Participant’s ability to exercise SARs shall be subject to such restrictions, if any, as the Committee may impose. These restrictions may be based upon completion of a specified number of years of service with the Company or a Subsidiary or upon completion of the performance goals as set out in advance in the Participant’s individual SAR Agreement. SARs may vary from Participant to Participant and between groups of Participants. Should the Committee elect to impose restrictions on a SAR, the Committee shall: (a) determine the nature, length and starting date of any Performance Period for the SAR; (b) select from among the Performance Factors to be used to measure performance goals, if any; and (c)

determine the number of Shares subject to such SAR. Prior to such SAR becoming exercisable, the Committee shall determine the extent to which such Performance Factors have been met. Performance Periods may overlap and Participants may participate simultaneously with respect to SAR that are subject to different Performance Periods and have different performance goals and other criteria.

**8.4 Exercise of Tandem SARs.** Tandem SARs may be exercised for all or part of the Shares subject to the related Option upon the surrender of the right to exercise the equivalent portion of the related Option. Tandem SARs may be exercised only with respect to the Shares for which the related Option is then exercisable. With respect to tandem SARs granted in connection with an Option: (a) the tandem SARs shall expire no later than the expiration of the underlying Option; (b) the value of the payout with respect to the tandem SARs shall be for no more than one hundred percent (100%) of the difference between the Exercise Price of the underlying Option and the Fair Market Value of the Shares subject to the underlying Option at the time the tandem SARs are exercised; and (c) the tandem SARs shall be exercisable only when the Fair Market Value of the Shares subject to the underlying Option exceeds the Exercise Price of the Option.

**8.5 Exercise of Freestanding SARs.** Freestanding SARs shall be exercisable on such terms and conditions as the Committee, in its sole discretion, shall determine.

**8.6 Payment of SAR Amount.** Upon exercise of a SAR, a Participant shall be entitled to receive payment from the Company in an amount determined by multiplying:

- (a) The difference between (i) the Fair Market Value of a Share on the date of exercise (or such other date as may be determined by the Committee and set forth in the Participant's SAR Agreement) and (ii) the Exercise Price; times
- (b) The number of Shares with respect to which the SAR is exercised.

At the discretion of the Committee, the payment upon exercise of the SAR may be in cash, in Shares of equivalent value, or in some combination thereof.

**8.7 Termination.** Notwithstanding the exercise periods set forth in the SAR Agreement, exercise of a SAR will always be subject to the following:

- (a) If the Participant is Terminated for any reason except death or Disability, then the Participant may exercise such Participant's SAR only to the extent that such SAR would have been exercisable upon the Termination Date no later than three (3) months after the Termination Date (or such shorter or longer time period not exceeding five (5) years as may be determined by the Committee), but in any event, no later than the expiration date of the SAR.
- (b) If the Participant is Terminated because of Participant's death or Disability (or the Participant dies within three (3) months after a Termination other than for Cause or because of Participant's Disability), then Participant's SAR may be exercised only to the extent that such SAR would have been exercisable by Participant on the Termination Date and must be exercised by Participant (or Participant's legal representative or authorized assignee) no later than twelve (12) months after the Termination Date, but in any event no later than the expiration date of the SAR.
- (c) Notwithstanding the provisions in paragraph 8.7(a) above, if a Participant is terminated for Cause, neither the Participant, the

Participant's estate nor such other person who may then hold the SAR shall be entitled to exercise any SAR with respect to any Shares whatsoever, after termination of service, whether or not after termination of service the Participant may receive payment from the Company or Subsidiary for vacation pay, for services rendered prior to termination, for services rendered for the day on which Termination occurs, for salary in lieu of notice, or for any other benefits. In the event that the Committee has delegated to one or more officers of the Company the authority set forth in Section 4.2 above and Participant has been notified that such officer or officers has made a determination that Participant has been terminated for Cause, Participant shall have five (5) business days (measured from the date he or she was first notified of such determination) to appeal such determination to the Committee. If Participant appeals to the Committee in a timely manner, the Committee shall give the Participant an opportunity to present to the Committee evidence on his or her behalf. If the Committee has not delegated to one or more officers of the Company the authority set forth in Section 4.2, and the Committee makes such Cause determination itself, such decision shall be deemed final and unappealable. For the purpose of this paragraph, termination of service shall be deemed to occur on the date when the Company or Subsidiary dispatches notice or advice to the Participant that his service is terminated.

**8.8 Modification, Extension or Renewal.** The Committee may modify, extend or renew outstanding SARs and authorize the grant of new SARs, provided however, that (i) any such action may not, without the written consent of a Participant, impair any of such Participant's rights under any SAR previously granted, (ii) any such action shall not extend the exercise period of the SAR to a date later than the later of (a) the fifteenth day of the third month following the date on which the SAR otherwise would have expired or (b) December 31 of the calendar year in which the Option would have otherwise expired, and (iii) the Committee may not reduce the Exercise Price of outstanding SARs without the approval of the stockholders.

**9. PAYMENT FOR SHARE PURCHASES.** Where expressly approved for the Participant by the Committee and where permitted by law, payment for Shares purchased pursuant to this Plan may:

- (a) be made in cash (by check);
- (b) by cancellation of indebtedness of the Company to the Participant;
- (c) by surrender of shares that either: (1) have been owned by Participant for more than six (6) months and have been paid for within the meaning of SEC Rule 144 (and, if such shares were purchased from the Company by use of a promissory note, such note has been fully paid with respect to such shares); or (2) were obtained by Participant in the public market;
- (d) by waiver of compensation due or accrued to the Participant for services rendered;
- (e) with respect only to purchases upon exercise of an Option, and provided that a public market for the Company's stock exists:
  - (1) through a "same day sale" commitment from the Participant and a broker-dealer that is a member of the National Association of Securities Dealers (an "**NASD Dealer**")

whereby the Participant irrevocably elects to exercise the Option and to sell a portion of the Shares so purchased to pay for the Exercise Price, and whereby the NASD Dealer irrevocably commits upon receipt of such Shares to forward the Exercise Price directly to the Company; or

(2) through a “margin” commitment from the Participant and a NASD Dealer whereby the Participant irrevocably elects to exercise the Option and to pledge the Shares so purchased to the NASD Dealer in a margin account as security for a loan from the NASD Dealer in the amount of the Exercise Price, and whereby the NASD Dealer irrevocably commits upon receipt of such Shares to forward the Exercise Price directly to the Company; or

(f) by withholding from the Shares to be issued upon exercise of an Award that number of Shares having a Fair Market Value equal to the minimum amount required to satisfy the Exercise Price or Purchase Price (the Fair Market Value of the Shares to be withheld shall be determined on the date that the Award is exercised by the Participant); or

(g) by any combination of the foregoing; or

(h) such other consideration and method of payment for issuance of Shares to the extent permitted by applicable laws.

#### **10. AUTOMATIC GRANTS TO OUTSIDE DIRECTORS .**

10.1 Types of Awards and Shares. Awards granted under this Plan and subject to this Section 10 may, at the discretion of the Committee, be NQSOs, SARs, or Restricted Stock Units; *provided, however* , that any payment upon exercise of SARs granted pursuant to this section 10 shall be in Shares of equivalent value.

10.2 Eligibility. Awards subject to this Section 10 shall be granted only to Outside Directors. Outside Directors shall also be eligible to receive Awards granted pursuant to sections 5, 6, 7 and 8 hereof at such times and on such conditions as determined by the Committee.

10.3 Initial Grant . Each Outside Director who first becomes a member of the Board on or after the Effective Date will automatically be granted (a) an Option or SAR, as determined by the Committee, for 17,500 Shares and (b) 2,500 Restricted Stock Units (together, an “ **Initial Grant** ”) on the date such Outside Director first becomes a member of the Board.

10.4 Succeeding Grants . Upon re-election to the Board at each Annual Meeting of Stockholders, each Outside Director will automatically be granted (a) an Option or SAR, as determined by the Committee, for 8,400 Shares and (b) 1,200 Restricted Stock Units (together, a “ **Succeeding Grant** ”); *provided, however* , that any such Outside Director who received an Initial Grant since the last Annual Meeting of Stockholders will receive a prorated Succeeding Grant consisting of (x) an Option or SAR, as determined by the Committee, to purchase a number of Shares equal to 8,400 multiplied by a fraction whose numerator is the number of calendar months or portions thereof that the Outside Director has served since the date of the Initial Grant and whose denominator is twelve, and (y) a grant of Restricted Stock Units equal to 1,200 multiplied by a fraction whose numerator is the number of calendar months or portions thereof that the Outside Director has served since the date of the Initial Grant and whose denominator is twelve.

#### 10.5 Vesting.

(a) The date an Outside Director receives an Initial Grant or a Succeeding Grant is referred to in this Plan as the “ **Start Date** ” for such Award. Each Initial Grant will vest (a) with respect to Options or SARs, as to 2% of the Shares on the Start Date for such Initial Grant, and as to an additional 2% of the Shares on the first day of each calendar month after the Start Date, so long as the Outside Director continuously remains a director of the Company, and (b) with respect to Restricted Stock Units, in accordance with the Restricted Stock Unit Agreement. Succeeding Grants will vest in accordance with each Stock Option, SAR or Restricted Stock Unit Agreement, as the case may be.

(b) Notwithstanding any provision to the contrary, in the event of a corporate transaction described in Section 19.1, the vesting of all Awards granted to Outside Directors pursuant to this Section 10 will accelerate and such Awards will become exercisable in full prior to the consummation of such event at such times and on such conditions as the Committee determines, and must be exercised, if at all, within three months of the consummation of said event. Any Awards not exercised within such three-month period shall expire.

10.6 Exercise Price . The exercise price of an Award pursuant to an Initial Grant or Succeeding Grant shall be the Fair Market Value of the Shares at the time that the Award is granted.

10.7 Shares in Lieu of Cash Compensation . Each Outside Director may elect to reduce all or part of the cash compensation otherwise payable for services to be rendered by him as a director (including the annual retainer and any fees payable for serving on the Board or a Committee of the Board) and to receive in lieu thereof Shares. Any such election shall be in writing and must be made before the services are rendered giving rise to such compensation, and may not be revoked or changed thereafter during the Outside Director’s term. On such election, the cash compensation otherwise payable will be increased by 10% for purposes of determining the number of Shares to be credited to such Outside Director. If an Outside Director so elects to receive Shares in lieu of cash, there shall be credited to such Outside Director a number of Shares equal to the amount of the cash compensation so reduced (increased by 10% as described in the preceding sentence) divided by the Fair Market Value on the day in which the compensation would have been paid in the absence of such election.

### 11. WITHHOLDING TAXES.

11.1 Withholding Generally . Whenever Shares are to be issued in satisfaction of Awards granted under this Plan, the Company may require the Participant to remit to the Company an amount sufficient to satisfy federal, state and local withholding tax and social security requirements prior to the delivery of any certificate or certificates for such Shares. Whenever, under this Plan, payments in satisfaction of Awards are to be made in cash, such payment will be net of an amount sufficient to satisfy federal, state, and local withholding tax and social security requirements.

11.2 Stock Withholding . When, under applicable tax or social security laws, a Participant incurs tax or social security liability in connection with the exercise or vesting of any Award that is subject to tax or social security withholding and the Participant is obligated to pay the Company the amount required to be withheld, the Committee may in its sole discretion allow the Participant to satisfy the minimum tax or social security withholding obligation by electing to have the Company withhold from the Shares to be issued that number of Shares having a Fair Market Value equal to the minimum amount required to be withheld, determined on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares withheld for this purpose will be made in accordance with the requirements established by the Committee and be in writing in a form acceptable to the Committee.

### 12. TRANSFERABILITY.

12.1 Except as otherwise provided in this Section 12, Awards granted under this Plan, and any interest therein, will not be transferable or assignable by Participant, and may not be made subject

to execution, attachment or similar process, otherwise than by will or by the laws of descent and distribution or as determined by the Committee and set forth in the Award Agreement with respect to Awards that are not ISOs.

12.2 All Awards other than NQSOs and SARs. All Awards other than NQSOs and SARs shall be exercisable: (i) during the Participant's lifetime, only by (A) the Participant, or (B) the Participant's guardian or legal representative; and (ii) after Participant's death, by the legal representative of the Participant's heirs or legatees.

12.3 NQSOs and SARs. Unless otherwise restricted by the Committee, a NQSO and SAR shall be exercisable: (i) during the Participant's lifetime only by (A) the Participant, (B) the Participant's guardian or legal representative, (C) a Family Member of the Participant who has acquired the NQSO or SAR by "permitted transfer;" and (ii) after Participant's death, by the legal representative of the Participant's heirs or legatees. "Permitted transfer" means, as authorized by this Plan and the Committee in a Stock Option Agreement or SAR Agreement, any transfer effected by the Participant during the Participant's lifetime of an interest in such NQSO and SAR but only such transfers which are by gift or domestic relations order. A permitted transfer does not include any transfer for value and neither of the following are transfers for value: (a) a transfer under a domestic relations order in settlement of marital property rights or (b) a transfer to an entity in which more than fifty percent of the voting interests are owned by Family Members or the Participant in exchange for an interest in that entity.

### **13. PRIVILEGES OF STOCK OWNERSHIP; RESTRICTIONS ON SHARES.**

13.1 Voting and Dividends. No Participant will have any of the rights of a stockholder with respect to any Shares until the Shares are issued to the Participant. After Shares are issued to the Participant, the Participant will be a stockholder and have all the rights of a stockholder with respect to such Shares, including the right to vote and receive all dividends or other distributions made or paid with respect to such Shares; provided, that if such Shares are Restricted Stock, then any new, additional or different securities the Participant may become entitled to receive with respect to such Shares by virtue of a stock dividend, stock split or any other change in the corporate or capital structure of the Company will be subject to the same restrictions as the Restricted Stock; provided, further, that the Participant will have no right to retain such stock dividends or stock distributions with respect to Shares that are repurchased at the Participant's Purchase Price or Exercise Price pursuant to Section 13.2.

13.2 Restrictions on Shares. At the discretion of the Committee, the Company may reserve to itself and/or its assignee(s) in the Award Agreement a right to repurchase a portion of or all Unvested Shares held by a Participant following such Participant's Termination at any time within ninety (90) days after the later of Participant's Termination Date and the date Participant purchases Shares under this Plan, for cash and/or cancellation of purchase money indebtedness, at the Participant's Exercise Price or Purchase Price, as the case may be.

**14. CERTIFICATES.** All certificates for Shares or other securities delivered under this Plan will be subject to such stock transfer orders, legends and other restrictions as the Committee may deem necessary or advisable, including restrictions under any applicable federal, state or foreign securities law, or any rules, regulations and other requirements of the SEC or any stock exchange or automated quotation system upon which the Shares may be listed or quoted.

