APPLE INC.

REPORT OF THE

SPECIAL LITIGATION COMMITTEE OF THE BOARD OF DIRECTORS

REGARDING MR. EDUARDO CUE

JANUARY 19, 2017

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I. EXECUTIVE SUMMARY

In December 2009 and January 2010, a three-person team of Apple employees negotiated with the largest book publishers in the United States to sell electronic books in Apple's iBookstore on the soon-to-be announced Apple iPad. The negotiating team was composed of Apple employee Eduardo Cue, Vice President of Internet Services, employee Keith Moerer, Director of TV, Books and Podcasting for iTunes, who reported directly to Mr. Cue, and Associate General Counsel Kevin Saul, the lead Apple attorney on the transactions who provided legal advice to the team, negotiated directly with the publishers' lawyers, and drafted the contracts. Mr. Cue reported directly to Apple CEO and Chairman Steve Jobs, who approved all aspects of the transactions.

Five of the six largest publishers ultimately entered into contracts that made Apple their agent for selling ebooks, that enabled the publishers to set retail prices, that provided caps for the pricing of certain ebooks, and that enabled Apple to match the lowest retail prices charged anywhere for the same ebook. Thereafter, those same publishers changed their ebook distribution relationship with Amazon from a wholesale model, where Amazon set the ebook retail price, to an agency model, where the publisher set the retail price. At the time, Amazon had over 80 percent of the electronic book market, and had been reselling ebook New York Times best sellers at generally $4 below the wholesale price. As a result of the publishers changing Amazon to an agent and the Apple contract terms, ebook prices rose.

Following the rise in prices, the United States Department of Justice, 33 states and territories, and separate private litigants sued Apple and the five publishers for violating Section 1 of the Sherman Antitrust Act, claiming a conspiracy in restraint of trade. No action or proceeding was brought against any individual. The publishers settled, but Apple did not. In a bench trial, Judge Denise Cote of the United States District Court for the Southern District of New York found Apple liable for a per se violation of the Sherman Antitrust Act (the "Antitrust Action"). Ultimately, Apple paid $450 million in settlement and the District Court imposed a Monitor for an initial two-year term to oversee the development of a comprehensive antitrust

compliance program at Apple. By the end of two years, Apple had developed a best-in-class antitrust compliance program and, with the approval of the United States Department of Justice, the District Court dismissed the Monitor on October 13, 2015.

On August 15, 2014, prior to the Monitor's discharge, the first of three derivative actions was filed in the Superior Court in Santa Clara, California, against Mr. Cue and eight current and former directors of Apple. The derivative actions were combined and are currently set forth in a Second Consolidated Amended Shareholder Derivative Complaint for Breach of Fiduciary Duty filed March 2, 2016 (the "SCAC"), which asserts the claim against Mr. Cue that is analyzed in this Report.

In its Order on the defendants' demurrer to an earlier version of the complaint, dated December 21, 2015, the Santa Clara Superior Court divided the derivative plaintiffs' (the "Derivative Plaintiffs" or "Plaintiffs") claim into three time periods: (1) the period from November 2009 to April 2010, during which the publishing agreements were negotiated and signed; (2) the period from April 2010 to September 4, 2013, the day before the District Court's final judgment; and (3) the period from the final judgment on September 5, 2013, through the end of the Monitorship, on October 13, 2015. As to the first period, the SCAC alleges that Mr. Cue's conduct as an Apple "officer" in negotiating and entering into the agreements was a breach of fiduciary duty, that the directors at the time failed to establish compliance practices at Apple that would have prevented the antitrust violation, and that the directors themselves should have known about and stopped the transactions. For the second period, the SCAC alleges that following the initiation of the action by the Justice Department, Apple's directors failed to put in place an appropriate antitrust compliance program by the time of the final judgment. For the third period, the SCAC alleges that Apple's directors affirmatively interfered with the Monitor's efforts to establish a high quality antitrust compliance program and exposed Apple to the risk of contempt in the District Court.

In response to the derivative actions, on April 26, 2016, Apple's Board of Directors formed this Special Litigation Committee (the "SLC") and granted it the authority to investigate

and evaluate all claims made on behalf of the corporation against Mr. Cue and the directors and to determine whether and to what extent it would be in Apple's best interests to sue its employee and directors. California law requires the members of the SLC to use their business judgment to determine whether it is in Apple's best interest to pursue, settle or seek to dismiss any or all of the claims.

