ELECTRONIC ARTS INC.
Form 10-Q
February 09, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2009

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	**94-2838567**
(State or other jurisdiction of incorporation or organization)	***(I.R.S. Employer Identification No.)***
209 Redwood Shores Parkway Redwood City, California	**94065**
(Address of principal executive offices)	***(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 þ NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ¨ NO þ

As of February 5, 2010, there were 326,644,249 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 DECEMBER 31, 2009

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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) **(In millions, except par value data)**	**December 31, 2009**	**March 31, 2009 (a)**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,114	$ 1,621
Short-term investments	352	534
Marketable equity securities	318	365
Receivables, net of allowances of $267 and $217, respectively	495	116
Inventories	144	217
Deferred income taxes, net	95	51
Other current assets	264	216
Total current assets	2,782	3,120
Property and equipment, net	550	354
Goodwill	1,097	807
Acquisition-related intangibles, net	215	221
Deferred income taxes, net	74	61
Other assets	221	115
TOTAL ASSETS	$ 4,939	$ 4,678
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 186	$ 152
Accrued and other current liabilities	790	723
Deferred net revenue (packaged goods and digital content)	895	261
Total current liabilities	1,871	1,136
Income tax obligations	281	268
Deferred income taxes, net	49	42
Other liabilities	139	98
Total liabilities	2,340	1,544
Commitments and contingencies (See Note 11)		
Stockholders equity:		
Preferred stock, $0.01 par value. 10 shares authorized		
Common stock, $0.01 par value. 1,000 shares authorized; 327 and 323 shares issued and outstanding, respectively	3	3
Paid-in capital	2,265	2,142
Retained earnings	93	800
Accumulated other comprehensive income	238	189

Total stockholders equity		2,599		3,134
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	4,939	$	4,678

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).

(a) Derived from audited consolidated financial statements.

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ELECTRONIC ARTS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited) (In millions, except per share data)	Three Months Ended December 31, 2009	2008	Nine Months Ended December 31, 2009	2008
Net revenue	$ 1,243	$ 1,654	$ 2,675	$ 3,352
Cost of goods sold	654	925	1,568	1,778
Gross profit	589	729	1,107	1,574
Operating expenses:				
Marketing and sales	208	250	559	575
General and administrative	84	82	241	258
Research and development	290	299	918	1,027
Acquired in-process technology		1		3
Amortization of intangibles	14	15	38	46
Certain abandoned acquisition-related costs				21
Goodwill impairment		368		368
Restructuring charges	100	18	120	41
Total operating expenses	696	1,033	1,876	2,339
Operating loss	(107)	(304)	(769)	(765)
Losses on strategic investments	(1)	(27)	(25)	(67)
Interest and other income (expense), net	(2)	14	8	36
Loss before provision for (benefit from) income taxes	(110)	(317)	(786)	(796)
Provision for (benefit from) income taxes	(28)	324	(79)	250
Net loss	$ (82)	$ (641)	$ (707)	$ (1,046)
Net loss per share:				
Basic and Diluted	$ (0.25)	$ (2.00)	$ (2.18)	$ (3.28)
Number of shares used in computation:				
Basic and Diluted	325	321	324	319

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).

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ELECTRONIC ARTS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In millions)	Nine Months Ended December 31, 2009	Nine Months Ended December 31, 2008
OPERATING ACTIVITIES		
Net loss	$ (707)	$ (1,046)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	145	147
Depreciation, amortization and accretion, net	142	152
Other non-cash restructuring charges	27	18
Net losses on investments and sale of property and equipment	20	67
Goodwill impairment		368
Acquired in-process technology		3
Change in assets and liabilities:		
Receivables, net	(356)	(476)
Inventories	77	(128)
Other assets	(53)	30
Accounts payable	36	102
Accrued and other liabilities	(42)	177
Deferred income taxes, net	(24)	258
Deferred net revenue (packaged goods and digital content)	634	125
Net cash used in operating activities	(101)	(203)
INVESTING ACTIVITIES		
Purchase of headquarters facilities	(233)	
Capital expenditures	(50)	(90)
Proceeds from sale of marketable equity securities	10	
Proceeds from maturities and sales of short-term investments	657	610
Purchase of short-term investments	(477)	(459)
Acquisition-related restricted cash	(100)	
Acquisition of subsidiaries, net of cash acquired	(278)	(58)
Net cash provided by (used in) investing activities	(471)	3
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	25	75
Excess tax benefit from stock-based compensation	13	2
Net cash provided by financing activities	38	77
Effect of foreign exchange on cash and cash equivalents	27	(51)
Decrease in cash and cash equivalents	(507)	(174)
Beginning cash and cash equivalents	1,621	1,553
Ending cash and cash equivalents	$ 1,114	$ 1,379
Supplemental cash flow information:		
Net cash paid during the period for income taxes	$ 8	$ 16

Non-cash investing activities:				
Change in unrealized losses on investments, net	$	(34)	$	(427)
Assumption of stock options in connection with acquisition	$	11	$	

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).

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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 video game software and content that can be played by consumers on a variety of platforms, including video game consoles (such as the PLAYSTATION® 3, Microsoft Xbox 360 and Nintendo Wii), personal computers, handheld game players (such as the PlayStation® Portable (PSP) and the Nintendo DS) and wireless devices (such as cellular phones and smart phones including the Apple iPhone). 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 , Need for Speed , Dead Space and Pogo). Our goal is to publish titles with global 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® 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.*, Harry Potter).