**15. ESCROW; PLEDGE OF SHARES.** To enforce any restrictions on a Participant's Shares, the Committee may require the Participant to deposit all certificates representing Shares, together with stock powers or other instruments of transfer approved by the Committee, appropriately endorsed in blank, with the Company or an agent designated by the Company to hold in escrow until such restrictions have lapsed or terminated, and the Committee may cause a legend or legends referencing such restrictions to be placed on the certificates. Any Participant who is permitted to execute a promissory note as partial or full consideration for the purchase of Shares under this Plan will be required to pledge and deposit with the Company all or part of the Shares so purchased as collateral to secure the payment of Participant's obligation to the Company under the promissory note; *provided, however*, that the Committee may require

or accept other or additional forms of collateral to secure the payment of such obligation and, in any event, the Company will have full recourse against the Participant under the promissory note notwithstanding any pledge of the Participant's Shares or other collateral. In connection with any pledge of the Shares, Participant will be required to execute and deliver a written pledge agreement in such form as the Committee will from time to time approve. The Shares purchased with the promissory note may be released from the pledge on a pro rata basis as the promissory note is paid.

**16. EXCHANGE AND BUYOUT OF AWARDS.** The Committee may, at any time or from time to time, authorize the Company, with the consent of the respective Participants, to issue new Awards in exchange for the surrender and cancellation of any or all outstanding Awards; *provided, however*, that no such exchange program may, without the approval of the Company's stockholders, allow for the cancellation of an outstanding Option followed by its immediate replacement with a new Option having a lower Exercise Price. The Committee may, subject to approval by the Company's stockholders, at any time buy from a Participant an Award previously granted with payment in cash, Shares (including Restricted Stock) or other consideration, based on such terms and conditions as the Committee and the Participant may agree.

**17. SECURITIES LAW AND OTHER REGULATORY COMPLIANCE.** An Award will not be effective unless such Award is in compliance with all applicable federal and state securities laws, rules and regulations of any governmental body, and the requirements of any stock exchange or automated quotation system upon which the Shares may then be listed or quoted, as they are in effect on the date of grant of the Award and also on the date of exercise or other issuance. Notwithstanding any other provision in this Plan, the Company will have no obligation to issue or deliver certificates for Shares under this Plan prior to: (a) obtaining any approvals from governmental agencies that the Company determines are necessary or advisable; and/or (b) completion of any registration or other qualification of such Shares under any state or federal law or ruling of any governmental body that the Company determines to be necessary or advisable. The Company will be under no obligation to register the Shares with the SEC or to effect compliance with the registration, qualification or listing requirements of any state securities laws, stock exchange or automated quotation system, and the Company will have no liability for any inability or failure to do so.

**18. NO OBLIGATION TO EMPLOY.** Nothing in this Plan or any Award granted under this Plan will confer or be deemed to confer on any Participant any right to continue in the employ of, or to continue any other relationship with, the Company or any Parent or Subsidiary of the Company or limit in any way the right of the Company or any Parent or Subsidiary of the Company to terminate Participant's employment or other relationship at any time, with or without cause.

## **19. CORPORATE TRANSACTIONS.**

**19.1 Assumption or Replacement of Awards by Successor.** Except for automatic grants to Outside Directors pursuant to Section 10 hereof, in the event of (a) a dissolution or liquidation of the Company, (b) a merger or consolidation in which the Company is not the surviving corporation (other than a merger or consolidation with a wholly-owned subsidiary, a reincorporation of the Company in a different jurisdiction, or other transaction in which there is no substantial change in the stockholders of the Company or their relative stock holdings and the Awards granted under this Plan are assumed, converted or replaced by the successor corporation, which assumption will be binding on all Participants), (c) a merger in which the Company is the surviving corporation but after which the stockholders of the Company immediately prior to such merger (other than any stockholder that merges, or which owns or controls another corporation that merges, with the Company in such merger) cease to own their shares or other equity interest in the Company, (d) the sale of substantially all of the assets of the Company, or (e) the acquisition, sale, or transfer of more than 50% of the outstanding shares of the Company by tender offer or similar transaction, any or all outstanding Awards may be assumed, converted or replaced by the successor corporation (if any), which assumption, conversion or replacement will be binding on all Participants. In the alternative, the successor corporation may substitute equivalent Awards or provide substantially similar consideration to Participants as was provided to stockholders (after taking into account the existing provisions of the Awards). The successor corporation may also issue, in place of outstanding Shares of the Company held by the Participants, substantially similar shares or other property subject to repurchase

restrictions no less favorable to the Participant. In the event such successor corporation (if any) refuses to assume or substitute Awards, as provided above, pursuant to a transaction described in this Section 19.1, such Awards will accelerate and will become exercisable in full prior to the consummation of such transaction at such time and on such conditions as the Committee will determine, and if such Awards are not exercised prior to the consummation of the corporate transaction, they shall terminate at such time as determined by the Committee.

**19.2 Other Treatment of Awards** . Subject to any greater rights granted to Participants under the foregoing provisions of this Section 19, in the event of the occurrence of any transaction described in Section 19.1, any outstanding Awards will be treated as provided in the applicable agreement or plan of merger, consolidation, dissolution, liquidation, or sale of assets.

**19.3 Assumption of Awards by the Company** . The Company, from time to time, also may substitute or assume outstanding awards granted by another company, whether in connection with an acquisition of such other company or otherwise, by either; (a) granting an Award under this Plan in substitution of such other company's award; or (b) assuming such award as if it had been granted under this Plan if the terms of such assumed award could be applied to an Award granted under this Plan. Such substitution or assumption will be permissible if the holder of the substituted or assumed award would have been eligible to be granted an Award under this Plan if the other company had applied the rules of this Plan to such grant. In the event the Company assumes an award granted by another company, the terms and conditions of such award will remain unchanged ( *except* that the exercise price and the number and nature of Shares issuable upon exercise of any such option will be adjusted appropriately pursuant to Sections 409A and 424(a) of the Code). In the event the Company elects to grant a new Option or SAR rather than assuming an existing option, such new Option or SAR may be granted with a similarly adjusted Exercise Price.

**20. ADOPTION AND STOCKHOLDER APPROVAL** . This Plan will become effective on the date that it is adopted by the Board (the “ *Effective Date* ”). This Plan shall be approved by the stockholders of the Company (excluding Shares issued pursuant to this Plan), consistent with applicable laws, within twelve (12) months before or after the date this Plan is adopted by the Board. Upon the Effective Date, the Committee may grant Awards pursuant to this Plan; *provided, however* , that: (a) no Option or SAR may be exercised prior to initial stockholder approval of this Plan; (b) no Option or SAR granted pursuant to an increase in the number of Shares subject to this Plan approved by the Board will be exercised prior to the time such increase has been approved by the stockholders of the Company; (c) in the event that initial stockholder approval is not obtained within the time period provided herein, all Awards granted hereunder shall be cancelled, any Shares issued pursuant to any Awards shall be cancelled and any purchase of Shares issued hereunder shall be rescinded; and (d) in the event that stockholder approval of such increase is not obtained within the time period provided herein, all Awards granted pursuant to such increase will be cancelled, any Shares issued pursuant to any Award granted pursuant to such increase will be cancelled, and any purchase of Shares pursuant to such increase will be rescinded.

**21. TERM OF PLAN/GOVERNING LAW** . Unless earlier terminated as provided herein, this Plan will terminate ten (10) years from the date this Plan is adopted by the Board or, if earlier, the date of stockholder approval. This Plan and all agreements thereunder shall be governed by and construed in accordance with the laws of the State of California.

**22. AMENDMENT OR TERMINATION OF PLAN** . The Board may at any time terminate or amend this Plan in any respect, including without limitation amendment of any form of Award Agreement or instrument to be executed pursuant to this Plan; *provided, however* , that the Board will not, without the approval of the stockholders of the Company, amend this Plan in any manner that requires such stockholder approval.

**23. NONEXCLUSIVITY OF THE PLAN** . Neither the adoption of this Plan by the Board, the submission of this Plan to the stockholders of the Company for approval, nor any provision of this Plan will be construed as creating any limitations on the power of the Board to adopt such additional compensation arrangements as it may deem desirable, including, without limitation, the granting of stock options and

bonuses otherwise than under this Plan, and such arrangements may be either generally applicable or applicable only in specific cases.

**24. DEFINITIONS.** As used in this Plan, the following terms will have the following meanings:

**25.**

**“Award”** means any award under this Plan, including any Option, Restricted Stock, Restricted Stock Unit or Stock Appreciation Right.

**“Award Agreement”** means, with respect to each Award, the signed written agreement between the Company and the Participant setting forth the terms and conditions of the Award.

**“Board”** means the Board of Directors of the Company.

**“Cause”** means the commission of an act of theft, embezzlement, fraud, dishonesty, other acts constituting gross misconduct, or a breach of fiduciary duty to the Company or a Parent or Subsidiary of the Company.

**“Code”** means the Internal Revenue Code of 1986, as amended.

**“Committee”** means the Compensation Committee of the Board.

**“Company”** means Electronic Arts Inc. or any successor corporation.

**“Disability”** means a disability, whether temporary or permanent, partial or total, as determined by the Committee.

**“Exchange Act”** means the Securities Exchange Act of 1934, as amended.

**“Exercise Price”** means the price at which a holder of an Option or a SAR, as the case may be, may purchase the Shares issuable upon exercise of such Option or SAR.

**“Fair Market Value”** means, as of any date, the value of a share of the Company’s Common Stock determined as follows:

- (a) if such Common Stock is then quoted on the Nasdaq National Market, its closing price on the Nasdaq National Market on the date of determination as reported in The Wall Street Journal ;
- (b) if such Common Stock is publicly traded and is then listed on a national securities exchange, its closing price on the date of determination on the principal national securities exchange on which the Common Stock is listed or admitted to trading as reported in The Wall Street Journal ;
- (c) if such Common Stock is publicly traded but is not quoted on the Nasdaq National Market nor listed or admitted to trading on a national securities exchange, the average of the closing bid and asked prices on the date of determination as reported in The Wall Street Journal ; or
- (d) if none of the foregoing is applicable, by the Committee in good faith.

**“Family Member”** includes any of the following:

- (a) child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the

- Participant, including any such person with such relationship to the Participant by adoption;
- (b) any person (other than a tenant or employee) sharing the Participant's household;
- (c) a trust in which the persons in (a) and (b) have more than fifty percent of the beneficial interest;
- (d) a foundation in which the persons in (a) and (b) or the Participant control the management of assets; or
- (e) any other entity in which the persons in (a) and (b) or the Participant own more than fifty percent of the voting interest.

**"Insider"** means an officer or director of the Company or any other person whose transactions in the Company's Common Stock are subject to Section 16 of the Exchange Act.

**"Option"** means an award of an option to purchase Shares pursuant to Section 5.

**"Outside Director"** means a member of the Board who is not an employee of the Company or any Parent or Subsidiary of the Company.

**"Parent"** means any corporation (other than the Company) in an unbroken chain of corporations ending with the Company if each of such corporations other than the Company owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

**"Participant"** means a person who receives an Award under this Plan.

**"Performance Factors"** means any of the factors selected by the Committee and specified in an Award Agreement, from among the following objective measures, either individually, alternatively or in any combination, applied to the Company as a whole or any business unit or Subsidiary, either individually, alternatively, or in any combination, and measured, to the extent applicable on an absolute basis or relative to a pre-established target, to determine whether the performance goals established by the Committee with respect to applicable Awards have been satisfied:

- (a) Net revenue;
- (b) Earnings before interest, income taxes, depreciation and amortization;
- (c) Operating income;
- (d) Operating margin;
- (e) Net income;
- (f) Earnings per share;
- (g) Total stockholder return;
- (h) The Company's stock price;
- (i) Growth in stockholder value relative to a pre-determined index;
- (j) Return on equity;

- (k) Return on invested capital;
- (l) Operating cash flow;
- (m) Free cash flow;
- (n) Economic value added; and
- (o) Individual confidential business objectives.

The Committee may, in recognition of unusual or non-recurring items such as acquisition-related activities or changes in applicable accounting rules, provide for one or more equitable adjustments (based on objective standards) to the Performance Factors to preserve the Committee's original intent regarding the Performance Factors at the time of the initial award grant. It is within the sole discretion of the Committee to make or not make any such equitable adjustments.

**"Performance Period"** means the period of service determined by the Committee, which shall be no less than one calendar quarter nor more than five years (unless tied to a specific and objective milestone or event), during which time of service or performance is to be measured for Awards.

**"Plan"** means this EA 2000 Equity Incentive Plan, as amended from time to time.

**"Restricted Stock Award"** means an award of Shares that are subject to restrictions pursuant to Section 6.

**"Restricted Stock Unit"** means an award of the right to receive, in cash or Shares, the value of a share of the Company's Common Stock pursuant to Section 7.

**"SEC"** means the Securities and Exchange Commission.

**"Securities Act"** means the Securities Act of 1933, as amended.

**"Shares"** means shares of the Company's Common Stock reserved for issuance under this Plan, as adjusted pursuant to Sections 2 and 19, and any successor security.

**"Stock Appreciation Right" or "SAR"** means an Award, granted alone or in tandem with a related Option that pursuant to Section 8 is designated as a SAR.

**"Subsidiary"** means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company if each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

**"Termination" or "Terminated"** means, for purposes of this Plan with respect to a Participant, that the Participant has for any reason ceased to provide services as an employee, officer, director, consultant, independent contractor, or advisor to the Company or a Parent or Subsidiary of the Company. An employee will not be deemed to have ceased to provide services in the case of (i) sick leave, (ii) military leave, or (iii) any other leave of absence approved by the Committee, provided, that such leave is for a period of not more than 90 days, unless reemployment upon the expiration of such leave is guaranteed by contract or statute or unless provided otherwise pursuant to formal policy adopted from time to time by the Company and issued and promulgated to employees in writing. In the case of any employee on an approved leave of absence, the Committee may make such provisions respecting suspension of vesting of the Award while on leave from the employ of the Company or a Subsidiary as it may deem appropriate, except that in no event may an Option be exercised after the expiration of the term set forth in the Option agreement. The Committee will have sole discretion to determine whether a Participant has ceased to provide services and the effective date on which the Participant ceased to provide services (the **"Termination Date"**).