Two Apple Board members were appointed to the SLC: James Bell and Susan Wagner. Mr. Bell became a director on October 1, 2015, more than one year after the derivative actions were filed, and twelve days before the Monitor was discharged. Ms. Wagner became a director on July 17, 2014, one month before the derivative actions were filed, at the end of the period covered by the second of four semi-annual Monitor reports. Less than one year after Ms. Wagner joined the Board, she was named as a ninth director defendant in the derivative actions. Neither Mr. Bell nor Ms. Wagner was a director during the ebook negotiations, from November 2009 to April 2010, the only period in which Mr. Cue is alleged to have engaged in actionable conduct.

The SLC has spent eight months investigating and evaluating the claim made on behalf of Apple in the SCAC against Mr. Cue and the directors. As of the writing of this Report, the SLC has completed the part of the investigation that relates to the claim asserted against Mr. Cue, but has not finalized its investigation of the nine present and former director defendants. The claim against Mr. Cue, who was an Apple employee and not an officer at the time of the ebook negotiations, is fundamentally different than the claims against the directors in terms of the facts and the law, and covers a more limited time period. Accordingly, while it is still in the process of completing the investigation of the allegations against all of the director defendants, the SLC has reached its final conclusion with regard to the entirely separate claim asserted against Mr. Cue.

In focusing here on Mr. Cue, the SLC is faced with the issue of whether Apple should seek to hold one of its employees liable to Apple where that employee was one of a number of Apple personnel working on the subject transactions, which were authorized and directed by the

CEO, documented by the corporation's lawyer, consistent with previously approved conduct and Apple's policies, and carried out with the advice of counsel. The SLC has not found any evidence that Mr. Cue knew or had reason to know that Apple's conduct violated the law. In its deliberations, the SLC considered whether a valid legal claim exists against Mr. Cue and considered Apple's business interest in pursuing a claim that would seek to hold an individual employee responsible for the costs to the corporation for having been found liable for an antitrust violation. The SLC has concluded that it is not in Apple's best interests to pursue the claim asserted in the derivative actions against Mr. Cue. Consequently, under the plenary powers granted by Apple's Board of Directors and pursuant to California law, the SLC has determined that dismissal of the claim against Mr. Cue is in the best interests of Apple and its shareholders.

II. BACKGROUND OF APPLE INC.

Apple Computers, Inc.—today Apple Inc.—was founded on April 1, 1976, by Steve Jobs and Steve Wozniak, who together had a vision of making user-friendly computers. According to Apple's 2016 Annual Report:

> The Company designs, manufactures and markets mobile communication and media devices, personal computers and portable digital music players, and sells a variety of related software, services, accessories, networking solutions and third-party digital content and applications. The Company's products and services include iPhone ® , iPad ® , Mac ® , iPod ® , Apple Watch ® , Apple TV ® , a portfolio of consumer and professional software applications, iOS, macOS™, watchOS ® and tvOS™ operating systems, iCloud ® , Apple Pay ® and a variety of accessory, service and support offerings. The Company sells and delivers digital content and applications through the iTunes Store ® , App Store ® , Mac App Store, TV App Store, iBooks Store™ and Apple Music ® (collectively "Internet Services"). The Company sells its products worldwide through its retail stores, online stores and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers and value-added resellers. In addition, the Company sells a variety of third-party Apple compatible products, including application software and various accessories through its retail and online stores. The Company sells to consumers, small and mid-sized businesses and education, enterprise and government customers.

Apple's Board of Directors consists of eight members: Arthur D. Levinson, former Chairman and Chief Executive Officer of Genentech, who serves as Chairman of Apple's Board; James A. Bell, former Chief Financial Officer and Corporate President of The Boeing Company; Tim Cook, Chief Executive Officer of Apple; Albert A. Gore Jr., former Vice President of the United States; Robert A. Iger, Chairman and Chief Executive Officer of The Walt Disney Company; Andrea Jung, President and Chief Executive Officer of Grameen America; Ronald D. Sugar, former Chairman and Chief Executive Officer of Northrop Grumman Corporation; and Susan L. Wagner, co-founder and Director of BlackRock.