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 ending or ended, as the case may be, March 31, 2010 and 2009 contain 53 and 52 weeks, respectively, and ends or ended, as the case may be, on April 3, 2010 and March 28, 2009, respectively. Our results of operations for the three months ended December 31, 2009 and 2008 contain 13 weeks and ended on January 2, 2010 and December 27, 2008, respectively. Our results of operations for the nine months ended December 31, 2009 and 2008 contain 40 and 39 weeks, respectively, and ended on January 2, 2010 and December 27, 2008, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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 reclassifications have been made to the fiscal year 2009 Condensed Consolidated Financial Statements to conform to the fiscal year 2010 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, 2009, as filed with the United States Securities and Exchange Commission (SEC) on May 22, 2009.

(2) FAIR VALUE MEASUREMENTS

On April 1, 2009, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures,* as it applies to nonfinancial assets and nonfinancial liabilities. These nonfinancial items include assets and liabilities such as a reporting unit measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. We measure certain financial and nonfinancial assets and liabilities at fair value on a recurring and nonrecurring basis.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Our money market funds, available-for-sale fixed income and marketable equity securities, deferred compensation plan assets, foreign currency derivatives and contingent consideration are measured and recorded at fair value on a recurring basis.

Our Level 1 assets are valued using quoted prices in active markets for identical instruments. Our Level 2 assets, including foreign currency derivatives, are valued using quoted prices for identical instruments in less active markets or using other observable market inputs for comparable instruments. Our Level 3 liabilities are valued using unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the contingent consideration. As of March 31, 2009, we did not have any Level 3 financial instruments that

were measured and recorded at fair value on a recurring basis.

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As of December 31, 2009 and March 31, 2009, our assets and liabilities that are measured and recorded at fair value on a recurring basis were as follows (in millions):

		Fair Value Measurements at Reporting Date Using			
	As of December 31, 2009	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Assets					
Money market funds	$ 611	$ 611	$	$	Cash equivalents
Available-for-sale securities:					
Marketable equity securities	318	318			Marketable equity securities
Corporate bonds	194		194		Short-term investments and cash equivalents
U.S. agency securities	87		87		Short-term investments and cash equivalents
U.S. Treasury securities	71	71			Short-term investments
Commercial paper	3		3		Short-term investments and cash equivalents
Asset-backed securities	1		1		Short-term investments
Deferred compensation plan assets [(a)]	12	12			Other assets
Foreign currency derivatives	2		2		Other current assets
Total assets at fair value	$ 1,299	$ 1,012	$ 287	$	
Liabilities					
Contingent consideration [(b)]	$ 64	$	$	$ 64	Other liabilities
Total liabilities at fair value	$ 64	$	$	$ 64	

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
	Contingent Consideration
Beginning Balance	$
Additions	64
Ending Balance	$ 64

	As of March 31, 2009	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
Assets					
Money market funds	$ 1,069	$ 1,069	$	$	Cash equivalents
Available-for-sale securities:					
Marketable equity securities	365	365			Marketable equity securities
U.S. Treasury securities	212	212			Short-term investments and cash equivalents
Corporate bonds	133		133		Short-term investments and cash equivalents
U.S. agency securities	118		118		Short-term investments and cash equivalents
Commercial paper	118		118		

							Short-term investments and cash equivalents
Asset-backed securites		15				15	Short-term investments
Deferred compensation plan assets [a]		9		9			Other assets
Foreign currency derivatives		2				2	Other current assets
Total assets at fair value	$	2,041	$	1,655	$	386	$

[a] The deferred compensation plan assets consist of various mutual funds.

[b] The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisition of Playfish Limited (Playfish) that is contingent upon the achievement of certain performance milestones. We estimated the fair value using expected future cash flows over the period in which the obligation is expected to be settled, and applied a discount rate that appropriately captures a market participant s view of the risk associated with the obligation.

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

During the three and nine months ended December 31, 2009, certain of our nonfinancial assets were measured and recorded at fair value on a nonrecurring basis. During the three and nine months ended December 31, 2009 and the three months ended December 31, 2008, none of our financial assets were measured and recorded at fair value on a nonrecurring basis. During the nine months ended December 31, 2008, certain of our financial assets were measured and recorded at fair value on a nonrecurring basis. The impairment recorded during these periods on a nonrecurring basis was as follows (in millions):

	Net Carrying Value as of December 31, 2009	Fair Value Measurements Using			Total Impairments for the Three Months Ended December 31, 2009	Total Impairments for the Nine Months Ended December 31, 2009
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Assets						
Property and equipment, net [a]	$ 21	$	$ 19	$ 4	$ 2	$ 5
Acquisition-related intangibles					7	7
Abandoned rights to intellectual property					9	10
Total impairments for assets held as of December 31, 2009					$ 18	$ 22
Impairment on acquisition-related intangibles no longer held					$ 1	$ 1
Impairment on property and equipment no longer held					1	1
Total impairments recorded for non-recurring measurements					$ 20	$ 24

	Net Carrying Value as of December 31, 2008	(Level 1)	(Level 2)	(Level 3)	Total Impairments for the Three Months Ended December 31, 2008	Total Impairments for the Nine Months Ended December 31, 2008
Assets						
Other investments	$ 8	$	$ 8	$	$	$ 10
Total impairments for assets held as of December 31, 2008					$	$ 10

[a] Our carrying value as of December 31, 2009, did not equal our fair value measurements at the time of the impairments due to the subsequent recognition of depreciation expense.

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In connection with our fiscal 2010 restructuring, certain of our property and equipment, acquisition-related intangibles, and abandoned rights to intellectual property were impaired during the nine months ended December 31, 2009 due to events and circumstances that indicated that the carrying value of the assets was not recoverable. These impairments are included in restructuring charges in our Condensed Consolidated Statements of Operations.

Other investments included in the table above were measured and recorded on a nonrecurring basis using other observable market inputs for comparable instruments. During the nine months ended December 31, 2008, we measured certain of our other investments at fair value due to various factors, including but not limited to, the extent and duration during which the fair value had been below cost. See Note 3 for information regarding other investments.

