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COPY

September 17, 1984

Mr. Algy Tamoshunas, Esquire
North American Philips Corporation
580 White Plains Road
Tarrytown, New York 10591

Re: Magnavox v. Activision

Dear Algy:

To confirm my telephone report to Tom last Thursday, I appeared before Judge Vukasin for a status hearing following the settlement conference before Magistrate Woelflen. The principal matter for resolution at the status conference was Activision's motion for continuance of the trial. The Judge stated that he was disinclined to grant continuances based on a change of counsel because this made it too easy for the parties to obtain delays by merely hiring new lawyers. However, he stated that Magnavox was not entirely without fault because of the delay in supplying Activision with responses to the interrogatories seeking the infringement contentions. Thus, he was inclined to grant a short delay of trial. He set this case for trial on his next open date, January 14, 1985, and allotted three weeks for trial. (However, his clerk noted that he had three other matters scheduled for January 14.) A pretrial conference was set for December 13. According to the Local Rules, pretrial statements must be filed by December 3, and pretrial briefs by January 7.

It was agreed during the hearing that there will be no patent law experts presented by either side, with the understanding that defendants will not raise any issue of

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September 12, 1984

CONFIDENTIAL: FOR SETTLEMENT PURPOSES ONLY

James T. Williams, Esq.
Neuman, Williams, Anderson & Olson
77 West Washington Street
Chicago, Illinois 60602

Re: Magnavox v. Activision

Dear Jim:

This letter and settlement offer are addressed to you but, of course, it may be shared with Messrs. Tamoshunas and Etlinger. As in any case the key conerns are:

(a) Chances of prevailing on the merits;

(b) Costs of litigation;

(c) Potential damages; and

(d) Ability to pay (or collect).

A. The Merits.

This letter will not recount our arguments as we feel both sides are well aware of the points which will be advanced if the case comes to trial. Suffice it to say we believe (1) the action of the Patent and Trademark Office on the 480 patent coupled with Speigel, the NASA Scene Generator, Space Wars and the numerous pre-Rusch examples of "bounce" games provides us with a very strong invalidity case; (2) contributory infringement cannot be found because the technology is not equivalent, the consoles used are all licensed, and use of cartridges is merely an adaptation of licensed systems, not a substitute or reconstruction; and (3) in any event, there is no "imparting of distinct motion" in Keystone Kapers, Fishing Derby, Decathlon, and Dolphin as you have defined that term.

We thus expect to prevail and have so advised our clients.

B. Costs of Litigation.

Both sides face non-recoverable costs and fees of preparation for litigation, litigation, and appeal as well as the delays in resolution of this matter which are endemic to this sort of case.

C. Exposure.

We have reviewed with some care the Coleco and Atari royalty agreements as well as the others entered into (all of which have a "most favored nations" clause).

Atari manufactured and sold domestically and in foreign markets far more product than Activision, was licensed for all relevant patents, and made both hardware and software as well as arcade games. They were granted a license for $1.5 million paid over 7 years.

Coleco's arrangement was:

0 - 100,000 units	5-1/2%	of net sales price
100,000 - 200,000 units	5%	of net sales price
200,000 - 250,000 units	4-1/2%	of net sales price
250,000 - 300,000 units	4%	of net sales price
300,000 - 350,000 units	3-1/2%	of net sales price
350,000+ units	3%	of net sales price

(Coleco was also subject to a minimum royalty of $1 per licensed product in its first year, 50 cents per licensed product the second year, and no minimum thereafter. Activision contends that these minimum royalty rates have no application to its products since Activision cartridges were sold at a fraction of the price charged by Coleco for its video game systems.)

Subsequent to the original Coleco deal, an amended arrangement was implemented which effectively eliminated the minimums and allowed Coleco to fix an annual ceiling on payments.

The following calculation shows the amount Activision would owe in "damages" under the Coleco arrangement, before applying maximums (for 9 games):

(1981)	100,000 units	$ 1,165,000 sales at 5-1/2%	=	$ 64,075
	31,957 units	372,299 sales at 5%	=	18,615
(1982)	68,043 units	835,908 sales at 5%	=	41,795
	50,000 units	614,250 sales at 4-1/2%	=	27,641
	50,000 units	614,250 sales at 4%	=	24,750
	50,000 units	614,250 sales at 3-1/2%	=	21,499
	1,296,219 units	20,446,473 sales at 3%	=	613,394
				811,589
1983 to present:		$29,464,940 sales at 3%	=	883,948
"De-list" sales to present:		$8,488,394 at 3%	=	254,652
		TOTAL		$1,950,189

When the Coleco maximums are applied the total is reduced by $804,807 to $1,145,382 and that number (1.145 million) would apply even if all 13 games were found to be infringing.

In addition to the above, it is Activision's position that a reasonable royalty as to it or any other softwafe-only manufacturer must take into account that it manufactures only a part of the system and that Magnavox has already received a royalty for the other part. By our calculations cartridges had between one-half and two-thirds of the total dollar market during the relevant period, so that a discount of 33-50% must be applied to whatever number is yielded to ascertain a proper royalty.

Ability to Pay.

Very early in this litigation Activision offered to settle this lawsuit for a payout of $1,000,000. (To avoid any possibility of future litigation on related patents, the offer embraced the Rusch, Baer, and all other patents listed in any of Magnavox' other royalty agreements which include the patent in suit.) At the time of that offer the following important conditions obtained: (1) The future was bright with consumer demand seemingly limitless; (2) In fiscal 1983 Activision had 288 employees and had before-tax income of $37.6 million; and (3) Magnavox' claims for damages had not been limited to 13 games, so potential exposure was difficult to ascertain.