Apple's C-level executive team consists of: Tim Cook, Chief Executive Officer; Jonathan Ive, Chief Design Officer; Luca Maestri, Chief Financial Officer; and Jeff Williams, Chief Operating Officer.

Apple has approximately 116,000 full-time equivalent employees. As of the close of its 2016 fiscal year ending September 24, 2016, Apple enjoyed a market capitalization of approximately $600 billion. In its 2016 fiscal year, Apple generated approximately $215 billion

in sales, $84 billion in gross margin, and $45 billion in net income. The total value of its assets during this period was approximately $321 billion.

Apple products and services are sold throughout the world. The Company maintains dedicated retail shopping websites in approximately 40 countries, and operates more than 450 brick-and-mortar retail stores with locations in 45 of 50 U.S. states, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates, and the United Kingdom.

III. APPLE'S ENTRY INTO THE EBOOKS MARKET AND THE TRANSACTIONS THAT GAVE RISE TO THE ANTITRUST JUDGMENT

The SLC's investigation has had the benefit of a voluminous trial record in the Antitrust Action, including extensive sworn deposition and trial testimony of relevant witnesses, many thousands of documents produced in that action, and the District Court's detailed factual findings, which the SLC has accepted. The SLC has comprehensively reviewed relevant material from the Antitrust Action. The factual summary below is based on the District Court's opinion after trial issued on July 10, 2013, the SLC's review of testimony and documentary evidence, and the SLC's interviews of witnesses.

A. Background Of The Ebook Industry

In late 2009, Apple CEO Steve Jobs was preparing to launch Apple's first iPad in early 2010, and considering whether to include with it an ebook reader application. At that time, consumers could read ebooks on Apple devices through third party applications, but Apple did not have its own tablet e-reader or online store selling ebooks. The ebook market was small but expected to grow significantly. Amazon's Kindle was launched in 2007, and became the first e-reader to be widely commercially accepted. Amazon quickly became the market leader in the sale of ebooks and ebook readers. Through 2009, Amazon sold nearly 90% of all ebooks.

At that time, book publishers distributed print and digital books through a wholesale pricing model, in which the publishers set a book's list price, and then sold books and ebooks to a retailer, such as Amazon, at wholesale prices. The retailer then offered the book and ebook to

consumers at whatever prices it chose. Amazon was selling new release ebooks at $9.99, which was lower than the wholesale price it paid for these ebooks.

Publishers feared that Amazon's $9.99 ebook price undercut their sales of hardcover books, threatened the viability of bookstores selling hardcover books, inhibited competition and innovation in the ebook market, and would ultimately erode prices for all books and damage the business model for the publishing industry. Publishers also feared that Amazon's dominance in the market would enable Amazon to demand lower wholesale prices and even cut publishers out of transactions altogether by Amazon negotiating directly with authors and agents for book rights.

Publishers attempted to combat Amazon's low pricing by increasing wholesale prices, and by withholding and delaying ebook releases until after the physical book had been released for sale for a period of time, a practice called "windowing." Four publishers—Macmillan, Simon & Schuster, Hachette, and HarperCollins—announced or implemented a policy of windowing some of their most popular ebook titles on Amazon. The publishers' attempts to combat Amazon's pricing, and in particular the publishers' practice of windowing ebooks, was widely publicized in articles in the Wall Street Journal, the New York Times, and other publications.

B. Apple's Initial Negotiations With Publishers

In mid-November 2009, Jobs directed Apple employee Eduardo Cue, Vice President, Internet Services, to "pursue an ebookstore," with the goal to announce the "iBookstore" together with the iPad at the iPad's launch on January 27, 2010. With this schedule, Cue had basically two months to acquire enough content to create a viable Apple ebookstore. Cue had been with Apple since 1989, and had been the lead negotiator for Apple's previous content stores: the Apple Online Store in 1998, the iTunes Store in 2003, and the App Store in 2008, as well as movies and television within the iTunes store. Since 2004, Cue had been responsible for running all of Apple's digital content stores.

Cue and Jobs discussed the publishing industry and developed a strategy for approaching

publishers to provide content for Apple's new ebookstore. Jobs and Cue initially determined that they would propose a wholesale model to publishers, similar to the arrangement Apple used to obtain movies and TV shows for resale through its iTunes store.