(3) FINANCIAL INSTRUMENTS

On April 1, 2009, we adopted FASB ASC 825, *Financial Instruments*, which requires disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies. See Note 2 for information on the methods and assumptions used to estimate the fair value of our financial instruments.

Cash, Cash Equivalents and Short-Term Investments

Cash, cash equivalents and short-term investments consisted of the following as of December 31, 2009 and March 31, 2009 (in millions):

	As of December 31, 2009				As of March 31, 2009			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:								
Cash	$ 499	$	$	$ 499	$ 490	$	$	$ 490
Money market funds	611			611	1,069			1,069
Commercial paper	2			2	39			39
U.S. agency securities	1			1	9			9
Corporate bonds	1			1	2			2
U.S. Treasury securities					12			12
Cash and cash equivalents	1,114			1,114	1,621			1,621
Short-term investments:								
Corporate bonds	191	2		193	130	1		131
U.S. agency securities	86			86	108	1		109
U.S. Treasury securities	71			71	198	2		200
Commercial paper	1			1	79			79
Asset-backed securities	1			1	15			15
Short-term investments	350	2		352	530	4		534
Cash, cash equivalents and short-term investments	$ 1,464	$ 2	$	$ 1,466	$ 2,151	$ 4	$	$ 2,155

As of December 31, 2009 and March 31, 2009, we had less than $1 million in each period in gross unrealized losses primarily attributable to our corporate bonds and U.S. Treasury securities. As of December 31, 2009 and March 31, 2009, these gross unrealized losses were primarily in loss positions for less than 12 months.

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent and ability to hold the investments for a period of time sufficient to allow for any anticipated recovery in market value, as well as any contractual terms impacting the prepayment or

settlement process. Based on our review, we did not consider the investments listed above to be other-than-temporarily impaired as of December 31, 2009 and March 31, 2009.

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The following table summarizes the gross realized gains and losses from the sale of short-term investments for the three and nine months ended December 31, 2009 and 2008 (in millions):

	December 31, 2009		December 31, 2008	
	Three months ended	Nine months ended	Three months ended	Nine months ended
Short-term investments				
Gross realized gains	$ 2	$ 4	$ 1	$ 3
Gross realized losses				(2)
Net realized gains [(a)]	$ 2	$ 4	$ 1	$ 1

(a) Realized gains and losses are calculated based on the specific identification method.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of December 31, 2009 and March 31, 2009 (in millions):

	As of December 31, 2009		As of March 31, 2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments excluding asset-backed securities				
Due in 1 year or less	$ 113	$ 113	$ 245	$ 245
Due in 1-2 years	144	146	156	159
Due in 2-3 years	92	92	114	115
Asset-backed securities				
Weighted average maturity less than 1 year	1	1	15	15
Short-term investments	$ 350	$ 352	$ 530	$ 534

Asset-backed securities are separately disclosed as they are not due at a single maturity date.

Foreign Currency Option Contracts

As of December 31, 2009, our foreign currency option contracts had a cost of $1 million, gross unrealized gains of $1 million, and a fair value of $2 million. As of March 31, 2009, our foreign currency option contracts had a cost of $3 million, gross unrealized losses of $1 million and a fair value of $2 million. See Note 4 for information regarding our derivative financial instruments.

Marketable Equity Securities

Our investments in marketable equity securities consist of investments in common stock of publicly traded companies and are accounted for as available-for-sale securities and are recorded at fair value. Unrealized gains and losses are recorded as a component of accumulated other comprehensive income in stockholders equity, net of tax, until either the security is sold or we determine that the decline in fair value of a security to a level below its cost basis is other-than-temporary. We evaluate our investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

Marketable equity securities consisted of the following as of December 31, 2009 and March 31, 2009 (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2009	$ 139	$ 179	$	$ 318
As of March 31, 2009	$ 175	$ 190	$	$ 365

During the three and nine months ended December 31, 2009, we recognized impairment charges of $1 million and $25 million, respectively, on our investment in The9. During the three and nine months ended December 31, 2008, we recognized impairment charges of $27 million on our investment in The9 and $57 million on our investments in Neowiz and The9, respectively. Due to various factors, including but not limited to the extent and duration during which the market prices had been below cost and our intent to hold certain securities, we concluded the decline in values were other-than-temporary. The impairments for the three and nine months ended December 31, 2009 and 2008 are included in losses on strategic investments on our Condensed Consolidated Statements of Operations.

During the three and nine months ended December 31, 2009, we received proceeds of $6 million and $10 million, respectively, and realized gains and losses of less than $1 million each, from selling a portion of our investment in The9. We did not sell any of our marketable equity securities during the three and nine months ended December 31, 2008.

Other Investments Included in Other Assets

Our other investments consist principally of non-voting preferred shares in two companies whose common stock is publicly traded and are accounted for under the cost method. Under this method these investments are recorded at cost on our Condensed Consolidated Balance Sheets until we determine that the fair values of the investments other-than-temporarily fall below their cost basis. We evaluate our investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

During the three and nine months ended December 31, 2009 and the three months ended December 31, 2008, we did not recognize any impairment charges with respect to these investments. During the nine months ended December 31, 2008, we recognized an impairment charge of $10 million on these investments. Due to various factors, including but not limited to, the extent and duration during which the fair value had been below cost, we concluded the decline in values were other-than-temporary. The $10 million impairment for the nine months ended December 31, 2008 is included in losses on strategic investments on our Condensed Consolidated Statements of Operations.

(4) DERIVATIVE FINANCIAL INSTRUMENTS

The assets or liabilities associated with our derivative instruments and hedging activities are recorded at fair value in other current assets or accrued and other current liabilities, respectively, in our Condensed Consolidated Balance Sheets. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on the use of the derivative and whether it is designated and qualifies for hedge accounting.

