

HIGHLY CONFIDENTIAL

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
OAKLAND DIVISION

EPIC GAMES, INC.,)
PLAINTIFF, COUNTER-DEFENDANT,) CASE NO.
VS.) 4:20-CV-05640-YGR
APPLE INC.,)
DEFENDANT, COUNTERCLAIMANT.)
IN RE APPLE IPHONE ANTITRUST) CASE NO.
LITIGATION) 4:11-CV-06714-YG

United States
Northern District
Case No. 4:20-cv
Case Title Epic Ga
Exhibit No. DX-3
Date Entered _____
Sus
By: _____

△ DEFENDANT △	United States District Court Northern District of California
	Case No. <u>4:20-cv-05640-YGR</u>
	Case Title <u>Epic Games, Inc. v. Apple, Inc.</u>
	Exhibit No. <u>DX-3039</u>
	Date Entered _____
	Susan Y. Soong, Clerk
	By: _____, Deputy Clerk

--- CAPTION CONTINUED ON FOLLOWING PAGE ---

*** HIGHLY CONFIDENTIAL UNDER PROTECTIVE ORDER ***

REMOTE PROCEEDINGS OF THE
VIDEOTAPED DEPOSITION OF JOE BABCOCK
FRIDAY, FEBRUARY 12, 2021

JOB NO. 4453692
REPORTED BY KIMBERLY EDELEN,
CSR. NO. 9042, CRR, RPR.
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5 THE REPORTER: Mr. Babcock, could you raise 09:12:06
6 your right hand, please. 09:12:08
7 You do solemnly swear that the testimony 09:12:09
8 you're about to give shall be the truth, the whole 09:12:09
9 truth and nothing but the truth? 09:12:09
10 THE WITNESS: Yes. 09:12:15

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EXAMINATION

14

15 Q Good morning, Mr. Babcock. Can you please 09:12:22
16 state and spell your name for the record. 09:12:24
17 A Sure. It's Joe Babcock, J-o-e, 09:12:26
18 B-a-b-c-o-c-k. 09:12:28

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8 Q You worked at Epic until March 2020? 09:20:56

9 A That's correct. 09:20:59

10 Q What was your position? 09:21:00

11 A Chief financial officer. 09:21:03

12 Q How long had you held that position? 09:21:06

13 A Boy, probably ten years in that role. 09:21:11

14 There was a point where I came on as the title of 09:21:19

15 controller. There wasn't a CFO at the time, and 09:21:22

16 then I was promoted into that role roughly ten years 09:21:25

17 ago. 09:21:29

18 Q And when did you join as controller? 09:21:29

19 A 2006. 09:21:31

20 Q So from approximately 2006 until 09:21:34

21 approximately 2010, you served as controller? 09:21:38

22 A That's about right, yes. 09:21:41

23 Q And then you were promoted into the 09:21:43

24 position of CFO; is that correct? 09:21:45

25 A Correct. 09:21:47

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10 Q Please tell me what your job 09:22:14
11 responsibilities were at Epic. 09:22:16
12 A Sure. I oversaw all aspects of the 09:22:19
13 financial operations of the company and some 09:22:24
14 administrative functions. 09:22:27
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25 Q When you say "finance," what do you mean by 09:23:00

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1	that?	09:23:05
2	A I mean aspects of creating financial	09:23:05
3	presentations for the board of directors or managing	09:23:09
4	that process, managing the accounting and overall	09:23:12
5	kind of bookkeeping and payroll of the company, you	09:23:16
6	know, completion of the annual audit, things like	09:23:22
7	that.	09:23:24
8	Q Taxes?	09:23:28
9	A Taxes, yes.	09:23:29
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15 Do you remember specifically when in 09:25:16
16 January 2020 you announced your retirement? 09:25:17
17 A I had a conversation with Tim probably 09:25:21
18 the -- maybe the second week in January. I'm not 09:25:22
19 exactly sure of the date. 09:25:30
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4 Q Okay. And who replaced you as CFO? 09:28:47
5 A A gentleman named Randy Gelber. 09:29:02
6 Q And did he come from within the company or 09:29:09
7 was he an external hire? 09:29:12
8 A He did. Well, he was an external hire 09:29:16
9 about a year prior to my leaving and was brought in 09:29:19
10 the role of, I believe, it was director or maybe VP 09:29:21
11 of business development. 09:29:28
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15 Q In September 2019, was the trend for 11:56:44
16 revenues related to Fortnite a declining trend over 11:56:46
17 the course of 2019? 11:56:50

18 A I don't have that information available. 11:56:56
19 But I -- my guess is that it probably -- probably 11:56:57
20 was in a total basis. But, you know, what you need 11:57:04
21 to kind of understand about how these games work is 11:57:09
22 that they all have a launch period that is 11:57:13
23 usually -- there's a ton of excitement and virality 11:57:17
24 around the game, and that may spike. 11:57:21