Cue's negotiating team included Keith Moerer, Director of TV, Books & Podcasting for iTunes. Moerer had worked with Cue on the launch of the iTunes podcasts and television stores in 2005, and was the head of iTunes. Prior to Apple, Moerer had worked at Amazon as Editorial Director, Books & Music. The other member of Apple's negotiation team was Associate General Counsel, Kevin Saul. Saul reported to Apple's General Counsel, Bruce Sewell. Saul had worked as an attorney with Cue since 2002 on most of Cue's content store negotiations, and Cue had a high opinion of Saul's legal ability. As counsel, Saul was responsible for advising Cue on legal matters, drafting and negotiating agreements and resolving legal issues as they arose during negotiations.

On December 15 and 16, 2009, Cue, Moerer, and Saul traveled to New York to meet separately with executives of each of the six publishers: Random House, Simon and Schuster, MacMillan, Hachette, Penguin, and HarperCollins (the "Publishers").[1] Cue brought Saul to the initial publisher meetings so that Saul could "start thinking about drafting a legal agreement." At Apple's initial meetings, Publishers expressed dissatisfaction that Amazon was selling new releases and New York Times Bestsellers below wholesale cost at a retail price of $9.99. Several Publishers said they were actively searching for a way to gain more control over pricing and were implementing tactics they would prefer to avoid, like windowing, to deal with Amazon's low pricing. Cue conveyed to some of the Publishers that Apple was willing to sell ebooks at higher retail prices up to $14.99.

During those initial meetings, Hachette and HarperCollins suggested entering into contracts with Apple using an agency model. In an agency model, the publisher sets the retail price that consumers pay for each ebook, and then pays the agent retailer (in this context, Apple)

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[1] Cue, Moerer and Saul never met or spoke with more than one publisher at a time.

a percentage of the sales price. Apple was familiar with the agency model since it sold apps through its App Store as an agent for app developers.

After those initial meetings, Cue believed that an agency sales model would be the best approach to enable Apple to be competitive with Amazon, and that a wholesale model would create pricing problems for Apple. Prevailing wholesale prices for ebooks typically fell in the range of $13 to $15, with some as high as $17.50. Apple would only enter the ebook market if it could sell ebooks at or around the same price as Amazon, but Amazon was selling at a price significantly below wholesale, and Apple was not willing to pursue a strategy of selling below cost. Cue made clear to each of the Publishers that Apple would only enter the ebooks market if it could be profitable from the start.

Cue emailed Jobs detailed descriptions of his meetings with the Publishers and discussed the benefits of an agency model with him. An agency model could ensure that Apple would make a profit from every ebook sale while giving Publishers the control over retail pricing that they desired. Apple decided to propose an agency model with a 30% commission, the same commission it earned in its App Store.

With Jobs' input and approval, Cue developed objectives and goals for Apple's entry into the ebook market, which Cue summarized as "selection, price, and profitability." As to "selection," Cue wanted Apple's ebook store to have the maximum number of ebooks possible, and he would not launch the store with ebooks from only a few of the Publishers. This meant that Apple had to enter into contracts with most of the six largest Publishers. Apple also had to release an ebook at the same time it was released in hardcover. Apple would not agree to the Publishers' practice of withholding, or windowing, a book so that it could be sold at a higher price in hardcover before it was released as an ebook. Cue believed that windowing would make the iBookstore unattractive to consumers. As to "price," Cue believed that, because an electronic book was less expensive to produce than a hardcover book, most of the cost savings should be passed on to consumers. This meant that in an agency relationship, retail prices had to be capped in an effort to keep Publishers from pricing ebooks above the retail price of hardcover books. As

to "profitability," Apple was unwilling to sell ebooks below cost like Amazon. In addition, Apple would not agree to sell ebooks at higher prices than they could be purchased from another source, as Apple recognized this would lead to failure of the iBookstore. Apple needed to be competitive with the lowest available price for each ebook and still make a profit on the sale. Overall, Cue believed that the iPad would provide a more enhanced consumer ebook experience with better visual quality, color, audio and video capabilities, touch screen functionality, and electronic links. Cue explained Apple's approach and concerns to each of the Publishers during the negotiations.

Between December 19 and 21, Cue spoke separately with representatives of Simon & Schuster, Macmillan, and Random House and proposed key contract terms: (1) the Publishers would have to adopt the agency model for all of their resellers, which would allow the Publishers to set retail prices; (2) Apple would receive a 30% commission; and (3) retail prices for new release ebooks would be set at $12.99 ($3 over Amazon's $9.99 retail price). Cue indicated in several of these meetings that changing to an agency model would allow publishers to increase retail prices for new release ebooks.