**"Unvested Shares"** means **"Unvested Shares"** as defined in the Award Agreement.

**"Vested Shares"** means **"Vested Shares"** as defined in the Award Agreement.



## ELECTRONIC ARTS INC.

## 2000 EMPLOYEE STOCK PURCHASE PLAN

## As Amended by the Stockholders on July 26, 2007

1. Establishment of Plan. Electronic Arts Inc., (the “Company”) proposes to grant options for purchase of the Company’s Common Stock to eligible employees of the Company and its Subsidiaries (as hereinafter defined) pursuant to this 2000 Employee Stock Purchase Plan (the “Plan”). For purposes of this Plan, “parent corporation” and “Subsidiary” (collectively, “Subsidiaries”) shall have the same meanings as “parent corporation” and “subsidiary corporation” in Sections 424(e) and 424(f), respectively, of the Internal Revenue Code of 1986, as amended (the “Code”). The Company intends that the Plan shall feature two components: (i) an “employee stock purchase plan” under Section 423 of the Code (including any amendments or replacements of such section) for participants residing in the U.S., and (ii) an “employee stock purchase plan” that is intended to grant purchase rights under rules, procedures or sub-plans that are not intended to qualify Section 423 of the Code for participants that are not residing in the U.S. Any term not expressly defined in the Plan but defined for purposes of Section 423 of the Code shall have the same definition herein. A total of 8,300,000 shares of Common Stock are reserved for issuance under the Plan. Such number shall be subject to adjustments effected in accordance with Section 14 of the Plan.

2. Purposes. The purpose of the Plan is to provide employees of the Company and its Subsidiaries designated by the Board of Directors as eligible to participate in the Plan with a convenient means to acquire an equity interest in the Company through payroll deductions, to enhance such employees’ sense of participation in the affairs of the Company and its Subsidiaries, and to provide an incentive for continued employment.

3. Administration. This Plan may be administered by the Board or a committee appointed by the Board (the “Committee”). The Plan shall be administered by the Board or a committee appointed by the Board consisting of not less than three (3) persons (who are members of the Board), each of whom is a disinterested director. As used in this Plan, references to the “Committee” shall mean either the committee appointed by the Board to administer this Plan or the Board if no committee has been established. Subject to the provisions of the Plan and the limitations of Section 423 of the Code or any successor provision in the Code, if applicable, all questions of interpretation or application of the Plan shall be determined by the Committee and its decisions shall be final and binding upon all participants. Members of the Committee shall receive no compensation for their services in connection with the administration of the Plan, other than standard fees as established from time to time by the Board of Directors of the Company for services rendered by Board members serving on Board committees. All expenses incurred in connection with the administration of the Plan shall be paid by the Company.

4. Eligibility. Any employee of the Company or the Subsidiaries is eligible to participate in an Offering Period (as hereinafter defined) under the Plan except the following:

(a) employees who are not employed by the Company or its Subsidiaries on the fifteenth (15th) day of the month before the beginning of such Offering Period;

(b) employees who, together with any other person whose stock would be attributed to such employee pursuant to Section 424(d) of the Code, own stock or hold options to purchase stock or who, as a result of being granted an option under the Plan with respect to such Offering Period, would own stock or hold options to purchase stock possessing five (5) percent or more of the total combined voting power or value of all classes of stock of the Company or any of its Subsidiaries; and

(c) employees who would, by virtue of their participation in such Offering Period, be participating simultaneously in more than one Offering Period under the Plan.

For employees of Subsidiaries located in the U.S., the following would not be eligible to participate in an Offering Period:

(a) employees who are customarily employed for less than 20 hours per week, and

(b) employees who are customarily employed for less than five (5) months in a calendar year.

5. Offering Dates. The Offering Periods of the Plan (the “Offering Period”) shall be of twelve (12) months duration commencing on the first business day of March and September of each year and ending on the last business day of February and August, respectively, hereafter. The first Offering Period shall commence on September 1, 2000. The first day of each

Offering Period is referred to as the “Offering Date”. Each Offering Period shall consist of two (2) six-month purchase periods (individually, a “Purchase Period”), during which payroll deductions of the participant are accumulated under this Plan. Each such six-month Purchase Period shall commence on the first business day of March and September of an Offering Period and shall end on the last business day of the following August and February, respectively. The last business day of each Purchase Period is hereinafter referred to as the Purchase Date. The Board of Directors of the Company shall have the power to change the duration of Offering Periods or Purchase Periods without stockholder approval if such change is announced at least fifteen (15) days prior to the scheduled beginning of the first Offering Period or Purchase Period, as the case may be, to be affected.

6. Participation in the Plan. Eligible employees may become participants in an Offering Period under the Plan on the first Offering Date after satisfying the eligibility requirements by delivering to the Company’s or Subsidiary’s (whichever employs such employee) payroll department (the “payroll department”) not later than the 15th day of the month before such Offering Date unless a later time for filing the subscription agreement is set by the Board for all eligible Employees with respect to a given Offering Period a subscription agreement authorizing payroll deductions. An eligible employee who does not deliver a subscription agreement to the payroll department by such date after becoming eligible to participate in such Offering Period under the Plan shall not participate in that Offering Period or any subsequent Offering Period unless such employee enrolls in the Plan by filing the subscription agreement with the payroll department not later than the 15th day of the month preceding a subsequent Offering Date. Once an employee becomes a participant in an Offering Period, such employee will automatically participate in the Offering Period commencing immediately following the last day of the prior Offering Period unless the employee withdraws from the Plan or terminates further participation in the Offering Period as set forth in Section 11 below. Such participant is not required to file any additional subscription agreements in order to continue participation in the Plan. Any participant whose option expires and who has not withdrawn from the Plan pursuant to Section 11 below will automatically be re-enrolled in the Plan and granted a new option on the Offering Date of the next Offering Period. A participant in the Plan may participate in only one Offering Period at any time.

In jurisdictions where payroll deductions are not permitted under local law, the eligible employees may participate in the Plan by making contributions in the form that is acceptable and approved by the Board or Committee.

7. Grant of Option on Enrollment. Enrollment by an eligible employee in the Plan with respect to an Offering Period will constitute the grant (as of the Offering Date) by the Company to such employee of an option to purchase on each Purchase Date up to that number of shares of Common Stock of the Company determined by dividing the amount accumulated in such employee’s payroll deduction account during such Purchase Period by the lower of (i) eighty-five percent (85%) of the fair market value of a share of the Company’s Common Stock on the Offering Date (the “Entry Price”) or (ii) eighty-five percent (85%) of the fair market value of a share of the Company’s Common Stock on the Purchase Date, provided, however, that the number of shares of the Company’s Common Stock subject to any option granted pursuant to this Plan shall not exceed the lesser of (a) the maximum number of shares set by the Board pursuant to Section 10(c) below with respect to all Purchase Periods within the applicable Offering Period or Purchase Period, or (b) 200% of the number of shares determined by using 85% of the fair market value of a share of the Company’s Common Stock on the Offering Date as the denominator. Fair market value of a share of the Company’s Common Stock shall be determined as provided in Section 8 hereof.

8. Purchase Price. The purchase price per share at which a share of Common Stock will be sold in any Offering Period shall be eighty-five percent (85%) of the lesser of:

- (a) the fair market value on the Offering Date, or
- (b) the fair market value on the Purchase Date.

For purposes of the Plan, the term “fair market value” on a given date shall mean the closing bid from the previous day’s trading of a share of the Company’s Common Stock as reported on the NASDAQ National Market System.

9. Payment of Purchase Price; Changes in Payroll Deductions; Issuance of Shares.

(a) The purchase price of the shares is accumulated by regular payroll deductions made during each Purchase Period. The deductions are made as a percentage of the employee’s compensation in one percent (1%) increments not less than two percent (2%) nor greater than ten percent (10%). Compensation shall mean base salary, commissions, overtime, performance bonuses, discretionary bonuses, stay bonuses, referral bonuses, sabbatical cash outs, shift differentials, and such other forms of compensation as the Committee, in the exercise of its discretion under the Plan, may designate as subject to payroll deductions for purposes of the Plan. Notwithstanding the foregoing, Compensation shall not include car benefits/allowances, income derived from stock options, equity-based compensation, or payments made in connection with termination (including, but not limited to, holiday accrual cash outs, severance pay, separation pay, or ex gratia payments).

Payroll deductions shall commence with the first pay period following the Offering Date and shall continue to the end of the Offering Period unless sooner altered or terminated as provided in the Plan.

(b) A participant may lower (but not increase) the rate of payroll deductions during a Purchase Period by filing with the payroll department a new authorization for payroll deductions, in which case the new rate shall become effective for the next payroll period commencing more than 15 days after the payroll department's receipt of the authorization and shall continue for the remainder of the Offering Period unless changed as described below. Such change in the rate of payroll deductions may be made at any time during an Offering Period, but not more than one change may be made effective during any Purchase Period. A participant may increase or lower the rate of payroll deductions for any subsequent Purchase Period by filing with the payroll department a new authorization for payroll deductions not later than the 15th day of the month before the beginning of such Purchase Period.

(c) Subject to the laws of the local jurisdiction, all payroll deductions made for a participant are credited to his or her account under the Plan and are deposited with the general funds of the Company; no interest accrues on the payroll deductions. Subject to the laws of the local jurisdiction, all payroll deductions received or held by the Company may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

(d) On each Purchase Date, as long as the Plan remains in effect and provided that the participant has not submitted a signed and completed withdrawal form before that date which notifies the Company that the participant wishes to withdraw from that Offering Period under the Plan and have all payroll deductions accumulated in the account maintained on behalf of the participant as of that date returned to the participant, the Company shall apply the funds then in the participant's account to the purchase of whole shares of Common Stock reserved under the option granted to such participant with respect to the Offering Period to the extent that such option is exercisable on the Purchase Date. The purchase price per share shall be as specified in Section 8 of the Plan. Any cash remaining in a participant's account after such purchase of shares shall be refunded to such participant in cash; provided, however, that any amount remaining in participant's account on a Purchase Date which is less than the amount necessary to purchase a full share of Common Stock of the Company shall be carried forward, without interest, into the next Purchase Period or Offering Period, as the case may be. In the event that the Plan has been oversubscribed, all funds not used to purchase shares on the Purchase Date shall be returned to the participant. No Common Stock shall be purchased on a Purchase Date on behalf of any employee whose participation in the Plan has terminated prior to such Purchase Date.

(e) As promptly as practicable after the Purchase Date, the Company shall arrange the delivery to each participant, as appropriate, of a certificate representing the shares purchased upon exercise of his option; provided that the Board may deliver certificates to a broker or brokers that hold such certificates in street name for the benefit of each such participant.

(f) During a participant's lifetime, such participant's option to purchase shares hereunder is exercisable only by him or her. The participant will have no interest or voting right in shares covered by his or her option until such option has been exercised. Shares to be delivered to a participant under the Plan will be registered in the name of the participant or in the name of the participant and his or her spouse.

#### 10. Limitations on Shares to be Purchased .

(a) No employee shall be entitled to purchase stock under the Plan at a rate which, when aggregated with his or her rights to purchase stock under all other employee stock purchase plans of the Company or any Subsidiary, exceeds US\$25,000 in fair market value, determined as of the Offering Date (or such other limit as may be imposed by the Code) for each calendar year in which the employee participates in the Plan.

(b) No more than 200% of the number of shares determined by using 85% of the fair market value of a share of the Company's Common Stock on the Offering Date as the denominator may be purchased by a participant on any single Purchase Date.

(c) No employee shall be entitled to purchase more than the Maximum Share Amount (as defined below) on any single Purchase Date. Not less than thirty days prior to the commencement of any Purchase Period, the Board may, in its sole discretion, set a maximum number of shares which may be purchased by any employee at any single Purchase Date (hereinafter the "Maximum Share Amount"). In no event shall the Maximum Share Amount exceed the amounts permitted under Section 10(b) above. If a new Maximum Share Amount is set, then all participants must be notified of such Maximum Share Amount not less than fifteen (15) days prior to the commencement of the next Purchase Period. Once the Maximum Share Amount is set, it shall continue to apply with respect to all succeeding Purchase Dates and Purchase Periods unless revised by the Board as set forth above.

(d) If the number of shares to be purchased on a Purchase Date by all employees participating in the Plan exceeds the number of shares then available for issuance under the Plan, the Company shall make a pro rata allocation of the remaining shares in as uniform a manner as shall be practicable and as the Board shall determine to be equitable. In such event, the Company shall give written notice of such reduction of the number of shares to be purchased under a participant's option to each employee affected thereby.

(e) Any payroll deductions accumulated in a participant's account which are not used to purchase stock due to the limitations in this Section 10 shall be returned to the participant as soon as practicable after the end of the Offering Period.

**11. Withdrawal.**

(a) Each participant may withdraw from an Offering Period under the Plan by signing and delivering to the payroll department notice on a form provided for such purpose. Such withdrawal may be elected at any time at least fifteen (15) days prior to the end of an Offering Period.

(b) Upon withdrawal from the Plan, the accumulated payroll deductions shall be returned to the withdrawn employee and his or her interest in the Plan shall terminate. In the event an employee voluntarily elects to withdraw from the Plan, he or she may not resume his or her participation in the Plan during the same Offering Period, but he or she may participate in any Offering Period under the Plan which commences on a date subsequent to such withdrawal by filing a new authorization for payroll deductions in the same manner as set forth above for initial participation in the Plan. However, if the participant is an "insider" for purposes of Rule 16(b), he or she shall not be eligible to participate in any Offering Period under the Plan which commences less than six (6) months from the date of withdrawal from the Plan.

(c) A participant may participate in the current Purchase Period under an Offering Period (the "Current Offering Period") and enroll in the Offering Period commencing after such Purchase Period (the "New Offering Period") by (i) withdrawing from participating in the Current Offering Period effective as of the last day of a Purchase Period within that Offering Period and (ii) enrolling in the New Offering Period. Such withdrawal and enrollment shall be effected by filing with the payroll department at least fifteen (15) days prior to the end of a Purchase Period such form or forms as are provided for such purposes.

**12. Termination of Employment.** Termination of a participant's employment for any reason, including retirement or death or the failure of a participant to remain an eligible employee, terminates his or her participation in the Plan immediately. In such event, the payroll deductions credited to the participant's account will be returned to him or her or, in the case of his or her death, to his or her legal representative. For this purpose, an employee will not be deemed to have terminated employment or failed to remain in the continuous employ of the Company in the case of sick leave, military leave, or any other leave of absence approved by the Board of Directors of the Company; provided that such leave is for a period of not more than ninety (90) days or re employment upon the expiration of such leave is guaranteed by contract or statute.

**13. Return of Payroll Deductions.** In the event an employee's interest in the Plan is terminated by withdrawal, termination of employment or otherwise, or in the event the Plan is terminated by the Board, the Company shall promptly deliver to the employee all payroll deductions credited to his account. No interest shall accrue on the payroll deductions of a participant in the Plan, unless otherwise required by the laws of a local jurisdiction.

**14. Capital Changes.** Subject to any required action by the stockholders of the Company, the number of shares of Common Stock covered by each option under the Plan which has not yet been exercised and the number of shares of Common Stock which have been authorized for issuance under the Plan but have not yet been placed under option (collectively, the "Reserves"), as well as the price per share of Common Stock covered by each option under the Plan which has not yet been exercised, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split or the payment of a stock dividend (but only on the Common Stock) or any other increase or decrease in the number of shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration". Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an option.