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency option contracts, generally with maturities of 15 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of approximately three months or less and are transacted near month-end. At each quarter-end, the fair value of the foreign currency forward contracts generally is not significant. We do not use foreign currency option or foreign currency forward contracts for speculative or trading purposes.

Cash Flow Hedging Activities

Our foreign currency option contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression, as well as other timing and probability criteria. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. 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. The gross amount of the effective portion of gains or losses resulting from changes in fair value of these hedges is subsequently reclassified into net revenue or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. 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 (expense), net, in our Condensed Consolidated Statements of Operations. The effective portion of hedges recognized in accumulated other comprehensive income will be reclassified to our Condensed Consolidated Statements of Operations within 12 months. As of December 31, 2009, we had foreign currency option contracts to purchase approximately $21 million in foreign currency and to sell approximately $37 million of foreign currencies. As of December 31, 2009, these foreign currency option contracts outstanding had a total fair value of $2 million and are included in other current assets. As of March 31, 2009, we had foreign currency option contracts to purchase approximately $19 million in foreign currency and to sell approximately $65 million of foreign currencies. As of March 31, 2009, these foreign currency option contracts outstanding had a total fair value of $2 million and are included in other current assets.

The effect of foreign currency option contracts on our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2009 was immaterial.

Balance Sheet Hedging Activities

Our foreign currency forward contracts are not designated as hedging instruments. Accordingly, any gains or losses resulting from changes in the fair value of the foreign currency forward contracts are reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses associated with the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. As of December 31, 2009, we had foreign currency forward contracts to purchase and sell approximately $529 million in foreign currencies. Of this amount, $390 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $131 million to purchase foreign currency in exchange for U.S. dollars and $8 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2009, we had foreign currency forward contracts to purchase and sell approximately $63 million in foreign currencies. Of this amount, $53 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $7 million to purchase foreign currencies in exchange for U.S. dollars and $3 million to sell foreign currencies in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of December 31, 2009 and March 31, 2009.

The effect of foreign currency forward contracts on our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2009, was as follows (in millions):

	Three Months Ended December 31, 2009		Nine Months Ended December 31, 2009	
	Location of Gain Recognized in Income on Derivative	**Amount of Gain Recognized in Income on Derivative**	**Location of Loss Recognized in Income on Derivative**	**Amount of Loss Recognized in Income on Derivative**
Foreign currency forward contracts not designated as hedging instruments	Interest and other income (expense), net	$ 5	Interest and other income (expense), net	$ (7)

(5) BUSINESS COMBINATIONS

On April 1, 2009, we adopted FASB ASC 805, *Business Combinations*, which requires the recognition of assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree at the acquisition date based on their fair value with limited exceptions. FASB ASC 805 changes the accounting treatment for certain specific items and includes a substantial number of new disclosure requirements.

Playfish

On November 9, 2009, we acquired all of the outstanding shares of Playfish for an aggregate purchase price of approximately $308 million in cash and equity. Playfish is a developer of free-to-play social games that can be played on social networking platforms. This acquisition accelerates our participation in social gaming and contributes to our digital business. The following table summarizes the acquisition date fair value of the consideration transferred which consisted of the following (in millions):

Cash	$ 297
Equity	11
Total purchase price	$ 308

The equity included in the consideration above consisted of restricted stock and restricted stock units, whose fair value was determined based on the quoted market price of our common stock on the date of grant.

In addition, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2011. The additional consideration is limited to a maximum of $100 million based on tiered revenue targets over a two-year period. The fair value of the contingent consideration arrangement at the acquisition date was $64 million. We estimated the fair value of the contingent consideration using expected future cash flows over the period in which the obligation is expected to be settled, and applied a discount rate that appropriately captures a market participant s view of the risk associated with the obligation. This fair value is based on significant inputs not observable in the market. As of December 31, 2009, there were no significant changes in the range of outcomes for the contingent consideration.

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The preliminary allocation of the purchase price was based upon preliminary valuations for certain assets and will be completed during the fourth quarter of fiscal year 2010. The preliminary allocation of the purchase price may have material adjustments once the valuations have been completed. The following table summarizes the preliminary fair values of assets acquired and liabilities assumed as of December 31, 2009 (in millions):

Current assets	$ 32
Deferred income taxes, net	22
Property and equipment, net	1
Goodwill	280
Finite-lived intangibles assets	45
Contingent consideration	(64)
Other liabilities	(8)
Total purchase price	$ 308

All of the goodwill was assigned to one of our immaterial operating segments. None of the goodwill recognized upon acquisition is deductible for tax purposes. See Note 6 for additional information related to the changes in the carrying amount of goodwill and Note 15 for segment information.

The results of operations of Playfish and the estimated fair market values of the assets acquired and liabilities assumed have been included in our Condensed Consolidated Financial Statements since the date of acquisition.

Other acquisition-related intangibles acquired in this transaction are finite-lived and are being amortized on a straight-line basis over their estimated lives ranging from two to five years. The intangible assets as of the date of the acquisition include:

	Gross Carrying Amount (in millions)	Weighted-Average Useful Life (in years)
Registered User Base	$ 29	2
Developed and Core Technology	10	5
Trade Names and Trademarks	4	5
Other Intangibles	2	4
Total Finite-Lived Intangibles	$ 45	3

Other Acquisitions

During the nine months ended December 31, 2009, we completed two additional acquisitions that did not have a significant impact on our Condensed Consolidated Financial Statements.

(6) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET

The changes in the carrying amount of goodwill are as follows (in millions):

	As of March 31, 2009	Goodwill Acquired	Effects of Foreign Currency Translation	As of December 31, 2009

Label Segment	$ 667	$	$ 6	$ 673
Other Segments	140	282	2	424
Total	$ 807	$ 282	$ 8	$ 1,097

Purchased goodwill is not amortized but rather subject to at least an annual assessment for impairment by applying a fair value-based test.