On December 21, Cue reported to Jobs that the meetings with the Publishers had gone "well and everyone understood our position and thought it was reasonable." Cue told Jobs that the publishers recognized "the plus" of moving to an agency model, namely it "solves Amazon issue," and that he believed that the Publishers would support moving all of their ebook resellers to an agency model. He also reported that the Publishers were troubled by a 30% commission for Apple.

On January 4 and 5, 2010, Cue sent nearly identical emails to each Publisher proposing an agreement with an agency pricing model, as Apple had done with the App Store, where Apple would act as the agent and receive a 30% commission for each transaction. He proposed price caps on the amount Publishers could charge customers, that would allow Publishers to raise many ebook retail prices by $3, and proposed that all retailers should be on an agency model.

C. The Written Publisher Agreements

Associate General Counsel Kevin Saul was responsible for drafting the Publisher agreements. In early January, 2010, Saul proposed to Cue that the agreement include a Most Favored Nations clause for retail prices (an "MFN"). Apple had used an MFN in at least one of its prior music agreements. The MFN required each Publisher to price any ebook in Apple's iBookstore at no more than the lowest retail price available for the same ebook elsewhere (*e.g.*, if the iBookstore was selling "War and Peace" for $11.99, and Amazon listed it for $9.99, then the iBookstore price would be reduced to $9.99). Cue discussed the MFN with Jobs, and Jobs agreed that the contracts should include an MFN. With the MFN it was no longer necessary to require the publishers to make all retailers agents; Apple would have the price protection it required because it could not be underpriced. Saul later described the MFN clause as an "elegant" solution that accomplished Apple's objectives.

On January 11, Saul emailed draft agency agreements to each of the six Publishers, which contained two restrictions on pricing: (1) caps on the prices that publishers could set in the iBookstore (that were higher than Amazon prices for New York Times bestseller ebooks at the time); and (2) the MFN. As agent, Apple would charge a publisher 30% of the retail price, leaving the publisher with 70% of the retail price. Neither the initial draft agreement nor the final agreement contained a provision requiring a Publisher to move all of its retailers to an agency model.

During the negotiations, in response to a question Random House had posed to Moerer, Cue explained to Moerer that the MFN made it unnecessary for Apple to include an explicit requirement that all retailers be changed to the agency model. Moerer asked Cue: "Are we willing to accept an agency model if other retailers continue a standard wholesale model for new releases without holdbacks?" Cue responded: "We are (I don't think we can legally force this). What we care about is price so the contract will say we get it at 30% less whatever the lowest retail price out in the market is (whether agency or wholesale)." In communications with Publishers, Cue conveyed that the agency model proposed by Apple was "the best chance for

publishers to challenge the 9.99 price point."[2]

On January 11, Moerer emailed each Publisher a pricing analysis of January 1 New York Times bestsellers to "help explain the price tiers we've proposed for hardcover new releases." The email showed that the price caps proposed by Apple would allow Publishers to sell ebooks above Amazon's $9.99 price point. Later that day, Moerer followed up with each Publisher, writing: "One point of clarification. The final column [on his earlier email's proposed pricing chart] is the top price tier we've proposed for hardcover new releases for titles at their respective list price. In the agency model [the Publisher] would set retail prices at its sole discretion, at this price or any lower tier, with Apple acting as your agent."

Also on January 11, Moerer traveled alone to New York to negotiate separately with each Publisher. He summarized his meetings to Cue and Saul in an email: "Primary focus of my meetings was around pricing. However, did hear some feedback on draft language publishers find troublesome or wanted greater clarity…." He emailed Cue a summary of his meetings with Penguin and HarperCollins, noting that Penguin did not think Apple's proposal would work. Moerer later emailed Cue regarding his meeting with Hachette:

> They're willing to move to an agency model, but only if there are more tiers and publishers have greater control at the higher end. … I told them that even if Hachette priced all its ebooks smartly & rationally, our experience with every other media type is that some providers will price ebooks stupidly (e.g., routinely ask for a premium above physical books). This will hurt both of us, especially our ability to grow a meaningful business together … Told me that since other ebook retailers are unlikely to accept new-release agency model, publishers are being