In the event of the proposed dissolution or liquidation of the Company, the Offering Period will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board. The Board may, in the exercise of its sole discretion in such instances, declare that the options under the Plan shall terminate as of a date fixed by the Board and give each participant the right to exercise his or her option as to all of the optioned stock, including shares

which would not otherwise be exercisable. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each option under the Plan shall be assumed or an equivalent option shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless the Board determines, in the exercise of its sole discretion and in lieu of such assumption or substitution, that the participant shall have the right to exercise the option as to all of the optioned stock. If the Board makes an option exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Board shall notify the participant that the option shall be fully exercisable for a period of twenty (20) days from the date of such notice, and the option will terminate upon the expiration of such period.

The Board may, if it so determines in the exercise of its sole discretion, also make provision for adjusting the Reserves, as well as the price per share of Common Stock covered by each outstanding option, in the event that the Company effects one or more reorganizations, recapitalizations, rights offerings or other increases or reductions of shares of its outstanding Common Stock, and in the event of the Company being consolidated with or merged into any other corporation.

15. *Nonassignability*. Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution or as provided in Section 22 hereof) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect.

16. *Reports*. Individual accounts will be maintained for each participant in the Plan. Each participant shall receive promptly after the end of each Purchase Period a report of his account setting forth the total payroll deductions accumulated, the number of shares purchased, the per share price thereof and the remaining cash balance, if any, carried forward to the next Purchase Period or Offering Period, as the case may be.

17. *Notice of Disposition*. Each participant shall notify the Company if the participant disposes of any of the shares purchased in any Offering Period pursuant to this Plan if such disposition occurs within two (2) years from the Offering Date or within twelve (12) months from the Purchase Date on which such shares were purchased (the "Notice Period"). Unless such participant is disposing of any of such shares during the Notice Period, such participant shall keep the certificates representing such shares in his or her name (and not in the name of a nominee) during the Notice Period. The Company may, at any time during the Notice Period, place a legend or legends on any certificate representing shares acquired pursuant to the Plan requesting the Company's transfer agent to notify the Company of any transfer of the shares. The obligation of the participant to provide such notice shall continue notwithstanding the placement of any such legend on certificates.

18. *No Rights to Continued Employment*. Neither this Plan nor the grant of any option hereunder shall confer any right on any employee to remain in the employ of the Company or any Subsidiary or restrict the right of the Company or any Subsidiary to terminate such employee's employment.

19. *Equal Rights and Privileges*. All eligible employees shall have equal rights and privileges with respect to the Plan. The Section 423 component of the Plan is intended to qualify as an "employee stock purchase plan" within the meaning of Section 423 or any successor provision of the Code and the related regulations. Any provision of the Section 423 component of the Plan which is inconsistent with Section 423 or any successor provision of the Code shall without further act or amendment by the Company or the Board be reformed to comply with the requirements of Section 423. This Section 19 shall take precedence over all other provisions in the Plan.

20. *Notices*. All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

21. *Stockholder Approval of Amendments*. Any required approval of the stockholders of the Company for an amendment shall be solicited at or prior to the first annual meeting of stockholders held subsequent to the grant of an option under the Plan as then amended to an officer or director of the Company. If such stockholder approval is obtained at a duly held stockholders' meeting, it must be obtained by the affirmative vote of the holders of a majority of the outstanding shares of the company represented and voting at the meeting, or if such stockholder approval is obtained by written consent, it must be obtained by the majority of the outstanding shares of the Company; provided, however, that approval at a meeting or by written consent may be obtained by a lesser degree of stockholder approval if the Board determines, in its discretion after consultation with the Company's legal counsel, that such lesser degree of stockholder approval will comply with all applicable laws and will not adversely affect the qualification of the Section 423 component of the Plan under Section 423 of the Code or Rule 16b-3 promulgated under the Exchange Act ("Rule 16b-3").

## 22. Designation of Beneficiary

(a) A participant may file a written designation of a beneficiary who is to receive any shares and cash, if any, from the participant's account under the Plan in the event of such participant's death subsequent to the end of a Purchase Period but prior to delivery to him of such shares and cash. In addition, a participant may file a written designation of a beneficiary who is to receive any cash from the participant's account under the Plan in the event of such participant's death prior to a Purchase Date.

(b) Such designation of beneficiary may be changed by the participant at any time by written notice. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such shares or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such shares or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

23. Conditions Upon Issuance of Shares ; Limitation on Sale of Shares . Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

24. Applicable Law . Except as otherwise expressly required under the laws of a country, the Plan and all rights thereunder shall be governed by and construed in accordance with the laws of the state of California, United States of America. Should any provision of this Plan be determined by a court of competent jurisdiction to be unlawful or unenforceable for a country, such determination shall in no way affect the application of that provision in any other country, or any of the remaining provisions of the Plan.

25. Amendment or Termination of the Plan . This Plan shall be effective on the day after the effective date of the Company's Registration Statement filed with the Securities Exchange Commission under the Securities Act of 1933, as amended, with respect to the shares issuable under the Plan (the "Effective Date"), subject to approval by the stockholders of the Company within twelve (12) months after the date the Plan is adopted by the Board of Directors of the company and the Plan shall continue until the earlier to occur of termination by the Board, issuance of all of the shares of Common Stock reserved for issuance under the Plan, or ten (10) years from the adoption of the Plan by the Board. The Board of Directors of the Company may at any time amend or terminate the Plan, except that any such termination cannot affect options previously granted under the Plan, nor may any amendment make any change in an option previously granted which would adversely affect the right of any participant, nor may any amendment be made without approval of the stockholders of the Company obtained in accordance with Section 21 hereof within 12 months of the adoption of such amendment (or earlier if required by Section 21) if such amendment would:

(a) Increase the number of shares that may be issued under the Plan;

(b) Change the designation of the employees (or class of employees) eligible for participation in the Plan; or

(c) Constitute an amendment for which stockholder approval is required in order to comply with Rule 16b-3 (or any successor rule) of the Exchange Act.

## 26. Rules for Foreign Jurisdictions .

(a) The Board or Committee may adopt rules or procedures relating to the operation and administration of the Plan to accommodate the specific requirements of the law and procedures of foreign jurisdictions. Without limiting the generality of the foregoing, the Board or Committee is specifically authorized to adopt rules and procedures regarding handling of payroll deductions, payment of interest, conversion of local currency, payroll tax, withholding procedures and handling of stock certificates that vary with local requirements.

(b) The Board or Committee may also adopt rules, procedures or sub-plans applicable to particular subsidiaries or locations, which — sub-plans may be designed to be outside the scope of Code Section 423. The rules of such sub-plans may take precedence over other provisions of this Plan, with the exception of Section 3, but unless otherwise superceded by the terms of such sub-plan, the provisions of the Plan shall govern the operation of such sub-plan. To extent inconsistent with the requirements of Code Section 423, such sub-plan shall be considered part of the Non-423 Plan, and options granted thereunder shall not be considered to comply with Code Section 423.

27. *Designation of Subsidiaries*. The Board or Committee shall designate from among the Subsidiaries, as determined from time to time, the Subsidiary or Subsidiaries whose Employees shall be eligible to participate in the Plan. The Board or Committee may designate a Subsidiary, or terminate the designation of a Subsidiary, without the approval of the shareowners of the Corporation.



**Electronic Arts Inc.  
Deferred Compensation Plan  
Master Plan Document**

**Amended and Restated as of January 1, 2005**

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# **ELECTRONIC ARTS INC. DEFERRED COMPENSATION PLAN**

**Amended and Restated as of January 1, 2005**

## **Purpose**

The purpose of this Plan is to provide specified benefits to a select group of management or highly compensated Employees and Directors who contribute materially to the continued growth, development and future business success of Electronic Arts Inc., a Delaware corporation, and its subsidiaries that sponsor this Plan. This Plan shall be unfunded for tax purposes and for purposes of Title I of ERISA. This Plan shall amend and supersede in its entirety the Predecessor Nonqualified Deferred Compensation Plan. Any and all balances accrued by a Participant under such predecessor plan shall be subject to the terms and conditions of this Plan and shall be referred to as the "Rollover Account."

This Plan as amended and restated is intended to comply with section 409A of the Code in order to avoid compensation deferred under the Plan which is subject to section 409A of the Code from being included in the gross income of participants under such section and the Plan shall be interpreted consistent with such intent.

## **ARTICLE 1**

### **Definitions**

For purposes of this Plan, unless otherwise clearly apparent from the context, the following phrases or terms shall have the following indicated meanings:

- 1.1 "401(k) Plan" shall be that Electronic Arts Inc. 401(k) Plan.
- 1.2 "Account Balance" shall mean, with respect to a Participant, a credit on the records of the Employer equal to the sum of (i) the Rollover Account balance, (ii) the Deferral Account balance, (iii) the vested Company Restoration Matching Account balance, and (iv) the vested Company Contribution Account balance. The Account Balance, and each other specified account balance, shall be a bookkeeping entry only and shall be utilized solely as a device for the measurement and determination of the amounts to be paid to a Participant, or his or her designated Beneficiary, pursuant to this Plan.
- 1.3 "Accounting Firm" shall have the same meaning as set forth in Section 3.10(e).
- 1.4 "Administrator" shall have the same meaning as set forth in Section 11.2.
- 1.5 "Annual Base Salary" shall mean the annual cash compensation relating to services performed during the period beginning on January 1 of a calendar year and ending on December 31 of the same calendar year (while the Employee is a Participant in the Plan), whether or not paid in such year or included on the Federal Income Tax Form W-2 for such year, excluding bonuses, commissions, overtime, fringe benefits, stock options, restricted stock, relocation expenses, unused and unpaid excess vacation days, incentive

payments, non-monetary awards, directors fees and other fees, automobile and other allowances paid to a Participant for employment services rendered (whether or not such allowances are included in the Employee's gross income). Annual Base Salary shall be calculated before reduction for compensation voluntarily deferred or contributed by the Participant pursuant to all qualified or non-qualified plans of any Employer and shall be calculated to include amounts not otherwise included in the Participant's gross income under sections 125, 402(e)(3), 402(h), or 403(b) of the Code pursuant to plans established by any Employer; provided, however, that all such amounts will be included in compensation only to the extent that, had there been no such plan, the amount would have been payable in cash to the Employee.

- 1.6 "Annual Bonus" shall mean any compensation, in addition to Annual Base Salary, relating to services performed during any Fiscal Year, and paid during the Plan Year, under any Employer's annual or quarterly bonus and/or cash incentive plans; notwithstanding the foregoing, "Annual Bonus" shall exclude compensation derived from awards made under any equity incentive, change in control, or severance plans or arrangements that the Company adopts, which includes compensation that an employee incurs from the exercise of a stock option or lapse of restrictions on an award of stock.
- 1.7 "Annual Company Contribution Amount" shall mean, for any one Plan Year, the amount determined in accordance with Section 3.7.
- 1.8 "Annual Company Restoration Matching Amount" shall mean, for any one Plan Year, the amount determined in accordance with Section 3.8.
- 1.9 "Annual Deferral Amount" shall mean that portion of a Participant's Annual Base Salary, Annual Bonus and Directors Fees that a Participant elects to have, and is deferred, in accordance with Article 3, for any one Plan Year. In the event of a Participant's suspension of deferrals due to Disability (if deferrals cease in accordance with Section 7.1(b)), in connection with a 401(k) Plan hardship withdrawal or death prior to the end of a Plan Year, such year's Annual Deferral Amount shall be the actual amount withheld prior to such event.
- 1.10 "Annual Installment Method" shall be an annual installment payment over the number of years (not to exceed 10) selected by the Participant in accordance with this Plan, calculated as follows: The Account Balance of the Participant shall be calculated as of the most recent Valuation Date. The annual installment shall be calculated by multiplying this balance by a fraction, the numerator of which is one, and the denominator of which is the remaining number of annual payments due the Participant. By way of example, if the Participant elects a 10-year Annual Installment Method, the first payment shall be 1/10 of the Account Balance as of the most recent Valuation Date. The following year, the payment shall be 1/9 of the Account Balance as of the most recent Valuation Date. Each annual installment shall be paid as soon as practicable after the amount is calculated, but not later than 90 days after the Valuation Date.

- 1.11 “Beneficiary” shall mean one or more persons, trusts, estates or other entities, designated in accordance with Article 8, that are entitled to receive benefits under this Plan upon the death of a Participant.
- 1.12 “Beneficiary Designation Form” shall mean the form established from time to time by the Committee that a Participant completes, signs and returns to the Committee to designate one or more Beneficiaries.
- 1.13 “Board” shall mean the board of directors of the Company, or a committee or individual(s) acting pursuant to a valid delegation of authority from such board of directors.
- 1.14 “Change in Control” shall mean a change in the ownership of the Company, or a change in the ownership of a substantial portion of the assets of the Company as defined in the regulations promulgated under section 409A of the Code.
- 1.15 “Claimant” shall have the meaning set forth in Section 13.1.
- 1.16 “Code” shall mean the Internal Revenue Code of 1986, as it may be amended from time to time.
- 1.17 “Committee” shall mean the committee described in Article 11.
- 1.18 “Company” shall mean Electronic Arts Inc., a Delaware corporation, and any successor to all or substantially all of the Company’s assets or business.
- 1.19 “Company Contribution Account” shall mean (i) the sum of all of a Participant’s Annual Company Contribution Amounts, plus (ii) amounts credited (net of amounts debited) in accordance with all the applicable crediting provisions of this Plan that relate to the Participant’s Company Contribution Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to the Participant’s Company Contribution Account.
- 1.20 “Company Restoration Matching Account” shall mean (i) the sum of all of a Participant’s Annual Company Restoration Matching Amounts, plus (ii) amounts credited (net of amounts debited) in accordance with all the applicable provisions of this Plan that relate to the Participant’s Company Restoration Matching Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to the Participant’s Company Restoration Matching Account.
- 1.21 “Deduction Limitation” shall mean the following delayed payment on a benefit that may otherwise be distributable pursuant to the provisions of this Plan. A distribution to a Participant may be delayed if an Employer determines in good faith that there is a reasonable likelihood that any compensation paid to a Participant for a taxable year of the Employer would not be deductible by the Employer solely by reason of the limitation under section 162(m) of the Code; provided, however, that such delay shall be in compliance with Treasury Regulation § 1.409A-2(b)(7) and the amounts so deferred and amounts credited thereon shall be distributed to the Participant or his or her Beneficiary

during such year such payment will not fail to be deductible because of section 162(m) of the Code.