We are required to perform a two-step approach to testing goodwill for impairment for each reporting unit annually, or whenever events or changes in circumstances indicate the fair value of a reporting unit is below its carrying amount. Our reporting units are determined by the components of our operating segments that constitute a business for which (1) discrete financial information is available and (2) segment management regularly reviews the operating results of that component. The first step measures 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. The fair values of the reporting units are estimated using a combination of the market approach, which utilizes comparable companies data, and/or the income approach, which utilizes discounted cash flows.

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Adverse economic conditions, including the decline in our market capitalization and our expected financial performance, indicated that a potential impairment of goodwill existed during the three months ended December 31, 2008. As a result, we performed goodwill impairment tests for our reporting units and determined that the fair value of our EA Mobile reporting unit fell below the carrying value of that reporting unit. As a result, we conducted the second step in the impairment testing and determined that the EA Mobile reporting unit s goodwill was impaired. The fair value of the EA Mobile reporting unit was determined using the income approach. Substantially all of our goodwill associated with our EA Mobile reporting unit was derived from our acquisition of JAMDAT Mobile Inc. in February 2006. During the three months ended December 31, 2008, we recognized a goodwill impairment charge of $368 million related to our EA Mobile reporting unit. During the three and nine months ended December 31, 2009, there were no indicators of impairment of our goodwill. See Note 15 for information regarding our segment information.

During the three months ended December 31, 2009, we estimated on a preliminary basis, the measurement of goodwill acquired in our acquisition of Playfish. The valuation will be completed in the fourth quarter of fiscal year 2010 and once completed there may be material adjustments to our goodwill amounts.

Acquisition-related intangibles, net, consist of the following (in millions):

	As of December 31, 2009			As of March 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and Core Technology	$ 253	$ (148)	$ 105	$ 249	$ (128)	$ 121
Trade Names and Trademarks	88	(53)	35	86	(43)	43
Carrier Contracts and Related	85	(54)	31	85	(51)	34
Registered User Base and Other Intangibles	77	(33)	44	51	(28)	23
Total	$ 503	$ (288)	$ 215	$ 471	$ (250)	$ 221

Amortization of intangibles for the three and nine months ended December 31, 2009 was $16 million (of which $2 million was recognized as cost of goods sold) and $46 million (of which $8 million was recognized as cost of goods sold), respectively. Amortization of intangibles for the three and nine months ended December 31, 2008 was $19 million (of which $4 million was recognized as cost of goods sold) and $57 million (of which $11 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 term of the related agreement, typically from two to fourteen years. During the three months ended December 31, 2009 we recognized impairment charges of $8 million on certain acquisition-related intangibles in connection with our fiscal 2010 restructuring plan. There were no impairment charges during the three and nine months ended December 31, 2008. As of December 31, 2009 and March 31, 2009, the weighted-average remaining useful life for finite-lived intangible assets was approximately 5.2 years and 6.0 years, respectively.

As of December 31, 2009, 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,	
2010 (remaining three months)	$ 17
2011	66
2012	46
2013	25
2014	17
Thereafter	44
Total	$ 215

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(7) RESTRUCTURING CHARGES

Restructuring information as of December 31, 2009 was as follows (in millions):

	Fiscal 2010 Restructuring			Fiscal 2009 Restructuring			Fiscal 2008 Reorganization			Other Restructurings			
	Workforce	Facilities-related	Other	Workforce	Facilities-related	Other	Workforce	Facilities-related	Other	Workforce	Facilities-related	Other	Total
Balances as of March 31, 2008	$	$	$	$	$	$	$ 1	$	$ 4	$	$ 9	$	$ 14
Charges to operations				32	7	2		22	12	4	1		80
Charges settled in cash				(24)	(1)		(1)		(13)	(4)	(3)		(46)
Charges settled in non-cash					(1)	(2)		(22)					(25)
Balances as of March 31, 2009				8	5				3		7		23
Charges to operations	63	6	27	1	13			3	7				120
Charges settled in cash	(15)			(9)	(8)				(10)				(42)
Charges settled in non-cash	(25)	(1)	(20)		(4)			(3)					(53)
Accrual reclassification											(7)		(7)
Balances as of December 31, 2009	$ 23	$ 5	$ 7	$	$ 6	$	$	$	$	$	$	$	$ 41

Fiscal 2010 Restructuring

In the quarter ended December 31, 2009, we announced details of a restructuring plan to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under this plan, we anticipate (1) reducing our workforce by approximately 1,350 employees, (2) consolidating or closing various facilities, (3) eliminating certain titles, and (4) incurring IT and other costs to assist in reorganizing certain activities. We expect the majority of these actions to be completed by March 31, 2010.

Since the inception of the fiscal 2010 restructuring plan through December 31, 2009, we have incurred charges of $96 million, of which (1) $63 million were for employee-related expenses, (2) $27 million related to abandoned rights to intellectual property and intangible asset impairment costs, as well as other costs to assist in the reorganization of our business support functions, and (3) $6 million related to the closure of certain of our facilities. The majority of the $35 million restructuring accrual as of December 31, 2009 related to our fiscal 2010 restructuring is expected to be settled by March 2010. This accrual is included in other accrued expenses presented in Note 9 of the Notes to Condensed Consolidated Financial Statements.