[2] In the Antitrust Action, the District Court focused on a statement later attributed to Cue by an Apple colleague that "any decent MFN forces the model," which the Court interpreted to mean that Apple intended the MFN to cause the industry, including Amazon, to move to an agency model. *United States v. Apple Inc.*, 952 F. Supp. 2d 638, 663 (S.D.N.Y. July 10, 2013). The District Court also pointed to communications between Cue and the Publishers as evidence that the contracts required Publishers to move all resellers to agency. For example, on January 21, Macmillan's CEO wrote to Cue that "he had 'misread' Cue in their previous discussions, and warned that '[t]he stumbling block is the single large issue we clearly had a misunderstanding about.' That stumbling block was 'significant enough for us that we may in fact give you a no later today.'" Cue responded that afternoon that he "d[id]n't believe we are asking you to do anything, you haven't told us you are doing. We are just trying to get a commitment." The District Court found that the "stumbling block" referred to in this email chain was the Publisher's commitment to move all resellers of ebooks to an agency model, which the Court concluded was an implicit requirement forced by the MFN. *Id.* at 672.

> asked to walk away from '80% of the current ebook business' to get one higher price point, $12.99, and that's not enough. Unless they're offered what they call 'a true agency model,' with greater control over pricing at lower and higher ends, they would rather take their chances with current holdback strategy.

After Moerer's meetings, Cue emailed Jobs that two of the Publishers, Penguin and Hachette, were "willing to do an agency model" and "go agency model for new releases with everyone else."

With the iPad launch coming up, Cue expressed a sense of urgency to the Publishers. On January 16, Cue emailed the Publishers that: "We will make a decision by Thu, at the latest, to determine whether we will launch a book store/reader. … There are 3 driving forces (selection, price and profitability) for us to succeed. …" He provided the Publishers with information about price tiers, stating, "Here are the maximum prices for new release hardback books. …" As negotiations progressed, Cue sent the price cap chart to Jobs.

By January 18, no Publisher had yet agreed to a contract with Apple. That day, Cue, Moerer, and Saul traveled to New York to conclude the negotiations and stayed for the nine days immediately preceding the iPad launch. During this time, Saul worked separately and directly with Publishers' counsel to negotiate the written agreement. Cue deferred to and relied on Saul to address all legal concerns about the contracts, including concerns that Publishers raised about the MFN.

The MFN was frequently discussed in the negotiations. For example, on January 21, Cue emailed the CEO of Hachette (and bcc'd Moerer and Saul): "Our teams spent a couple of hours going through the agreement. My understanding is we made significant progress but there were a couple of major deal breaking issues. First, we have asked for an MFN on the new release book pricing. There seems to be some concern on your team on the wording of this. Kevin, our attorney, is available to meet with your counsel to discuss this but we know this is not an issue as we have this in all other deals not just in books but other media. … By the way, we completed our first deal and are very close with the next two publishers."

On January 21, with six days until the anticipated iPad launch, Cue emailed Jobs an update on the negotiations with five of the Publishers' lawyers and informed him that no contract

was signed yet. Cue's update included the following:

- Simon & Schuster: "Lawyers from both sides have agreed there [are] no material issues but there is still wording that they are working on. I am confident we will get a signature."
- Penguin: "We are working with their GC tomorrow to get to a signature but I can see it running through the weekend."
- MacMillan: "After a long afternoon with their general counsel, we are in agreement on the terms, but the CEO and GC have legal concerns over the price matching. He is going to talk to his outside counsel tomorrow morning."
- HarperCollins: "We have gone through the agreement with their lawyers and can close it but their CEO is backing away…."
- Hachette: "I'm not sure whether we can get them to the finish line. … they have legal concerns over price matching and can't seem to do anything without the French parent. We have gone through the agreement with their lawyers so we just need the CEO to agree to close."

Cue also informed Jobs that "no conversations" were occurring with Random House, and shared with Jobs an email from the CEO of Random House conveying that Random House would not sign a deal prior to the iPad launch.