- 1.22 “Deferral Account” shall mean (i) the sum of all of a Participant’s Annual Deferral Amounts, plus (ii) amounts credited in accordance with all the applicable crediting provisions of this Plan that relate to the Participant’s Deferral Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to his or her Deferral Account.
- 1.23 “Director” shall mean any member of the Board.
- 1.24 “Director Fees” shall mean the annual fees paid by any Employer, including retainer fees and meeting fees, as compensation for serving on the Board.
- 1.25 “Disability” shall mean the Participant is determined to be totally disabled by the Social Security Administration.
- 1.26 “Disability Benefit” shall mean the benefit set forth in Article 7.
- 1.27 “Election Form” shall mean the form established from time to time by the Committee that a Participant completes, signs and returns to the Committee to make an election under the Plan.
- 1.28 “Employee” shall mean a person who is an employee of any Employer.
- 1.29 “Employer(s)” shall mean the Company and/or any of its subsidiaries (now in existence or hereafter formed or acquired) that have been selected by the Board to participate in the Plan and have adopted the Plan as a sponsor.
- 1.30 “ERISA” shall mean the Employee Retirement Income Security Act of 1974, as it may be amended from time to time.
- 1.31 “Fiscal Year” shall mean the fiscal year of the Company as reported on its Form 10-K for the applicable year.
- 1.32 “Identification Date” shall mean each December 31.
- 1.33 “Key Employee” shall mean a Participant who, on an Identification Date, is:
  - (a) An officer of the Company having annual compensation greater than the compensation limit in section 416(i)(1)(A)(i) of the Code, provided that no more than fifty officers of the Company shall be determined to be Key Employees as of any Identification Date;
  - (b) A five percent owner of the Company; or
  - (c) A one percent owner of the Company having annual Compensation from the Company of more than \$150,000.

If a Participant is identified as a Key Employee on an Identification Date, then such Participant shall be considered a Key Employee for purposes of the Plan during the period beginning on the first April 1 following the Identification Date and ending on the next March 31.

- 1.34 "Measurement Fund" shall have the same meaning as set forth in Section 3.11(c).
- 1.35 "Participant" shall mean any Employee or Director (i) who is selected to participate in the Plan, (ii) who elects to participate in the Plan, (iii) who completes and signs a Plan Agreement and an Election Form, (iv) whose completed and signed Plan Agreement and Election Form are accepted by the Committee, (v) who commences participation in the Plan, and (vi) whose Plan Agreement has not terminated. A spouse or former spouse of a Participant shall not be treated as a Participant in the Plan or have an account balance under the Plan, even if he or she has an interest in the Participant's benefits under the Plan as a result of applicable law or property settlements resulting from legal separation or divorce.
- 1.36 "Plan" shall mean the Electronic Arts Inc. Deferred Compensation Plan, as amended from time to time, which shall be evidenced by this instrument and by each Plan Agreement, as they may be amended from time to time.
- 1.37 "Plan Agreement" shall mean a written agreement, as may be amended from time to time, which is entered into by and between an Employer and a Participant. Each Plan Agreement executed by a Participant and the Participant's Employer shall provide for the entire benefit to which such Participant is entitled under the Plan; should there be more than one Plan Agreement, the Plan Agreement bearing the latest date of acceptance by the Employer shall supersede all previous Plan Agreements in their entirety and shall govern such entitlement. The terms of any Plan Agreement may be different for any Participant, and any Plan Agreement may provide additional benefits not set forth in the Plan or limit the benefits otherwise provided under the Plan; provided, however, that any such additional benefits or benefit limitations must be agreed to by both the Employer and the Participant.
- 1.38 "Plan Year" shall mean a period beginning on January 1 of each calendar year and continuing through December 31 of the same calendar year.
- 1.39 "Predecessor Nonqualified Deferred Compensation Plan" shall mean the Electronic Arts Deferred Compensation Plan, adopted January 21, 1994, as amended on June 1, 1995, June 27, 1996 and April 1, 2003.
- 1.40 "Rollover Amount" shall mean the amount determined in accordance with Section 3.6.
- 1.41 "Rollover Account" shall mean (i) the sum of the Participant's Rollover Amount, plus (ii) amounts credited or debited in accordance with all the applicable crediting and debiting provisions of this Plan that relate to the Participant's Rollover Account, less (iii) all distributions made to the Participant or his or her Beneficiary pursuant to this Plan that relate to the Participant's Rollover Account.

- 1.42 "Separation from Service" shall mean termination of employment with the Employer, other than by reason of Disability or death. A Participant shall not be deemed to have Separated from Service if the Participant continues to provide services to an Employer in a capacity other than as an employee and if the former employee is providing services at an annual rate that is twenty percent or more of the services rendered, on average, during the immediately preceding three full years of employment with an Employer (or if employed by an Employer less than three years, such lesser period); provided, however, that a Separation from Service will be deemed to have occurred if a Participant's service with an Employer is reduced to an annual rate that is less than twenty percent of the services rendered, on average, during the immediately preceding three years of employment with an Employer (or if employed by an Employer less than three years, such lesser period).
- 1.43 "Short-Term Payout" shall mean the payout set forth in Section 4.1.
- 1.44 "Survivor Benefit" shall mean the benefit set forth in Article 5.
- 1.45 "Termination Benefit" shall mean the benefit set forth in Section 3.4(b).
- 1.46 "Trust" shall mean one or more trusts established pursuant to that certain Trust Agreement, dated as of September 1, 2003 between the Company and the trustee named therein, as amended from time to time.
- 1.47 "Unforeseeable Emergency" shall have the same meaning as defined in section 409A(a)(2)(B)(ii) of the Code.
- 1.48 "Valuation Date" shall mean the last day of the Plan Year or any other date as of which the Committee, in its sole and absolute discretion, designates as a Valuation Date. Notwithstanding the foregoing or anything in this Plan to the contrary, the Valuation Date may be different for different Participants.
- 1.49 "Years of Service" shall mean the total number of years in which a Participant has been employed by one or more Employers. For purposes of this definition, a year of employment shall be a 365 day period (or 366 day period in case of a leap year) that, for the first year of employment, commences on the Employee's date of hiring and that, for any subsequent year, commences on an anniversary of that hiring date. The Committee shall make a determination as to the number of Years of Service a Participant shall be deemed to have completed, including whether any partial year of employment shall be counted, and any such determination may, in the sole and absolute discretion of the Committee, take into account any similar definitions or provisions contained in the 401(k) Plan.

## ARTICLE 2

### Selection/Enrollment/Eligibility

- 2.1 **Selection by Committee.** Eligibility for the Plan shall be limited to a select group of management or highly compensated Employees and Directors of the Employers, as

determined by the Committee in its sole and absolute discretion. From that group, the Committee shall select, in its sole and absolute discretion, Employees and Directors to participate in the Plan.

- 2.2 **Enrollment Requirements.** As a condition to participation, each newly selected Employee or Director shall complete, execute and return to the Committee a Plan Agreement and an Election Form and a Beneficiary Designation Form, all within 30 days after he or she is first selected to participate in the Plan. An Election Form submitted under this Section 2.2 shall be irrevocable on the day after the 30-day period ends. In addition, the Committee shall establish from time to time such other enrollment requirements (including additional forms) as it determines are necessary in its sole and absolute discretion.
- 2.3 **Eligibility; Commencement of Participation.** Provided an Employee or Director selected to participate in the Plan has met all enrollment requirements set forth in this Plan and required by the Committee, including returning all required forms and documents to the Committee within the specified time period, that Employee or Director shall commence participation in the Plan on the first day of the month following the month in which the Employee or Director completes all enrollment requirements. If an Employee or a Director fails to meet all such requirements within the required period, in accordance with Section 2.2, that Employee or Director shall not be eligible to participate in the Plan until the first day of the Plan Year following the delivery to and acceptance by the Committee of the required documents.
- 2.4 **Termination of Participation and/or Deferrals.** If the Committee determines in good faith that a Participant no longer qualifies as a member of a select group of management or highly compensated employees, as membership in such group is determined in accordance with sections 201(2), 301(a)(3) and 401(a)(1) of ERISA, the Committee shall have the right, in its sole and absolute discretion, to prevent the Participant from making future deferral elections. If a Participant receives a distribution on account of an hardship withdrawal from the 401(k) Plan, such Participant's deferral election shall be cancelled and the Participant may not defer any amounts under this Plan for a period of at least six months, as the Company determines in its discretion.

### ARTICLE 3

#### Deferral Commitments/Rollover Amounts/Company Restoration Matching Amounts/Company Contribution Amounts/Vesting/Crediting/Taxes

3.1 **Minimum Deferrals.**

- (a) **Annual Base Salary, Annual Bonus and Director Fees.** For each Plan Year, a Participant may elect to defer, as his or her Annual Deferral Amount, Annual Base Salary, Annual Bonus and/or Director Fees in the following minimum amount:

| Deferral                               | Minimum Amount       |
|----------------------------------------|----------------------|
| Annual Base Salary and/or Annual Bonus | \$5,000 in aggregate |
| Director Fees                          | \$5,000              |

If an election is made for less than such minimums or if no election is made, the amount deferred shall be zero.

- (b) **Short Plan Year.** Notwithstanding the foregoing, if a Participant first becomes a Participant after the first day of a Plan Year, or in the case of the First Plan Year of this Plan, the minimum Annual Deferral Amount shall be an amount equal to the minimum set forth above, multiplied by a fraction, the numerator of which is the number of complete months remaining in the Plan Year and the denominator of which is 12.

### 3.2 **Maximum Deferral.**

- (a) Annual Base Salary, Annual Bonus and Director Fees. For each Plan Year, a Participant may elect to defer, as his or her Annual Deferral Amount, Annual Base Salary, Annual Bonus and/or Director Fees up to the following maximum percentages for each deferral elected:

| Deferral           | Maximum Amount |
|--------------------|----------------|
| Annual Base Salary | 75%            |
| Annual Bonus       | 100%           |
| Director Fees      | 100%           |

- (b) **Short Plan Year.** Notwithstanding the foregoing, if a Participant first becomes a Participant after the first day of a Plan Year, or in the case of the first Plan Year of the Plan itself, the maximum Annual Deferral Amount with respect to Annual Base Salary, Annual Bonus and/or Director Fees shall be limited to the amount of compensation not yet earned by the Participant as of the first day of the month following the month in which the Employee or Director's Election Form becomes irrevocable.

### 3.3 **Election to Defer; Effect of Election Form.**

- (a) **First Plan Year.** In connection with a Participant's commencement of participation in the Plan, the Participant shall make an irrevocable deferral election for the Plan Year in which the Participant commences participation in the Plan, along with such other elections as the Committee deems necessary or desirable under the Plan. For these elections to be valid, the Election Form must be completed and signed by the Participant, timely delivered to the Committee (in accordance with Section 2.2 above) and accepted by the Committee.
- (b) **Subsequent Plan Years.** For each Plan Year subsequent to the first Plan Year as described in subsection (a) above, a deferral election for that Plan Year, and such other elections as the Committee deems necessary or desirable under the Plan,

shall be made by timely delivering to the Committee, in accordance with the Committee's rules and procedures, a new Election Form but, subject to paragraph (c) below, no later than the last day of the calendar year preceding the year in which the Annual Deferral Amounts are earned by the Participant. An Election Form delivered under this subsection (b) shall be irrevocable at such time the Committee determines, which date will be provided in the Election Form, but not later than the last day of the calendar year preceding the Plan Year. If no such Election Form is timely delivered for a Plan Year, the Annual Deferral Amount shall be zero for that Plan Year.

- (c) **Elections to Defer Performance-Based Compensation** . The Company, in its discretion, may permit a separate election to defer performance-based compensation as defined in treasury regulation section 1.409A-1(e) of the Code, and such election may be made no later than six months prior to the end of the applicable performance period; provided, however, that such election shall be made prior to the date that such performance-based compensation is readily ascertainable.
- (d) **Special Distribution Election on or before December 31, 2007** . Participants who are identified by the Committee, in its sole discretion, may make a special distribution election to receive a distribution of their Account Balance in calendar year 2008 or later; provided that the distribution election is made at least twelve months in advance of the newly elected distribution date (and the previously scheduled distribution date, if any) and the election is made no later than December 31, 2007. An election made pursuant to this Section 3.3(d) shall be subject to any special administrative rules imposed by the Committee including rules intended to comply with section 409A of the Code. No election under this Section 3.3(d) shall (i) change the payment date of any distribution otherwise scheduled to be paid in 2007 or cause a payment to be paid in 2007, or (ii) be permitted after December 31, 2007.

3.4 **Form of Distributions.** For each Plan Year a Participant shall elect whether deferrals, and associated earnings or losses, will be distributed as a Short-Term Payout or Termination Benefit.

- (a) **Short-Term Payout.** In connection with each election to defer an Annual Deferral Amount, a Participant may irrevocably elect to receive a future "Short-Term Payout" from the Plan with respect to a portion or all of such Annual Deferral Amount. Subject to the Deduction Limitation, the Short-Term Payout shall be a lump sum payment in an amount equal to the portion of the Annual Deferral Amount elected for such Short-Term Payout by the Participant and credited earnings or losses as determined under Section 3.11, determined at the time that the Short-Term Payout becomes payable (rather than the date of a Separation from Service).
- (b) **Termination Benefit.** In connection with each election to defer an Annual Deferral Amount, a Participant may elect to receive his or her Termination

Benefit in a lump sum or pursuant to the Annual Installment Method. A "Termination Benefit" includes the Annual Deferral Amount that the Participant designates as a Termination Benefit on his or her Election Form, the Participant's Annual Company Restoration Matching Amount, the vested portion of the Participant's Annual Company Contribution Amount, and credited earnings or losses as determined under Section 3.9 for the aggregate amounts in the same Plan Year.

The Participant may change his or her election to an allowable alternative payout period by submitting new Election Form to the Committee; provided that any such Election Form is not effective for 12 months, submitted at least twelve months prior to the date the Participant Separates from Service or otherwise is scheduled to receive a payment, the scheduled date of payment is at least five years subsequent to the originally scheduled date of payment, and is accepted by the Committee, in its sole and absolute discretion. A change to the form of distribution of a Termination Benefit may be modified or revoked until twelve months prior to the time a Participant Separates from Service, at which time such change shall become irrevocable. The last valid Election Form accepted by the Committee shall govern the payout of the Termination Benefit.

If a Participant does not make any election with respect to the form of distribution, then such payment shall be deemed to be a Termination Benefit. If a Participant does not make any election with respect to the payment of the Termination Benefit, then such benefit shall be payable in a lump sum. The Company may determine the form of payment of a Participant's Annual Company Contribution Amount if the Participant has not made an election with respect to such amount; provided, however, if the Company does not determine the form of payment at the time it credits a Participant's Annual Company Contribution Amount, then such amount shall be payable in a lump sum.