During the remainder of fiscal year 2010, we anticipate incurring between $35 million and $40 million of restructuring charges related to the fiscal 2010 restructuring. Overall, including charges incurred through December 31, 2009, we expect to incur total cash and non-cash charges between $150 million and $155 million by March 31, 2012. These charges will consist primarily of (1) employee-related costs (approximately $70 million), (2) intangible asset impairment, abandoned rights to intellectual property costs, and other costs to assist in the reorganization of our business support functions (approximately $35 million), (3) facilities exit costs (approximately $30 million), and (4) other reorganizational costs including IT and consulting costs (approximately $20 million).

Fiscal 2009 Restructuring

In fiscal year 2009, we announced details of a cost reduction plan as a result of our performance combined with the economic environment. This plan included a narrowing of our product portfolio, a reduction in our worldwide workforce of approximately 11 percent, or 1,100 employees, the closure of 10 facilities, and reductions in other variable costs and capital expenditures.

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Since the inception of the fiscal 2009 restructuring plan through December 31, 2009, we have incurred charges of $55 million, of which (1) $33 million were for employee-related expenses, (2) $20 million related to the closure of certain of our facilities, and (3) $2 million related to asset impairments. After December 31, 2009, we anticipate incurring less than $1 million of additional restructuring charges under this plan. The restructuring accrual of $6 million as of December 31, 2009 related to our fiscal 2009 restructuring is expected to be settled by September 2016. This accrual is included in other accrued expenses presented in Note 9 of the Notes to Condensed Consolidated Financial Statements.

Fiscal 2008 Reorganization

In June 2007, we announced a plan to reorganize our business into several new divisions including, at the time four new Labels : EA SPORTS , EA Games, EA Casual Entertainment and The Sims in order to streamline decision-making, improve global focus, and speed new ideas to market. In October 2007, our Board of Directors approved a plan of reorganization (fiscal 2008 reorganization plan) in connection with the reorganization of our business into four new Labels. During fiscal year 2009, we consolidated and reorganized two of our Labels. As a result, we have three Labels, EA SPORTS, EA Games and EA Play, as well as a new organization, EA Interactive, which reports into our Publishing business. Each Label, as well as EA Interactive, operates with dedicated studio and product marketing teams focused on consumer-driven priorities.

Since the inception of the fiscal 2008 reorganization plan through December 31, 2009, we have incurred charges of $141 million, of which (1) $12 million were for employee-related expenses, (2) $83 million related to the closure of our Chertsey, England and Chicago, Illinois facilities, which included asset impairment and lease termination costs, and (3) $46 million related to other costs including other contract terminations, as well as IT and consulting costs to assist in the reorganization of our business support functions. We do not expect to incur any additional charges under this plan.

Other Restructurings

We also engaged in various other restructurings based on management decisions. From April 1, 2008 through June 30, 2009, $7 million in cash had been paid out under these restructuring plans. The $7 million restructuring accrual as of March 31, 2009 was reclassified during the three months ended June 30, 2009, from accrued and other current liabilities to other liabilities on our Condensed Consolidated Balance Sheet.

(8) 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 products.

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 expensed 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. Royalty liabilities are classified as current liabilities to the extent such royalty obligations are contractually due within the next twelve months. As of December 31, 2009 and March 31, 2009, approximately $14 million and $37 million, respectively, of minimum guaranteed royalty obligations had been recognized and are included in the royalty-related assets and liabilities tables below.

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Each quarter, we also evaluate the expected 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. We evaluate long-lived royalty-based assets for impairment based on an undiscounted cash flow basis when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts and, therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (*i.e.*, cease use) or the contractual rights to use the intellectual property are terminated. During the three and nine months ended December 31, 2009, we recognized impairment charges of $9 million and $10 million, respectively. We recognized the $9 million impairment charge during the three months ended December 31, 2009, in connection with our fiscal 2010 restructuring. This impairment is included in restructuring charges presented in Note 7 of the Notes to Condensed Consolidated Financial Statements. We had no impairment or loss charges during the three months ended December 31, 2008. During the nine months ended December 31, 2008, we recognized an impairment charge of $5 million.

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 December 31, 2009	As of March 31, 2009
Other current assets	$ 64	$ 74
Other assets	41	47
Royalty-related assets	$ 105	$ 121

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 accrued liabilities. The current and long-term portions of accrued royalties, included in accrued and other current liabilities and other liabilities, consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Accrued and other current liabilities	$ 213	$ 237
Other liabilities	3	29
Royalty-related liabilities	$ 216	$ 266

In addition, as of December 31, 2009, we were committed to pay approximately $1,305 million to content licensors, independent software developers 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.

(9) BALANCE SHEET DETAILS

Inventories

Inventories as of December 31, 2009 and March 31, 2009 consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Raw materials and work in process	$ 7	$ 7

In-transit inventory		1		9
Finished goods		136		201
Inventories	$	144	$	217

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Property and Equipment, Net

Property and equipment, net, as of December 31, 2009 and March 31, 2009 consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Computer equipment and software	$ 720	$ 663
Buildings	342	143
Leasehold improvements	103	125
Office equipment, furniture and fixtures	73	63
Land	64	11
Warehouse equipment and other	14	14
Construction in progress	10	16
	1,326	1,035
Less accumulated depreciation	(776)	(681)
Property and equipment, net	$ 550	$ 354

Depreciation expense associated with property and equipment amounted to $30 million and $93 million for the three and nine months ended December 31, 2009, respectively. Depreciation expense associated with property and equipment amounted to $28 million and $89 million for the three and nine months ended December 31, 2008, respectively.

On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease obligation. This $14 million loss is included in general and administrative expense on our Condensed Consolidated Statements of Operations. Subsequent to our purchase, we classified the facilities on our Condensed Consolidated Balance Sheet as property and equipment, net and recognized depreciation expense for the property acquired on a straight-line basis over the estimated useful lives, excluding the land acquired.