Cue informed each Publisher when other Publishers reached agreement in an effort to pressure and encourage them to sign the deal.[3] On January 21, Cue separately informed Hachette, Macmillan and Penguin that Apple had completed its first agency agreement and was "very close" on two more, without identifying them by name. This practice of letting others know his progress was consistent with how Cue had simultaneously negotiated with multiple

[3] While there is no direct evidence that Cue encouraged the publishers to speak with each other about entering into an agreement with Apple, based on the timing of calls between Cue and individual Publishers and between Publishers, the District Court concluded that: "Cue urged the Publisher Defendants' CEOs to have discussions with one another to clarify aspects of the Agreements or to convince others to sign on." *Apple,* 952 F. Supp. 2d at 706.

suppliers for other content stores. No one had informed Cue that this strategy created antitrust risk. In Cue's experience, it was very difficult to sign the first company, because of a fear of looking bad if someone later negotiates a better deal. Each Publisher also feared that Amazon might retaliate against it for signing an agency agreement with Apple and that such retaliation would have serious consequences because Amazon sold most of the ebooks in the market and also sold physical books. Cue's confirmation of how many Publishers had signed agreements provided each Publisher with assurance that they would not have to face Amazon alone.

On January 22, Cue informed Jobs that he had commitments from Hachette, Simon & Schuster, Macmillan, and Penguin. Meanwhile, negotiations with HarperCollins stalled. On January 22, HarperCollins' CEO wrote to Cue that HarperCollins wanted "flexibility" on price outside the Apple tiers, wanted to sell through other agents at a higher price than the retail prices in the iBookstore, wanted to reduce Apple's commission to 10%, and wanted to have a shorter "new release window." HarperCollins' CEO also explained that: "We need to have flexibility on the agency window. We believe this window should be 6 months rather than 12 months in the event that one or more large retailers do not move to an agency model." Cue asked Jobs to become involved with the HarperCollins negotiation.

On January 23, Jobs emailed James Murdoch of News Corp, HarperCollins' parent company, and wrote:

> 1. The current business model of companies like Amazon distributing ebooks below cost or without making a reasonable profit isn't sustainable for long. As ebooks become a larger business, distributors will need to make at least a small profit, and you will want this too so that they invest in the future of the business with infrastructure, marketing, etc.
>
> 2. All the major publishers tell us that Amazon's $9.99 price for new releases is eroding the value perception of their products in customer's minds, and they do not want this practice to continue for new releases.
>
> 3. Apple is proposing to give the cost benefits of a book without raw materials, distribution, remaindering, cost of capital, bad debt, etc., to the customer, not Apple. This is why a new release would be priced at $12.99, say, instead of $16.99 or even higher. Apple doesn't want to make more than the slim profit margin it makes distributing music, movies, etc.

> 4. $9 per new release should represent a gross margin neutral business model for the publishers. We are not asking them to make any less money. As for the artists, giving them the same amount of royalty as they make today, leaving the publisher with the same profits, is as easy as sending them all a letter telling them that you are paying them a higher percentage for ebooks. They won't be sad.
>
> 5. Analysts estimate that Amazon has sold slightly more than one million Kindles in 18+ months (Amazon has never said). We will sell more of our new devices than all of the Kindles ever sold during the first few weeks they are on sale. If you stick with just Amazon, B&N, Sony, etc., you will likely be sitting on the sidelines of the mainstream ebook revolution.
>
> 6. Customers will demand an end-to-end solution, meaning an online bookstore that carries the books, handles the transactions with their credit cards, and delivers the books seamlessly to their device. So far, there are only two companies who have demonstrated online stores with significant transaction volume -- Apple and Amazon. Apple's iTunes Store and App Store have over 120 million customers with credit cards on file and have downloaded over 12 billion products. This is the type of online assets that will be required to scale the ebook business into something that matters to the publishers.
>
> So, yes, getting around $9 per new release is less than the $12.50 or so that Amazon is currently paying. But the current situation is not sustainable and not a strong foundation upon which to build an ebook business. And the amount we will pay should be gross margin neutral. Apple is the only other company currently capable of making a serious impact, and we have 4 of the 6 big publishers signed up already. Once we open things up for the second tier of publishers, we will have plenty of books to offer. We'd love to have HC among them.

Jobs later wrote to Murdoch regarding Apple's proposed price tiers:

> Our proposal does set the upper limit for ebook retail pricing based on the hardcover price of each book. The reason we are doing this is that, with our experience selling a lot of content online, we simply don't think the ebook market can be successful with pricing higher than $12.99 or $14.99. Heck, Amazon is selling these books at $9.99, and who knows, maybe they are right and we will fail even at $12.99. But we're willing to try at the prices we've proposed. We are not willing to try at higher prices because we are pretty sure we'll all fail….