- 3.5 **Withholding of Annual Deferral Amounts.** For each Plan Year, the Annual Base Salary portion of the Annual Deferral Amount shall be withheld from each regularly scheduled Annual Base Salary payroll in equal amounts over each pay period, as adjusted from time to time for increases and decreases in Annual Base Salary. The Annual Bonus and/or Director Fees portion of the Annual Deferral Amount shall be withheld at the time the Annual Bonus or Director Fees are or otherwise would be paid to the Participant, whether or not this occurs during the Plan Year itself.
- 3.6 **Rollover Amount.** If an Employee has an account balance in the Predecessor Nonqualified Deferred Compensation Plan, an amount equal to his/her account balance valued as of March 31, 2003 shall be credited to the Participant's Rollover Account under this Plan on April 1, 2003. The Rollover Amount shall be subject to the terms and conditions of this Plan and any Participant with a Rollover Amount shall have no right to demand distribution of such amounts other than as provided for herein.
- 3.7 **Annual Company Restoration Matching Amount.** A Participant's Annual Company Restoration Matching Amount for any Plan Year shall be equal to an amount that is

determined pursuant to the following three steps: (i) calculate the Company matching contribution that would have been made to the Participant's account in the Company's 401(k) Plan had the Participant's Annual Deferral Amount in this Plan been zero; (ii) calculate the Company matching contribution that was actually made to the Participant's account in the Company's 401(k) Plan; (iii) subtract item (ii) from item (i). The amount so credited to a Participant under this Plan shall be for that Participant the Annual Company Restoration Matching Amount for that Plan Year and shall be credited to the Participant's Company Restoration Matching Account on a date or dates to be determined by the Committee, in its sole and absolute discretion.

- 3.8 **Annual Company Contribution Amount.** For each Plan Year, an Employer, in its sole and absolute discretion, may, but is not required to, credit any amount it desires to any Participant's Company Contribution Account under this Plan, which amount shall be for that Participant the Annual Company Contribution Amount for that Plan Year. The amount so credited to a Participant may be greater or less than the amount credited to any other Participant, and the amount credited to any Participant for a Plan Year may be zero, even though one or more other Participants receive an Annual Company Contribution Amount for that Plan Year. The Annual Company Contribution Amount, if any, shall be credited on a date or dates to be determined by the Committee in its sole and absolute discretion, and the crediting date or dates may be different for different Participants. Notwithstanding anything in this Section or the Plan to the contrary, if a Participant is not employed by an Employer as of the last day of a Plan Year other than by reason of his or her death while employed, the Annual Company Contribution Amount for that Plan Year shall be zero.
- 3.9 **Investment of Trust Assets.** The trustee of the Trust shall be authorized, upon written instructions received from the Committee or investment manager appointed by the Committee, to invest and reinvest the assets of the Trust in accordance with the applicable Trust Agreement.
- 3.10 **Vesting.**
- (a) A Participant shall at all times be 100% vested in his or her Rollover Account and Deferral Account.
  - (b) A Participant shall be vested in his or her Company Contribution Account in accordance with the vesting schedules established by the Committee, in its sole and absolute discretion, for each Annual Company Contribution Amount (and amounts credited or debited thereon) at the time such Annual Company Contribution Amount is first credited to the Participant's Account Balance under the Plan. The Committee, in its sole and absolute discretion, will determine over what period of time and in what percentage increments a Participant shall vest in his or her Company Contribution Account. The Committee may establish different vesting schedules for different Participants, in its sole and absolute discretion.

- (c) A Participant shall at all times be 100% vested in his or her Annual Company Restoration Matching Account.
  - (d) Notwithstanding anything in this Section to the contrary, except as provided in subsection (e) below, in the event of a Change in Control, a Participant's Company Contribution Account shall immediately become 100% vested (without regard to whether it is already vested in accordance with the above vesting schedules).
  - (e) Notwithstanding subsection (d) above, the vesting schedule for a Participant's Company Contribution Account shall not be accelerated to the extent that the Committee determines that such acceleration would cause the deduction limitations of section 280G of the Code to become effective. In the event that all of a Participant's Company Contribution Account is not vested pursuant to such a determination, the Participant may request independent verification of the Committee's calculations with respect to the application of section 280G of the Code. In such case, the Committee must provide to the Participant within 30 business days of such a request an opinion from a regionally-recognized accounting firm selected by the Committee in its sole and absolute discretion (the "Accounting Firm"). The opinion shall state the Accounting Firm's opinion that any limitation in the vested percentage hereunder is necessary to avoid the limits of section 280G of the Code and contain supporting calculations. The cost of such opinion shall be paid for by the Company.
- 3.11 **Crediting/Debiting of Account Balances.** In accordance with, and subject to, the rules and procedures that are established from time to time by the Committee, in its sole and absolute discretion, amounts shall be credited or debited to a Participant's Account Balance in accordance with the following rules:
- (a) **Election of Measurement Funds.** A Participant, in connection with his or her initial deferral election in accordance with Section 3.3(a) above, shall elect, on the Election Form, one or more Measurement Fund(s) to be used to determine the additional amounts to be credited to his or her Account Balance for the first business day in which the Participant commences participation in the Plan and continuing thereafter for each subsequent day in which the Participant participates in the Plan, unless changed in accordance with the next sentence. Commencing with the first business day that follows the Participant's commencement of participation in the Plan and continuing thereafter for each subsequent day in which the Participant participates in the Plan, the Participant may (but is not required to) elect, by submitting an Election Form to the Committee that is accepted by the Committee, to add or delete one or more Measurement Fund(s) to be used to determine the additional amounts to be credited to his or her Account Balance, or to change the portion of his or her Account Balance allocated to each previously or newly elected Measurement Fund. If an election is made in accordance with the previous sentence, it shall apply to the next business day and continue thereafter for each subsequent day in which the Participant participates in the Plan, unless changed in accordance with the previous sentence.

- (b) **Proportionate Allocation.** In making any election described in Section 3.11(a) above, the Participant shall specify on the Election Form, in increments of five percentage points (5%), the percentage of his or her Account Balance to have gains and losses measured by a Measurement Fund.
- (c) **Measurement Funds.** From time to time, the Committee in its sole and absolute discretion shall select and announce to Participants its selection of mutual funds, insurance company separate accounts, indexed rates or other methods (each, a “Measurement Fund”), for the purpose of providing the basis on which gains and losses shall be attributed to Account Balances under the Plan. The Committee may, in its sole and absolute discretion, discontinue, substitute or add a Measurement Fund at any time. Each such action will take effect as of the first day of the month that follows by 30 days the day on which the Committee gives Participants advance written notice of such change.
- (d) **Crediting or Debiting Method.** The performance of each elected Measurement Fund (either positive or negative) will be determined by the Committee, in its reasonable discretion, based on available reports of the performance of the Measurement Funds. A Participant’s Account Balance shall be credited or debited on a daily basis based on the performance of each Measurement Fund selected by the Participant, as determined by the Committee in its sole and absolute discretion, as though (i) a Participant’s Account Balance were invested in the Measurement Fund(s) selected by the Participant, in the percentages applicable to such day, as of the close of business on such day, at the closing price on such date; (ii) the portion of the Annual Deferral Amount that was actually deferred during any day were invested in the Measurement Fund(s) selected by the Participant, in the percentages applicable to such day, no later than the close of business on the first business day after the day on which such amounts are actually deferred from the Participant’s Annual Base Salary through reductions in his or her payroll, at the closing price on such date; and (iii) any distribution made to a Participant that decreases such Participant’s Account Balance ceased being invested in the Measurement Fund(s), in the percentages applicable to such day, no earlier than one business day prior to the distribution, at the closing price on such date.
- (e) **No Actual Investment.** Notwithstanding any other provision of this Plan that may be interpreted to the contrary, the Measurement Funds are to be used for measurement purposes only, and a Participant’s election of any such Measurement Fund, the allocation to his or her Account Balance thereto, the calculation of additional amounts and the crediting or debiting of such amounts to a Participant’s Account Balance shall not be considered or construed in any manner as an actual investment of his or her Account Balance in any such Measurement Fund. In the event that the Company or the trustee (as that term is defined in the Trust), in its own discretion, decides to invest funds in any or all of the Measurement Funds, no Participant shall have any rights in or to such investments themselves. Without limiting the foregoing, a Participant’s Account Balance shall at all times be a bookkeeping entry only and shall not represent any

investment made on his or her behalf by the Company or the Trust; the Participant shall at all times remain an unsecured creditor of the Company.

**3.12 FICA and Other Taxes.**

- (a) **Annual Deferral Amounts.** For each Plan Year in which an Annual Deferral Amount is being withheld from an Employee Participant, the Participant's Employer(s) shall withhold from that portion of the Participant's Annual Base Salary and/or Annual Bonus that is not being deferred, in a manner determined by the Employer(s), the Participant's share of FICA and other employment taxes on such Annual Deferral Amount. If necessary, the Committee may reduce the Annual Deferral Amount in order to comply with this Section.
- (b) **Company Restoration Matching Amounts.** For a Participant's Company Restoration Matching Amount, the Participant's Employer(s) shall withhold from the Participant's Annual Base Salary and/or Annual Bonus that is not deferred, in a manner determined by the Employer(s), the Participant's share of FICA and other employment taxes. If necessary, the Committee may reduce the vested portion of the Participant's Company Restoration Matching Account in order to comply with this Section.
- (c) **Other Amounts.** When an Employee Participant becomes vested in a portion of his or her Annual Company Contribution Amounts, the Participant's Employer(s) shall withhold from the Participant's Annual Base Salary and/or Annual Bonus that is not deferred, in a manner determined by the Employer(s) in its sole and absolute discretion, the Participant's share of FICA and other employment taxes on the portion of the Annual Company Contribution Amounts that becomes vested. If necessary, the Committee may reduce the vested portion of the Participant's aforementioned amounts in order to comply with this Section.
- (d) **Distributions.** The Participant's Employer(s), or the trustee of the Trust, shall withhold from any payments made to a Participant under this Plan all federal, state and local income, employment and other taxes required to be withheld by the Employer(s), or the trustee of the Trust, in connection with such payments, in amounts and in a manner to be determined in the sole and absolute discretion of the Employer(s) and the trustee of the Trust.

**ARTICLE 4**

**Short-Term Payout/Unforeseeable Financial Emergencies/ Withdrawal Election**

- 4.1 **Short-Term Payout.** Subject to the Deduction Limitation and the other terms and conditions of this Plan, each Short-Term Payout elected shall be paid out during a 60-day period commencing immediately after the last day of any Plan Year designated by the Participant that is at least three Plan Years after the end of the Plan Year in which the Annual Deferral Amount is actually deferred. By way of example, if a three year Short-Term Payout is elected for Annual Deferral Amounts that are deferred in the Plan Year commencing January 1, 2006, the three year Short-Term Payout would become payable

during a 60-day period commencing January 1, 2010. In addition, subject to the terms and conditions of this Section 4.1, Section 4.2 and all other provisions of this Plan, any similar elections made pursuant to the terms of the Predecessor Nonqualified Deferred Compensation Plan, shall be deemed to remain in effect under this Plan. The distribution date selected by a Participant in connection with such election (s) under the Predecessor Nonqualified Deferred Compensation Plan shall remain binding on the parties. The Committee shall, in its sole and absolute discretion, determine how any amounts deferred under the Predecessor Nonqualified Deferred Compensation Plan shall be treated pursuant to the language of Article 4 and the Plan.

- 4.2 **Other Benefits Take Precedence Over Short-Term.** Should an event occur that triggers a benefit under Article 5, 6, 7 or 8, any Annual Deferral Amount, plus amounts credited or debited thereon, that is subject to a Short-Term Payout election under Section 4.1 shall not be paid in accordance with Section 4.1 but shall be paid in accordance with the other applicable Article.
- 4.3 **Withdrawal Payout/Suspensions for Unforeseeable Financial Emergencies.** If the Participant experiences an Unforeseeable Emergency, the Participant may petition the Committee to (i) suspend any deferrals required to be made by a Participant and/or (ii) receive a partial or full payout from the Plan. The payout shall not exceed the lesser of the Participant's Account Balance, calculated as if such Participant were receiving a Termination Benefit, or the amount reasonably needed to satisfy the Unforeseeable Emergency. If, subject to the sole and absolute discretion of the Committee, the petition for a suspension and/or payout is approved, suspension shall take effect upon the date of approval and, if applicable, any payout shall be made within 60 days of the date of approval. The payment of any amount under this Section 4.3 shall not be subject to the Deduction Limitation.

## **ARTICLE 5**

### **Survivor Benefit**

- 5.1 **Survivor Benefit.** If the Participant dies before he or she experiences a Separation from Service or suffers a Disability prior to such date, the Participant's Beneficiary shall be entitled to receive the Termination Benefit described in Section 6.2 as if Participant had experienced a Separation from Service and the valid Election Form(s) most recently on file with the Company shall control the manner in which the Survivor Benefit is paid.

## **ARTICLE 6**

### **Termination Benefit**

- 6.1 **Termination Benefit.** Upon a Separation from Service, a Participant shall receive a distribution of the vested portion of his or her Termination Benefit in the form that the Participant elected to receive under Section 3.4 if a Participant experiences a Separation from Service prior to his or her death or Disability. Notwithstanding any other provision of this Article 6 to the contrary, any distribution scheduled to be made upon Separation from Service to a Participant who is identified as a Key Employee as of the date he

Separates from Service shall be delayed for a minimum of six months following the Participant's Separation from Service. Any payment to a Key Employee delayed under this Section 6.1 shall be made (without interest) within 90 days after the six-month anniversary of the Participant's Separation from Service. The identification of a Participant as a Key Employee shall be made by the Committee in accordance with Section 1.33 of the Plan and sections 416(i) and 409A of the Code and the regulations promulgated thereunder.

- 6.2 **Payment of Termination Benefit.** The Termination Benefit will be paid in a lump sum or Annual Installments as the Participant elected, and will begin, in the first 60 days of the calendar year following the calendar year in which the Participant experiences a Separation from Service, unless if delayed pursuant to Sections 3.4(b) and 6.1. Any payment made shall be subject to the Deduction Limitation. If a Participant becomes Disabled after his or her Separation from Service, distributions shall be made under Article 6 and not under Article 7 below. Notwithstanding the foregoing or anything in this Plan to the contrary, to the extent a Participant's Account Balance is less than \$25,000 at the time of Separation from Service, the Committee shall cause the Termination Benefit to be paid in a lump sum.