Acquisition-Related Restricted Cash Included in Other Assets

In connection with our acquisition of Playfish on November 9, 2009, we deposited $100 million into an escrow account to be used to pay the former shareholders of Playfish in the event certain performance milestones through December 31, 2011 are achieved. During the three months ended December 31, 2009, no distributions were made from the restricted cash amount. As this deposit is restricted in nature, it has been included in other assets on our Condensed Consolidated Balance Sheet as of December 31, 2009. See Note 5 regarding our acquisition of Playfish.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of December 31, 2009 and March 31, 2009 consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Other accrued expenses	$ 333	$ 237
Accrued royalties	213	237
Accrued compensation and benefits	145	142
Deferred net revenue (other)	99	107
Accrued and other current liabilities	$ 790	$ 723

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 $895 million as of December 31, 2009 and $261 million as of March 31, 2009. Deferred net revenue (packaged goods and digital content) includes the deferral of (1) the total net revenue from bundle sales of certain online-enabled packaged goods and digital content for which either we do not have vendor-specific objective evidence of fair value (VSOE) for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) revenue from certain packaged goods sales of massively-multiplayer online role-playing games, and (3) revenue from the sale of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. We recognize revenue from sales of online-enabled packaged goods and digital content for which (1) we do not have VSOE for the online service that we provided in connection with the sale and (2) we have an obligation to deliver incremental unspecified digital content in the future without an additional fee on a straight-line basis over an estimated six month period beginning in the month after shipment. However, 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).

(10) INCOME TAXES

We estimate our annual effective tax rate at the end of each quarterly period, and we record the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur, including changes in judgment about deferred tax valuation allowances. In addition, jurisdictions with a projected loss for the year or a year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter depending on the mix and timing of actual earnings versus annual projections.

We recognize deferred tax assets and liabilities for both the expected impact of differences between the financial statement amount and the tax basis of assets and liabilities and for the expected future tax benefit to be derived from tax losses and tax credit carry forwards. We record a valuation allowance against deferred tax assets when it is considered more likely than not that all or a portion of our deferred tax assets will not be realized. In making this determination, we are required to give significant weight to evidence that can be objectively verified. It is generally difficult to conclude that a valuation allowance is not needed when there is significant negative evidence, such as cumulative losses in recent years. Forecasts of future taxable income are considered to be less objective than past results, particularly in light of the economic environment. Therefore, cumulative losses weigh heavily in the overall assessment. Based on the assumptions and requirements noted above, we have recorded a valuation allowance against most of our U.S. deferred tax assets. In addition, we expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized.

The Worker, Homeownership and Business Assistance Act of 2009 (the Act) was signed into law on November 6, 2009. The Act provides that taxpayers may elect to increase the carry back period for tax losses incurred in a taxable year beginning or ending in either 2008 or 2009. During the three months ended December 31, 2009, we elected to increase the carry back period for tax losses incurred in fiscal year 2009. This election resulted in a reduction in the valuation allowance on our U.S. deferred tax assets due to an increase in the sources of taxable income from the extended carry back period. As a result, we recorded a tax benefit of approximately $28 million in the three months ended December 31, 2009 for the reduction in the valuation allowance.

In determining the valuation allowance we recorded at June 30, 2009, we did not include as a source of future taxable income the taxable temporary difference related to the accumulated tax depreciation on our headquarters facilities in Redwood City, California. On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to leases which expired in July 2009, and had been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease obligation. Therefore, in the fiscal quarter ended September 30, 2009, we recorded a tax benefit of approximately $31 million, consisting of approximately $6 million related to the loss on our lease obligation and a $25 million reduction in our valuation allowance due to the inclusion of a significant portion of the remaining taxable temporary difference as a source of future taxable income.

On May 27, 2009, the Ninth Circuit Court of Appeals (the Court) overturned a 2005 Tax Court decision (2009 Decision) in *Xilinx Inc. v. Commissioner* (Xilinx). The Court s 2009 Decision changed the tax treatment of share-based compensation expenses for the purpose of determining intangible development costs under an entity s research and development cost sharing arrangement. The Court held that related parties to such an arrangement must share stock option costs, notwithstanding the U.S. Tax Court s finding that unrelated parties in such an arrangement would not share such costs. The case is subject to further appeal. Nevertheless, as a result of this decision, we recorded additional reserves for unrecognized tax benefits of approximately $59 million during the nine months ended December 31, 2009. These reserves relate primarily to windfall tax benefits recognized for stock-based compensation, and were therefore recorded as reductions in paid-in capital.

A portion of the additional reserves for unrecognized tax benefits recorded as a result of the Xilinx decision were included as a source of taxable income in determining the valuation allowance we recorded at June 30, 2009. As a result, we recorded a tax benefit of approximately $11 million in the three months ended June 30, 2009 for the corresponding reduction in the valuation allowance.

The tax benefit reported for the three and nine months ended December 31, 2009 is based on our projected annual effective tax rate for fiscal year 2010, and also includes certain discrete tax charges recorded during the period. Our effective tax rates for the three and nine months ended December 31, 2009 were a tax benefit of 24.9 percent and 10.0 percent, respectively. The effective tax rates for the three and nine months ended December 31, 2008 are not meaningful due to the discrete tax charge of $244 million to establish the deferred tax valuation allowance. The effective tax rates for the three and nine months ended December 31, 2009 differ from the statutory rate of 35.0 percent primarily due to U.S. losses for which no benefit is recognized, non-U.S. losses with a reduced or zero tax benefit, partially offset by benefits related to the resolution of examinations by taxing authorities and reductions in the valuation allowance on U.S. deferred tax assets. The effective tax rates for the three and nine months ended December 31, 2009 differ from the same periods in fiscal year 2009 primarily due to the discrete tax charge to establish the valuation allowance in fiscal year 2009, tax charges incurred in fiscal year 2009 related to our integration of VG Holding Corp., and tax benefits related to the resolution of tax examinations.