25 And then the goal of a company like ours is 11:57:24

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1 to make sure that we, kind of, try to flatten that 11:57:27
2 tail out. You know, there will be a tail over time. 11:57:30
3 You know, a movie kind of goes up and 11:57:33
4 straight down from a loss in DVD sales. But a 11:57:37
5 video game -- if you can, in a live-feed video game 11:57:40
6 like this, you can try to maintain that tail as long 11:57:42
7 as possible. And that's kind of what's going on 11:57:44
8 here. 11:57:48
9 So I think that's what David's referring 11:57:49
10 to. I mean, you can't always expect this enormous 11:57:52
11 growth curve. You need to be real. And so we 11:57:55
12 should be thinking about a declining revenue state 11:58:01
13 going forward. But this wasn't raising red flags or 11:58:04
14 anything. 11:58:10
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18 Q Okay. If we wanted to calculate the gross 13:40:19
19 profit margin for Fortnite alone in 2018, could we 13:40:26
20 do that? 13:40:30
21 A Gross profit margin for Fortnite in 2018. 13:40:35
22 Are you defining gross profit margin as just the 13:40:37
23 gross revenue less the direct costs associated with 13:40:46
24 it? 13:40:49
25 Q Well, if you were going to do it, what 13:40:51

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1 would you include as input? 13:40:53
2 A Well, I think when people ask for a margin 13:40:57
3 related to a product line, a lot of times they're 13:41:00
4 looking for it to be -- like what's termed as "fully 13:41:03
5 loaded," which means, you know, there's people 13:41:07
6 costs, development costs, like the ongoing costs in 13:41:09
7 there. 13:41:14
8 And Epic systems aren't created or 13:41:15
9 maintained to do that. So when somebody says like, 13:41:18
10 Hey, give me a format P&L, like that's extremely 13:41:22
11 difficult. You can't really put that together for 13:41:27
12 Fortnite itself because of our financial systems. 13:41:30
13 But if you were saying just the gross 13:41:34
14 revenue less some of those direct costs, like we saw 13:41:35
15 before, including costs of sales, I think that's -- 13:41:38
16 that's probably possible. 13:41:40
17 Q But you didn't create -- you didn't 13:41:43
18 maintain a Fortnite specific P&L? 13:41:45
19 A No. 13:41:47
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10 (Deposition Exhibit 351) 13:44:34
11 was marked for identification.) 13:44:34
12 BY MS. BRASS: 13:45:07
13 Q And Exhibit 351 is numbered EPIC_04537390 13:45:07
14 to 4537404. 13:45:13
15
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18 Q Do you recognize Exhibit 351? 13:47:40
19 A I do. 13:47:43
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1 So is this something that you prepared or 13:48:14
2 that was prepared at your direction? 13:48:16
3 A I participated in the preparation of it 13:48:20
4 with Randy Gelber. 13:48:22
5 Q Is it accurate, to the best of your 13:48:30
6 understanding? 13:48:32
7 A Well, to the -- 13:48:32
8
9 THE WITNESS: -- best of my knowledge, yes. 13:48:38
10
11 Q And it was prepared by the finance 13:48:40
12 department during the period of the transition of 13:48:42
13 CFO from you to Randy; is that correct? 13:48:43
14 A It was prepared by -- as I mentioned, a 13:48:46
15 joint effort between the finance department and the 13:48:50
16 corporate development department. 13:48:52
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21 In the projections, you are projecting the 13:51:15
22 cost of the Epic Games Store here to continue to 13:51:20
23 exceed the revenue generated by the Epic Games 13:51:24
24 Store; is that correct? 13:51:27
25 A That's correct. 13:51:34

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1 Q And the costs will exceed revenue as 13:51:36
2 projected by approximately \$216 million? 13:51:40
3 A That's correct. 13:51:48

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12 Q And we talked about that you did not track 13:52:23
13 or forecast profit margin by a specific product. 13:52:26
14 Did you track profit margin across 13:52:36
15 different platforms? 13:52:39

16 A No. 13:52:42

17 Q Did you track expenses across different 13:52:45
18 platforms? 13:52:47

19 A No. 13:52:49

20 Q Did you track development costs by 13:52:51
21 platform? 13:52:54

22 A No. 13:52:56

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24 Q We looked earlier today at some of your 14:58:08
25 monthly flash reports. 14:58:10