## **ARTICLE 7**

### **Disability Benefit**

#### **7.1 Disability Benefit.**

- (a) **Distribution.** The Participant shall receive a distribution equal to his or her Account Balance as if the Participant experiences a Separation from Service, pursuant to the Committee's determination that the Participant has suffered a Disability. If a Participant subsequently experiences a Separation from Service pursuant to his or her Disability, distributions shall be made under this paragraph (a) and not under Article 6.
- (b) **Waiver of Deferral.** A Participant who is determined by the Committee to be suffering from a Disability shall be (i) excused from fulfilling that portion of the Annual Deferral Amount commitment that would otherwise have been withheld from a Participant's Annual Base Salary, Annual Bonus and/or Directors Fees for the Plan Year during which the Participant first suffers a Disability. During the period of Disability, the Participant shall not be allowed to make any additional deferral elections, but will continue to be considered a Participant for all other purposes of this Plan.
- (c) **Return to Work.** If a Participant returns to employment, or service as a Director, with an Employer, after a Disability ceases, the Participant may elect to defer an Annual Deferral Amount for the Plan Year following his or her return to employment or service and for every Plan Year thereafter while a Participant in the Plan; provided that the Participant meets the eligibility requirement in Article 2 and such deferral elections are otherwise allowed and an Election Form is

delivered to and accepted by the Committee for each such election in accordance with Section 3.3(b) above. Notwithstanding the foregoing, the Participant shall continue receiving the distribution under paragraph (a) above.

## **ARTICLE 8**

### **Beneficiary Designation**

- 8.1 **Beneficiary.** Each Participant shall have the right, at any time, to designate his or her Beneficiary(ies) (both primary as well as contingent) to receive any benefits payable under the Plan to a beneficiary upon the death of a Participant. The Beneficiary designated under this Plan may be the same as or different from the Beneficiary designation under any other plan of an Employer in which the Participant participates.
- 8.2 **Beneficiary Designation; Change; Spousal Consent.** A Participant shall designate his or her Beneficiary by completing and signing the Beneficiary Designation Form, and returning it to the Committee or its designated agent. A Participant shall have the right to change a Beneficiary by completing, signing and otherwise complying with the terms of the Beneficiary Designation Form and the Committee's rules and procedures, as in effect from time to time. If the Participant names someone other than his or her spouse as a Beneficiary, a spousal consent, in the form designated by the Committee, must be signed by that Participant's spouse and returned to the Committee. Upon the acceptance by the Committee of a new Beneficiary Designation Form, all Beneficiary designations previously filed shall be canceled. The Committee shall be entitled to rely on the last valid Beneficiary Designation Form filed by the Participant and accepted by the Committee prior to his or her death.
- 8.3 **Acknowledgment.** No designation or change in designation of a Beneficiary shall be effective until received and acknowledged in writing by the Committee or its designated agent.
- 8.4 **No Beneficiary Designation.** If a Participant fails to designate a Beneficiary as provided in Sections 8.1, 8.2, and 8.3 above or, if all designated Beneficiaries predecease the Participant or die prior to complete distribution of the Participant's benefits, then the Participant's designated Beneficiary shall be deemed to be his or her surviving spouse. If the Participant has no surviving spouse, the benefits remaining under the Plan to be paid to a Beneficiary shall be payable to the executor or personal representative of the Participant's estate.

Upon the Committee or its designated agent being provided with written notice of the dissolution of marriage of a Participant, and notwithstanding any of the preceding provisions of this Article 8, any earlier designation of the Participant's former spouse as a Beneficiary for a portion or all of the benefits specified herein shall be treated as though the Participant's former spouse had predeceased the Participant. Notwithstanding the preceding sentence, any designation of the Participant's former spouse as a Beneficiary shall not be treated as though the Participant's former spouse had predeceased the Participant if, after the dissolution of the Participant's marriage and prior to payment of

benefits on behalf of the Participant (1) the Participant executes and delivers a new Beneficiary designation that complies with this Plan that clearly names such former spouse as a Beneficiary, or (2) there is delivered to the Plan a domestic relations order providing that the former spouse is to be treated as the Beneficiary. In any case in which the Participant's former spouse is treated under the Participant's Beneficiary designation as having predeceased the Participant, no heirs or other beneficiaries of the former spouse shall receive benefits from this Plan as a Beneficiary of the Participant except as provided otherwise in the Participant's Beneficiary designation.

(The following example illustrates the application of the preceding paragraph. Assume that a Participant, 'Participant A,' is married to 'Spouse A' and that Participant A files a valid and effective Beneficiary designation under this Plan naming Spouse A as a 50% Beneficiary and each of Participant A's two children with Spouse A (the 'Children') as a 25% Beneficiary. Assume that Participant A becomes divorced from Spouse A after making such Beneficiary designation. Upon the Committee or its designated agent being provided with written notice of the divorce, Spouse A shall be deemed to have predeceased Participant A for purposes of Participant A's Beneficiary designation subject to the second sentence of the preceding paragraph. If Participant A later dies without having made a valid post-divorce Beneficiary designation under this Plan and assuming that no Plan benefits have been paid and that there is no domestic relations order to the contrary, Participant A's Beneficiaries shall be deemed to be his two Children, with each child being a 50% Beneficiary.)

- 8.5 **Doubt as to Beneficiary.** If the Committee has any doubt as to the proper Beneficiary to receive payments pursuant to this Plan, the Committee shall have the right, exercisable in its sole and absolute discretion, to cause the Participant's Employer to withhold such payments until this matter is resolved to the Committee's satisfaction.
- 8.6 **Discharge of Obligations.** The payment of benefits under the Plan to a Beneficiary shall fully and completely discharge all Employers and the Committee from all further obligations under this Plan with respect to the Participant, and that Participant's Plan Agreement shall terminate upon such full payment of benefits.

## **ARTICLE 9**

### **Leave of Absence**

- 9.1 **Paid Leave of Absence.** Unless otherwise provided under section 409A of the Code, if a Participant is authorized by the Participant's Employer for any reason to take a bona fide paid leave of absence from the employment of the Employer, the Participant shall continue to be considered employed by the Employer and the Annual Deferral Amount shall continue to be withheld during such paid leave of absence in accordance with Section 3.3.
- 9.2 **Unpaid Leave of Absence.** Unless otherwise provided under section 409A of the Code, if a Participant is authorized by the Participant's Employer for any reason to take a bona fide unpaid leave of absence from the employment of the Employer, the Participant shall

continue to be considered employed by the Employer and the Participant shall be excused from making deferrals until the earlier of the date the leave of absence expires or the Participant returns to a paid employment status. Upon such expiration or return, deferrals shall resume for the remaining portion of the Plan Year in which the expiration or return occurs, based on the deferral election, if any, made for that Plan Year. If no election was made for that Plan Year, no deferral shall be withheld.

## **ARTICLE 10**

### **Termination/Amendment or Modification**

- 10.1 **Termination.** Although each Employer anticipates that it will continue the Plan for an indefinite period of time, there is no guarantee that any Employer will continue the Plan or will not terminate the Plan at any time in the future.

In the event the Plan is terminated, in the Board's discretion, the Account Balances of Participants may be distributed within the period beginning twelve months after the date the Plan was terminated and ending twenty-four months after the date the Plan was terminated. If the Plan is terminated and Account Balances are distributed, the Company shall terminate all account balance non-qualified deferred compensation plans with respect to all participants and shall not adopt a new account balance non-qualified deferred compensation plan for at least three years after the date the Plan was terminated.

The Board, in its discretion, may terminate the Plan 30 days prior to or twelve months following a Change in Control that is a change in the ownership or effective control of the Company or a change in the ownership of a substantial portion of the assets of the Company as defined in the regulations promulgated under Section 409A of the Code and distribute the Accounts of the Participants within the twelve-month period following the termination of the Plan. If the Plan is terminated and Account Balances are distributed, the Company shall terminate all substantially similar non-qualified deferred compensation plans sponsored by the Company and all of the benefits of the terminated plans shall be distributed within twelve months following the termination of the plans.

The Board, in its discretion, may terminate the Plan upon a corporate dissolution or liquidation of the Company that is taxed under Section 331 of the Code or with the approval of a bankruptcy court pursuant to 11 U.S.C. Section 503(b)(1)(A), provided that the Participant's Accounts are distributed and included in the gross income of the Participants by the latest of (i) the calendar year in which the Plan terminates, or (ii) the first calendar year in which payment of the Accounts is administratively practicable.

The termination of the Plan shall not adversely affect any Participant or Beneficiary who has become entitled to the payment of any benefits under the Plan as of the date of termination.

- 10.2 **Amendment.** The Company may, at any time, amend or modify the Plan in whole or in part by the action of its Board as appropriate in its sole and absolute discretion; provided, however, that: (i) no amendment or modification shall be effective to decrease or restrict the value of a Participant's Account Balance in existence at the time the amendment or

modification is made, calculated as if the Participant had experienced a Separation from Service as of the effective date of the amendment or modification, (ii) no amendment or modification shall be effective upon or after a Change in Control without the prior written consent of a majority of Participants, and (iii) no amendment or modification of Section 10.2(i) or 10.2(ii) of the Plan shall be effective. The amendment or modification of the Plan shall not affect any Participant or Beneficiary who has become entitled to the payment of benefits under the Plan as of the date of the amendment or modification.

- 10.3 **Plan Agreement.** Despite the provisions of Sections 10.1 and 10.2 above, if a Participant's Plan Agreement contains benefits or limitations that are not in this Plan document, the Employer may only amend or terminate such provisions with the consent of the Participant.
- 10.4 **Effect of Payment.** The full payment of the applicable benefit under Articles 4, 5, 6, 7 or 8 of the Plan shall completely discharge all obligations to a Participant and his or her designated Beneficiaries under this Plan and the Participant's Plan Agreement shall terminate.

## **ARTICLE 11**

### **Administration**

- 11.1 **Committee Duties.** Except as otherwise provided in this Article 11, this Plan shall be administered by a Committee, which shall consist of those persons appointed by the Chief Executive Officer of the Company from time to time. If the Chief Executive Officer of the Company fails to appoint the Committee, the Committee shall be the Company until such time as the Chief Executive Officer appoints the members of the Committee pursuant to the previous sentence. Members of the Committee may be Participants under this Plan. The Committee shall also have the discretion and authority to (i) make, amend, interpret, and enforce all appropriate rules and regulations for the administration of this Plan and (ii) decide or resolve any and all questions including interpretations of this Plan, as may arise in connection with the Plan. Any individual serving on the Committee who is a Participant shall not vote or act on any matter relating solely to himself or herself. When making a determination or calculation, the Committee shall be entitled to rely on information furnished by a Participant or the Company.
- 11.2 **Administration Upon Change In Control.** For purposes of this Plan, the Committee shall be the "Administrator" at all times prior to the occurrence of a Change in Control. Upon and after the occurrence of a Change in Control, the "Administrator" shall be an independent third party selected by the trustee of the Trust and approved by the individual who, immediately prior to such event, was the Company's Chief Executive Officer or, if not available or willing to assume such responsibility, the Company's highest ranking officer (the "Ex-CEO"). The Administrator shall have the discretionary power to determine all questions arising in connection with the administration of the Plan and the interpretation of the Plan and Trust including, but not limited to benefit entitlement determinations; provided, however, upon and after the occurrence of a Change in Control, the Administrator shall have no power to direct the investment of

Plan or Trust assets or select any investment manager or custodial firm for the Plan or Trust. Upon and after the occurrence of a Change in Control, the Company must: (1) pay all reasonable administrative expenses and fees of the Administrator; (2) indemnify the Administrator against any costs, expenses and liabilities including, without limitation, attorney's fees and expenses arising in connection with the performance of the Administrator hereunder, except with respect to matters resulting from the gross negligence or willful misconduct of the Administrator or its employees or agents; and (3) supply full and timely information to the Administrator or all matters relating to the Plan, the Trust, the Participants and their Beneficiaries, the Account Balances of the Participants, the date of circumstances of the Disability, death or Separation from Service of the Participants, and such other pertinent information as the Administrator may reasonably require. Upon and after a Change in Control, the Administrator may be terminated (and a replacement appointed) by the trustee of the Trust only with the approval of the Ex-CEO. Upon and after a Change in Control, the Administrator may not be terminated by the Company.

- 11.3 **Agents.** In the administration of this Plan, the Committee may, from time to time, employ agents and delegate to them such administrative duties as it sees fit (including acting through a duly appointed representative) and may from time to time consult with counsel who may be counsel to any Employer.
- 11.4 **Binding Effect of Decisions.** The decision or action of the Administrator with respect to any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
- 11.5 **Indemnity of Committee.** All Employers shall indemnify and hold harmless the members of the Committee, and any Employee to whom the duties of the Committee may be delegated, and the Administrator against any and all claims, losses, damages, expenses or liabilities arising from any action or failure to act with respect to this Plan, except in the case of willful misconduct by the Committee, any of its members, any such Employee or the Administrator.
- 11.6 **Employer Information.** To enable the Committee and/or Administrator to perform its functions, the Company and each Employer shall supply full and timely information to the Committee and/or Administrator, as the case may be, on all matters relating to the compensation of its Participants, the date and circumstances of the Disability, death or Separation from Service of its Participants, and such other pertinent information as the Committee or Administrator may reasonably require.

## ARTICLE 12

### Other Benefits and Agreements

- 12.1 **Coordination with Other Benefits.** The benefits provided for a Participant and Participant's Beneficiary under the Plan are in addition to any other benefits available to such Participant under any other plan or program for employees of the Participant's

Employer. The Plan shall supplement and shall not supersede, modify or amend any other such plan or program except as may otherwise be expressly provided.