During the three months ended September 30, 2009, we reached a final settlement with the Internal Revenue Service (IRS) for the fiscal years 1997 through 1999. As a result, we recorded a tax benefit of approximately $6 million due to a reduction in our accrual for interest and penalties.

During the three months ended June 30, 2009, we recorded approximately $21 million of previously unrecognized tax benefits and reduced our accrual for interest and penalties by approximately $12 million due to the expiration of statutes of limitation in the United Kingdom.

During the three and nine months ended December 31, 2009, we recorded an increase of $8 million and an increase of $18 million in gross unrecognized tax benefits, respectively. This includes a reduction in gross unrecognized tax benefits of approximately $48 million related to the settlements with the IRS for fiscal years 1997 through 1999 during the three months ended September 30, 2009. This settlement and agreement to pay will be partially offset by prior cash deposits of approximately $40 million. The total gross unrecognized tax benefits as of December 31, 2009 is $296 million, of which approximately $31 million would be offset by prior cash deposits to tax authorities for issues pending resolution. A portion of our unrecognized tax benefits will affect our effective tax rate if they are recognized upon favorable resolution of the uncertain tax positions. As of December 31, 2009, approximately $92 million of the unrecognized tax benefits would affect our effective tax rate, approximately $125 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance, and approximately $65 million would increase paid-in capital.

During the three and nine months ended December 31, 2009, we recorded no net increase in tax and a net increase of $1 million, respectively, for accrued interest and penalties related to tax positions taken on our tax returns, including a reduction related to the settlement with the IRS for fiscal years 1997 through 1999. As of December 31, 2009, the combined amount of accrued interest and penalties related to uncertain tax positions was approximately $57 million.

The IRS has completed its examination of our federal income tax returns through fiscal year 2005. As of December 31, 2009, the IRS had proposed, and we had 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. As of December 31, 2009, we had not agreed to certain other proposed adjustments for fiscal years 2000 through 2005, and those issues were pending resolution by the Appeals section of the IRS. Furthermore, the IRS has commenced an examination of our fiscal year 2006, 2007 and 2008 tax returns. We are also under income tax examination in Canada for fiscal years 2004 and 2005, in France for fiscal years 2006 through 2008, and in Germany for fiscal years 2004 through 2007. We remain subject to income tax examination in Canada for fiscal years after 2001, in France for fiscal years after 2005, in Germany for fiscal years after 2003, in the United Kingdom for fiscal years after 2007, and in Switzerland for fiscal years after 2007.

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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. Although potential resolution of uncertain tax positions involve multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to $20 million of unrecognized tax benefits may occur within the next 12 months, some of which, depending on the nature of the settlement or expiration of statutes of limitations, may affect our income tax provision (benefit) and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

(11) COMMITMENTS AND CONTINGENCIES

Lease Commitments

As of December 31, 2009, we leased certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities. See Note 9 regarding the purchase of our Redwood Shores headquarters facilities on July 13, 2009.

The following table summarizes our minimum contractual obligations as of December 31, 2009 (in millions):

Fiscal Year Ending March 31,	**Leases [a]**
2010 (remaining three months)	$ 13
2011	45
2012	34
2013	28
2014	20
Thereafter	38
Total	$ 178

[a] Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately $10 million due in the future under non-cancelable sub-leases.

The amounts represented in the table above reflect our minimum 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. Included in the amounts above are $2 million and $3 million in lease commitments for fiscal years 2010 and 2011, respectively, for leases expiring in less than one year as of December 31, 2009.

Legal Proceedings

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

(12) STOCK-BASED COMPENSATION

Valuation Assumptions

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 and restricted stock is determined based on the quoted market price of our common stock on the date of grant. The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan (ESPP), respectively, 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. The key assumptions for the Black-Scholes valuation calculation are:

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.

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

	Stock Option Grants				ESPP	
	Three Months Ended December 31,		Nine Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008	2009	2008
Risk-free interest rate	1.4 - 2.7%	1.0 - 1.8%	1.4 - 3.0%	1.0 - 3.8%	0.2 - 0.4%	1.9 - 2.1%
Expected volatility	41 - 45%	44 - 52%	41 - 48%	32 - 52%	45 - 57%	35%
Weighted-average volatility	43%	48%	45%	42%	51%	35%
Expected term	4.4 years	4.2 years	4.2 years	4.3 years	6-12 months	6-12 months
Expected dividends	None	None	None	None	None	None

There were no ESPP shares valued during the three months ended December 31, 2009 and 2008.

Stock-Based Compensation Expense

Employee stock-based compensation expense recognized during the three and nine months ended December 31, 2009 and 2008 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.

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Cost of goods sold	$	$	$ 1	$ 1
Marketing and sales	4	5	12	15
General and administrative	9	11	24	34
Research and development	29	28	82	97
Restructuring charges	26		26	
Stock-based compensation expense	68	44	145	147
Provision for income taxes		21		
Stock-based compensation expense, net of tax	$ 68	$ 65	$ 145	$ 147

As of December 31, 2009, our total unrecognized compensation cost related to stock options was $87 million and is expected to be recognized over a weighted-average service period of 2.5 years. As of December 31, 2009, our total unrecognized compensation cost related to restricted stock, restricted stock units and notes payable in shares of common stock (collectively referred to as restricted stock rights) was $352 million (inclusive of approximately $65 million of additional remaining compensation cost associated with the Employee Stock Option Exchange Program discussed below) and is expected to be recognized over a weighted-average service period of 2.0 years.

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Stock Options

The following table summarizes our stock option activity for the nine months ended December 31, 2009:

	Options (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2009	34,360	$ 42.04		
Granted	4,303	20.44		
Exchange Program (granted)				