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1	Do you remember seeing those?	14:58:12
2	A We do. I do.	14:58:14
3	Q Okay. And they described your revenue by	14:58:15
4	platform in a given month for Fortnite.	14:58:21
5	Do you remember that?	14:58:25
6	A Uh-huh. I do.	14:58:26
7	Q And PlayStation 4 was the largest	14:58:29
8	revenue-generating platform in each of the flash	14:58:33
9	reports we looked at, correct?	14:58:38
10	A In the ones we looked at today, yes.	14:58:42
11	Q Yeah.	14:58:44
12	And iOS was the lowest or the second	14:58:47
13	lowest -- if Android was listed, Android was lower	14:58:52
14	than iOS, but of the platforms listed for Fortnite,	14:58:57
15	iOS was always the lowest or the second lowest if	14:59:00
16	Android was listed, correct?	14:59:03
17	A Yes.	14:59:05
18	Q So it generated less revenue than	14:59:05
19	PlayStation 4, correct?	14:59:10
20	A Correct.	14:59:11
21	Q Less revenue than the Xbox?	14:59:14
22	A Yes.	14:59:17
23	Q Less revenue than Switch?	14:59:19
24	A Yes.	14:59:23
25	Q And less revenue than PCs?	14:59:24

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1	A	You said "Switch," right?	14:59:26
2	Q	Yes.	14:59:28
3	A	Yeah, I -- there may have been a launch	14:59:29
4		period where Switch may have been higher or	14:59:31
5		something, but in general, less than Switch.	14:59:33
6	Q	And less than PCs as well, correct?	14:59:38
7	A	Yes.	14:59:40
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14 Q And can you describe for me, in your own 15:07:52
15 words, the Unreal Engine business model? 15:07:55
16 A You know, the Unreal Engine business model 15:08:03
17 is it provides the most compelling technology to 15:08:06
18 game developers and content developers to offer 15:08:12
19 experiences to their consumers. 15:08:16
20 And, you know, I think one of the 15:08:17
21 differentiating models is -- for that, is that we 15:08:22
22 said we weren't going to monetize on, you know, an 15:08:26
23 ad basis or anything like that. We said -- or a 15:08:28
24 pay-to-play, kind of, license basis. But we -- I 15:08:33
25 think Tim has always said, Hey, you only pay us if 15:08:35

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1 you succeed, so we succeed when you succeed, and we 15:08:40
2 want to help you get there. 15:08:44
3 That's kind of the underlying ethos of the 15:08:46
4 business model for the engine. 15:08:50
5 So it would be -- for most game developers, 15:08:59
6 it's free. They're able to build a game with it for 15:09:02
7 free. And then if they sell a product down the 15:09:05
8 road, they would owe us a royalty. So if they 15:09:07
9 succeed, we can participate in that success. 15:09:10
10 MS. BRASS: Zac, can you please load the 15:09:26
11 next exhibit. 15:09:28
12 (Deposition Exhibit 358 15:09:29
13 was marked for identification.) 15:09:29
14 MS. BRASS: And it should be Exhibit 358, 15:09:51
15 which begins on EPIC_04462249 and ends on 15:09:53
16 EPIC_04462269. 15:10:06
17 THE WITNESS: Okay. 15:10:36
18 BY MS. BRASS:
19 Q And what is Exhibit 358? 15:10:37
20 A It looks like it's the Unreal Engine EULA, 15:10:41
21 end user license agreement. 15:10:48
22 Q Okay. And this is signed or agreed to by 15:10:49
23 people who want to use Unreal Engine, including 15:10:52
24 those who are going to use it only for free; is that 15:10:55
25 correct? 15:10:57

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1	A	Correct.	15:10:59
2	Q	And I'll ask you to turn to the page	15:11:03
3		numbered 04462255. It's the seventh page of the	15:11:05
4		document. And it says, in the middle of the page,	15:11:12
5		"5 Royalty."	15:11:18
6	A	Yeah.	15:11:25
7	Q	Okay. And the first sentence says "You	15:11:25
8		agree to pay Epic a royalty equal to five percent of	15:11:26
9		all worldwide gross revenue actually attributable to	15:11:29
10		each product regardless of whether the revenue is	15:11:32
11		received by you or any other person or legal entity,	15:11:35
12		as follows," and then there are a series of more	15:11:38
13		specific terms for specific uses.	15:11:43
14		Is that fair to say?	15:11:46
15	A	Yes.	15:11:48
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Q When you were CFO, did Epic Games calculate 15:13:15
gross margins on the Unreal Engine? 15:13:19
A No. 15:13:24
MS. BRASS: Zac, can we please load 15:13:29
Exhibit 359, which is EPIC_04540976 through 0979. 15:13:30
(Deposition Exhibit 359 15:13:49
was marked for identification.) 15:13:49