### **ARTICLE 13** **Claims Procedures**

- 13.1 **Presentation of Claim.** Any Participant or Beneficiary of a deceased Participant (such Participant or Beneficiary being referred to below as a “Claimant”) may deliver to the Committee a written claim for a determination with respect to the amounts distributable to such Claimant from the Plan. If such a claim relates to the contents of a notice received by the Claimant, the claim must be made within 60 days after such notice was received by the Claimant. All other claims must be made within 180 days of the date on which the event that caused the claim to arise occurred. The claim must state with particularity the determination desired by the Claimant.
- 13.2 **Notification of Decision.** The Committee shall consider a Claimant’s claim within a reasonable time, and shall notify the Claimant in writing:
- (a) that the Claimant’s requested determination has been made, and that the claim has been allowed in full; or
  - (b) that the Committee has reached a conclusion contrary, in whole or in part, to the Claimant’s requested determination, and such notice must set forth in a manner calculated to be understood by the Claimant:
    - (i) the specific reason(s) for the denial of the claim, or any part of it;
    - (ii) specific reference(s) to pertinent provisions of the Plan upon which such denial was based;
    - (iii) a description of any additional material or information necessary for the Claimant to perfect the claim, and an explanation of why such material or information is necessary; and
    - (iv) an explanation of the claim review procedure set forth in Section 13.3 below.
- 13.3 **Review of a Denied Claim.** Within 60 days after receiving a notice from the Committee that a claim has been denied, in whole or in part, a Claimant (or the Claimant’s duly authorized representative) may file with the Committee a written request for a review of the denial of the claim. Thereafter, but not later than 30 days after the review procedure began, the Claimant (or the Claimant’s duly authorized representative):
- (a) may review pertinent documents;
  - (b) may submit written comments or other documents; and/or

- (c) may request a hearing, which the Committee, in its sole and absolute discretion, may grant.
- 13.4 **Decision on Review.** The Committee shall render its decision on review promptly, and not later than 60 days after the filing of a written request for review of the denial, unless a hearing is held or other special circumstances require additional time, in which case the Committee's decision must be rendered within 120 days after such date. Such decision must be written in a manner calculated to be understood by the Claimant, and it must contain:
- (a) specific reasons for the decision;
  - (b) specific reference(s) to the pertinent Plan provisions upon which the decision was based; and
  - (c) such other matters as the Committee deems relevant.
- 13.5 **Mediation.** Should the parties be unable to resolve the dispute pursuant to these procedures, the claim shall be referred to non-binding mediation, conducted by the Employment panel of Judicial Arbitration Mediation Services ("JAMS"), in accordance with JAMS' standard mediation rules. A mutually agreeable mediator will be selected. The parties shall share all costs of the mediation equally, including attorney fees. Not sooner than 20 days following the mediator's final determination, either party may request binding arbitration.
- 13.6 **Binding Arbitration.** Following the expiration of the 20-day period referenced in Section 13.5, either party may initiate binding arbitration by making a written demand for it on the other party. Such binding arbitration shall be conducted under the applicable rules of the American Arbitration Association using a mutually selected arbitrator in San Mateo or San Francisco County. The cost of the arbitration shall be borne by the non-prevailing party or as otherwise determined by the arbitrator.

## **ARTICLE 14**

### **Trust**

- 14.1 **Establishment of the Trust.** The Company shall establish the Trust, and each Employer shall at least annually transfer over to the Trust such assets as the Employer determines, in its sole and absolute discretion, are necessary to provide, on a present value basis, for its respective future liabilities created with respect to the Rollover Amounts, Annual Company Contribution Amounts, Company Restoration Matching Contribution Amounts, and Annual Deferral Amounts for such Employer's Participants for all periods prior to the transfer, as well as any debits and credits to the Participants' Account Balances for all periods prior to the transfer, taking into consideration the value of the assets in the trust at the time of the transfer.
- 14.2 **Interrelationship of the Plan and the Trust.** The provisions of the Plan and the Plan Agreement shall govern the rights of a Participant to receive distributions pursuant to the

Plan. The provisions of the Trust shall govern the rights of the Employers, Participants and the creditors of the Employers to the assets transferred to the Trust. Each Employer shall at all times remain liable to carry out its obligations under the Plan.

- 14.3 **Distributions From the Trust.** Each Employer's obligations under the Plan may be satisfied with Trust assets distributed pursuant to the terms of the Trust, and any such distribution shall reduce the Employer's obligations under this Plan.

## **ARTICLE 15**

### **Miscellaneous**

- 15.1 **Status of Plan.** The Plan is intended to be a plan that is not qualified within the meaning section 401(a) of the Code and that "is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employee" within the meaning of sections 201(2), 301(a)(3) and 401(a)(1) of ERISA. The Plan shall be administered and interpreted to the extent possible in a manner consistent with that intent.
- 15.2 **Unsecured General Creditor.** Participants and their Beneficiaries, heirs, successors and assigns shall have no legal or equitable rights, interests or claims in any property or assets of an Employer. For purposes of the payment of benefits under this Plan, any and all of an Employer's assets shall be, and remain, the general, unpledged unrestricted assets of the Employer. An Employer's obligation under the Plan shall be merely that of an unfunded and unsecured promise to pay money in the future.
- 15.3 **Employer's Liability.** An Employer's liability for the payment of benefits shall be defined only by the Plan and the Plan Agreement, as entered into between the Employer and a Participant. An Employer shall have no obligation to a Participant under the Plan except as expressly provided in the Plan and his or her Plan Agreement.
- 15.4 **Nonassignability.** Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, transfer, hypothecate, alienate or convey in advance of actual receipt, the amounts, if any, payable hereunder, or any part thereof which are, and all rights to which are expressly declared to be, unassignable and non-transferable. Except as provided in Section 15.15, no part of the amounts payable shall, prior to actual payment, be subject to seizure, attachment, garnishment or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency or be transferable to a spouse as a result of a property settlement or otherwise.
- 15.5 **Not a Contract of Employment.** The terms and conditions of this Plan shall not be deemed to constitute a contract of employment between any Employer and the Participant. Such employment is hereby acknowledged to be an "at will" employment relationship that can be terminated at any time for any reason, or no reason, with or without cause, and with or without notice, unless expressly provided in a written

employment agreement. Nothing in this Plan shall be deemed to give a Participant the right to be retained in the service of any Employer, either as an Employee or a Director, or to interfere with the right of any Employer to discipline or discharge the Participant at any time.

- 15.6 **Furnishing Information.** A Participant or his or her Beneficiary will cooperate with the Committee by furnishing any and all information requested by the Committee and take such other actions as may be requested in order to facilitate the administration of the Plan and the payments of benefits hereunder, including but not limited to taking such physical examinations as the Committee may deem necessary.
- 15.7 **Terms.** Whenever any words are used herein in the masculine, they shall be construed as though they were in the feminine in all cases where they would so apply; and whenever any words are used herein in the singular or in the plural, they shall be construed as though they were used in the plural or the singular, as the case may be, in all cases where they would so apply.
- 15.8 **Captions.** The captions of the articles, sections and paragraphs of this Plan are for convenience only and shall not control or affect the meaning or construction of any of its provisions.
- 15.9 **Governing Law.** Subject to ERISA, the provisions of this Plan shall be construed and interpreted according to the internal laws of the State of California without regard to its conflicts of laws principles.
- 15.10 **Notice.** Any notice or filing required or permitted to be given to the Committee under this Plan shall be sufficient if in writing and hand-delivered, or sent by registered or certified mail, to the address below:
- Senior Vice President, Human Resources  
Electronic Arts Inc.  
209 Redwood Shores Pkwy  
Redwood City, CA 94065
- Such notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of the date shown on the postmark on the receipt for registration or certification.
- Any notice or filing required or permitted to be given to a Participant under this Plan shall be sufficient if in writing and hand-delivered, or sent by mail, to the last known address of the Participant.
- 15.11 **Successors.** The provisions of this Plan shall bind and inure to the benefit of the Participant's Employer and its successors and assigns and the Participant and the Participant's designated Beneficiaries.
- 15.12 **Spouse's Interest.** The interest in the benefits hereunder of a spouse of a Participant who has predeceased the Participant shall automatically pass to the Participant and shall

not be transferable by such spouse in any manner, including but not limited to such spouse's will, nor shall such interest pass under the laws of in testate succession.

- 15.13 **Validity.** In case any provision of this Plan shall be illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining parts hereof, but this Plan shall be construed and enforced as if such illegal or invalid provision had never been inserted herein.
- 15.14 **Incompetent.** If the Committee determines in its discretion that a benefit under this Plan is to be paid to a minor, a person declared incompetent or to a person incapable of handling the disposition of that person's property, the Committee may direct payment of such benefit to the guardian, legal representative or person having the care and custody of such minor, incompetent or incapable person. The Committee may require proof of minority, incompetence, incapacity or guardianship, as it may deem appropriate prior to distribution of the benefit. Any payment of a benefit shall be a payment for the account of the Participant and the Participant's Beneficiary, as the case may be, and shall be a complete discharge of any liability under the Plan for such payment amount.
- 15.15 **Court Order.** The Committee is authorized to make any payments directed by court order in any action in which the Plan or the Committee has been named as a party. In addition, if a court determines that a spouse or former spouse of a Participant has an interest in the Participant's benefits under the Plan in connection with a property settlement or otherwise, the Committee, in its sole and absolute discretion, shall have the right, notwithstanding any election made by a Participant, to immediately distribute the spouse's or former spouse's interest in the Participant's benefits under the Plan to that spouse or former spouse.
- 15.16 **Distribution in the Event of Taxation.**
- (a) **In General.** If, for any reason, all or any portion of a Participant's benefits under this Plan becomes taxable to the Participant prior to receipt, a Participant may petition the Committee before a Change in Control, or the trustee of the Trust after a Change in Control, for a distribution of that portion of his or her benefit that has become taxable. Upon the grant of such a petition, which grant shall not be unreasonably withheld (and, after a Change in Control, shall be granted), a Participant's Employer shall distribute to the Participant immediately available funds in an amount equal to the taxable portion of his or her benefit (which amount shall not exceed a Participant's unpaid Account Balance under the Plan). If the petition is granted, the tax liability distribution shall be made within 90 days of the date when the Participant's petition is granted. Such a distribution shall affect and reduce the benefits to be paid under this Plan.
- (b) **Trust.** If the Trust terminates in accordance with Section 3.6(e) of the Trust and benefits are distributed from the Trust to a Participant in accordance with that Section, the Participant's benefits under this Plan shall be reduced to the extent of such distributions.

- 15.17 **Insurance.** The Employers, on their own behalf or on behalf of the trustee of the Trust, and, in their sole and absolute discretion, may apply for and procure insurance on the life of the Participant, in such amounts and in such forms as the Trust may choose. The Employers or the trustee of the Trust, as the case may be, shall be the sole owner and beneficiary of any such insurance. The Participant shall have no interest whatsoever in any such policy or policies, and at the request of the Employers shall such information and execute such documents as may be required by the insurance company or companies to whom the Employers have applied for insurance.
- 15.18 **Legal Fees To Enforce Rights After Change in Control.** The Company and each Employer is aware that upon the occurrence of a Change in Control, the Board or the board of directors of a Participant's Employer (which might then be composed of new members), the Committee, or a shareholder of the Company, of the Participant's Employer or of any successor corporation might then cause or attempt to cause the Company, the Participant's Employer or such successor corporation to refuse to comply with its obligations under the Plan and/or to seek to deny Participants the benefits intended under the Plan. In these circumstances, the purpose of the Plan could be frustrated. Accordingly, if, following a Change in Control, a Participant or Beneficiary institutes any litigation or other legal action which seeks to recover benefits under the Plan or which otherwise asserts that the Committee, the Company, the Employer or any successor entity to the Company or the Employer has failed to comply with any of its obligations under the Plan or any agreement thereunder with respect to such Participant or Beneficiary, or if the Committee, the Company, the Employer or any other person takes any action to declare the Plan void or unenforceable or institutes any litigation or other legal action designed to deny, diminish or to recover from any Participant or Beneficiary the benefits intended to be provided under the Plan, and the Participant or Beneficiary retains counsel in connection with such litigation or legal action, then (unless the final decision of a court of competent jurisdiction or arbitrator determines that the Participant or Beneficiary's initiation or defense of such litigation or legal action was frivolous, based on the information known to the Participant or Beneficiary at the time of the initiation or defense) the Company and such Employer (who shall be jointly and severally liable) shall be required to pay the reasonable attorneys fees and expenses of the Participant or Beneficiary in connection with the initiation or defense of such litigation or legal action with respect to such matters, whether by or against the Committee, the Company, the Employer or any director, officer, shareholder or other person affiliated with the Company, the Employer or any successor thereto in any jurisdiction. The reasonable attorneys fees and expenses, if any, that become due and owing to a Participant (or Beneficiary) in accordance with this Section shall be paid no later than 180 days following the date such fees and expenses are incurred.

IN WITNESS WHEREOF, the Company has signed this Plan document as of August 1, 2007.

"Company"

Electronic Arts Inc., a Delaware corporation

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**Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm**

The Board of Directors  
Electronic Arts Inc.:

With respect to the registration statements on Form S-8 (Nos. 33-66836, 33-55212, 33-53302, 33-41955, 33-82166, 33-61781, 33-61783, 333-01397, 333-09683, 333-09893, 333-32239, 333-32771, 333-46937, 333-60513, 333-60517, 333-84215, 333-39430, 333-39432, 333-44222, 333-60256, 333-67430, 333-82888, 333-99525, 333-107710, 333-117990, 333-120256, 33-127156, 333-131933, and 333-138532) and the registration statement on Form S-3 (No. 333-102797), of Electronic Arts Inc., we acknowledge our awareness of the incorporation by reference therein of our report dated August 6, 2007 relating to the unaudited condensed consolidated interim financial statements of Electronic Arts Inc. and subsidiaries that are included in this Form 10-Q for the three-month period ended June 30, 2007.

Pursuant to Rule 436 under the Securities Act of 1933 (the Act), such report is not considered part of a registration statement prepared or certified by an independent registered public accounting firm, or a report prepared or certified by an independent registered public accounting firm within the meaning of Sections 7 and 11 of the Act.

KPMG LLP

Mountain View, California  
August 6, 2007



**ELECTRONIC ARTS INC.**

**Certification of Chief Executive Officer  
Pursuant to Rule 13a-14(a) of the Exchange Act  
As Adopted Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, John S. Riccitiello, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Electronic Arts Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 6, 2007

By: /s/ John S. Riccitiello

John S. Riccitiello  
Chief Executive Officer



**ELECTRONIC ARTS INC.**

**Certification of Executive Vice President, Chief Financial and Administrative Officer  
Pursuant to Rule 13a-14(a) of the Exchange Act  
As Adopted Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Warren C. Jenson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Electronic Arts Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 6, 2007

By: /s/ Warren C. Jenson

Warren C. Jenson  
Executive Vice President,  
Chief Financial and Administrative Officer



**ELECTRONIC ARTS INC.**

**Certification of Chief Executive Officer  
Pursuant to 18 U.S.C. Section 1350  
As Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Electronic Arts Inc. on Form 10-Q for the period ended June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John S. Riccitiello, Chief Executive Officer of Electronic Arts Inc., certify, pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ("Section 906"), that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Electronic Arts Inc. for the periods presented therein.

/s/ John S. Riccitiello

\_\_\_\_\_  
John S. Riccitiello  
Chief Executive Officer  
Electronic Arts Inc.

August 6, 2007

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Electronic Arts and will be retained by Electronic Arts and furnished to the Securities and Exchange Commission or its staff upon request.



**ELECTRONIC ARTS INC.**

**Certification of Executive Vice President, Chief Financial and Administrative Officer  
Pursuant to 18 U.S.C. Section 1350  
As Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report of Electronic Arts Inc. on Form 10-Q for the period ended June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Warren C. Jenson, Executive Vice President and Chief Financial and Administrative Officer of Electronic Arts Inc., certify, pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ("Section 906"), that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Electronic Arts Inc. for the periods presented therein.

/s/ Warren C. Jenson

Warren C. Jenson  
Executive Vice President,  
Chief Financial and Administrative Officer  
Electronic Arts Inc.

August 6, 2007

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Electronic Arts and will be retained by Electronic Arts and furnished to the Securities and Exchange Commission or its staff upon request.