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5 As you said, this is an e-mail you're 15:15:26
6 copied on between the bankers and Dara dated -- the 15:15:28
7 final e-mail from Dara is February 19, 2020. The 15:15:36
8 bankers, that's Raine and Credit Suisse; is that 15:15:39
9 correct? 15:15:46
10 A Yes. 15:15:47
11 Q And that's in connection with the 15:15:48
12 fundraising project that you described earlier; is 15:15:49
13 that correct? 15:15:51
14 A Yes. E2. 15:15:51
15 Q And is E2 and Project Empire, are they the 15:15:55
16 same thing? 15:15:58
17 A Yes, I think so. 15:15:59
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15 Q And do you agree with her statement that 15:19:00
16 the engine business is 100 percent gross margin? 15:19:01
17 A No, not necessarily. I would ask where 15:19:07
18 the -- are there any hosting costs in here, and -- 15:19:08
19 you know, it's a pretty broad estimate. But there's 15:19:13
20 not a whole lot of direct costs like there are -- 15:19:22
21 like if you're comparing it to something like 15:19:24
22 Fortnite, there's really not a whole lot of direct 15:19:26
23 costs, other than deploying it under CDN. 15:19:31

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16 MS. BRASS: Zac, can you mark Exhibit 360, 15:23:36

17 please. 15:23:39

18 (Deposition Exhibit 360 15:23:39

19 was marked for identification.) 15:23:39

20 MS. BRASS: For the record, this is 15:25:00

21 EPIC_00143735. 15:25:02

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5 Q Okay. Is this document in a format of the 15:25:57
6 kind that you saw in the course of your work as CFO 15:25:59
7 at Epic? 15:26:04
8 A Yes. 15:26:05
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17 And would you have endeavored to make them 15:26:30
18 accurate at the time of creation? 15:26:34
19 A Yes. 15:26:37
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25 Q And this was something created for and used 15:26:56

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1 by members in the finance organization; is that 15:26:58
2 correct? 15:27:02
3 A Yes. 15:27:03
4
5 Justin, can you please load Exhibit 361. 15:27:11
6 (Deposition Exhibit 361 15:27:15
7 was marked for identification.) 15:27:15
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14 Q Is this document familiar to you either in 15:28:06
15 form or in content? 15:28:09
16 A In context it is. I just -- you know, both 15:28:14
17 of the last two documents you showed me are 15:28:22
18 extraordinarily early on in the Fortnite forecasting 15:28:25
19 process, so it's a bit fuzzy. And we were 15:28:33
20 struggling to forecast back then. We didn't know 15:28:38
21 exactly what -- what we were dealing with. 15:28:42
22 Q Do you -- 15:28:54
23 A As I referenced before, I said to you, in 15:28:56
24 2018, we had no idea how up or down 2020 would look. 15:28:58
25 As evidenced by these two forecasts that 15:29:03

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1 we're seeing just several months apart, it was just 15:29:07
2 extraordinarily difficult to try to forecast this 15:29:10
3 game, as it was taking off like it was. From our 15:29:13
4 perspective, it was some wild growth. 15:29:17

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10 Q And do you understand this to be a forecast 15:29:47
11 or a P&L for the conclusion of Q1 2018? 15:29:50

12 A It's -- it's very difficult to tell here. 15:30:04

13 I can tell you about what I'm seeing in Columns J, K 15:30:12
14 and L. This is a very rough -- this is not a 15:30:15
15 finished product. And I'm not sure if this is 15:30:18
16 actuals or a forecast at this moment. 15:30:27

17 Q Sitting here today, you can't remember one 15:30:30
18 way or another; is that correct? 15:30:33

19 A No, I can't. 15:30:34

20 Q And this was created, however, by the 15:30:37
21 finance organization, by you and your reports; is 15:30:39
22 that correct? 15:30:46

23 A Probably accumulated by, but -- you know, 15:30:48
24 for example, my reports and I -- like we don't have 15:30:52
25 direct access -- or did I? -- I guess, at this time, 15:30:58

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1 probably to systems that would have shown us things 15:31:01
2 like average hours played per MAU. That all comes 15:31:03
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13 Zac, can we please load Exhibit 362. And 15:31:40
14 that is a presentation labeled EPIC_00191127 through 15:31:47
15 191131. 15:31:57
16 (Deposition Exhibit 362 15:31:59
17 was marked for identification.) 15:31:59
18
19 BY MS. BRASS: 15:33:18
20 Q Do you recognize this document, 15:33:19
21 Mr. Babcock? 15:33:20
22 A You know, it -- in form, I do, but I don't 15:33:21
23 think I had anything to do with this one. If this 15:33:24
24 was a presentation of year-to-date February 2020 15:33:27
25 results, and presented in the late March board 15:33:32

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1 meeting, I was not -- I did not attend that. 15:33:36

2 Q Okay. This is after you had resigned and 15:33:39

3 retired; is that correct? 15:33:42

4 A Yes. 15:33:43

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