On January 23, 2010, Cue sent Jobs an update on the status of contract negotiations, including his opinion that involvement of Publishers' outside counsel (in addition to in-house counsel) was slowing the negotiations:

> None were signed today though all publishers worked on them. At this point, there are no material issues with the agreements but that can obviously change until they get signed. The process is very slow because they have never done an agreement like this and given all the issues they have had with their existing partners, they want to make sure they don't make a huge mistake. In addition, all these guys use external lawyers to review what their internal ones do so it makes everything slower. I know we are way past where we should be with them getting signed, but I am pushing them really hard (even to the point of killing the deal). I

> hope we can get signed tomorrow because all of them at this point are really close. …

On January 25, Cue updated Jobs that Hachette had signed, and Simon & Schuster and Macmillan were scheduled to sign the following day. As for Penguin, he wrote: "Once previous two are signed, I will head to their offices to get this one signed." On January 26, the day before the iPad launch, Cue emailed Jobs that Hachette, Simon & Schuster, Macmillan, and Penguin had signed and HarperCollins was close. That day, Murdoch responded to Jobs that, "I think there are still a number of issues with the deal—and with the precedents. But I also think we should move ahead and agree, and Brian will be communicating this to Eddie in the next few minutes." HarperCollins accepted and executed the agreement that day.

By the end of the day before the iPad launch, Cue had signed agency agreements with five of the six largest Publishers. Each Publisher had negotiated vigorously with Cue and demanded different concessions; there was no consistency among the Publishers in the separate points and demands each made. Notwithstanding the Publishers' different demands, with only minor concessions from Cue the agreements contained the same material terms.

Throughout the ebook negotiations, Cue had relied on Saul's legal advice and never had any concerns that Saul's advice was inaccurate or unreliable. Cue knew that Saul was working with a team of Apple in-house lawyers and with outside counsel to resolve legal issues, including potential antitrust issues. For example, Saul conveyed in a meeting with Cue and HarperCollins that he had reviewed the ebooks contracts with outside counsel and that the MFN did not create antitrust problems. Saul also told Cue that he discussed the MFN with Apple's General Counsel, Bruce Sewell. Saul knew that Cue conveyed to Publishers that all of the Apple ebooks contracts would be substantially similar and that Cue regularly informed Publishers how many other Publishers had already signed a deal with Apple. Saul drafted the agreements, including the MFN, that were the basis of the antitrust violation. Saul never advised Cue that anything about the transactions might violate the antitrust laws.

Throughout the negotiations, Cue also kept Jobs informed about key issues and contract terms. Cue had worked with Jobs on many important deals over the years; Cue knew that if Jobs

did not like something about the deal, Jobs would let Cue know in no uncertain terms. Cue followed all directives that he received from Jobs during the negotiations.

D. The Launch of the iPad and iBookstore

On January 27, 2010, the day after the fifth publisher agreement was executed, Jobs introduced the highly anticipated iPad at a presentation in San Francisco, California. Jobs announced that iPads would include a new Apple-designed application, iBooks, that ebooks published by Penguin, HarperCollins, Simon & Schuster, MacMillan, and Hachette would be available for purchase from Apple's iBookstore, and that Apple was "going to open the floodgates for the rest of the publishers in the world starting this afternoon."

During his presentation of the iBookstore, Jobs demonstrated purchasing an ebook, Ted Kennedy's "True Compass" memoir, for $14.99. Jobs was asked by a reporter after his presentation why people would pay $14.99 in the iBookstore to purchase an ebook that was selling at Amazon for $9.99. Jobs responded, "Well, that won't be the case. … The price will be the same," and explained that "Publishers are actually withholding their books from Amazon because they are not happy." The day after the iPad launch, Jobs explained to his biographer, Walter Isaacson:

> Amazon screwed it up. It paid the wholesale price for some books, but started selling them below cost at $9.99. The publishers hated that -- they thought it would trash their ability to sell hardcover books at $28. So before Apple even got on the scene, some booksellers were starting to withhold books from Amazon. So we told the publishers, "We'll go to the agency model, where you set the price, and we get our 30%, and yes, the customer pays a little more, but that's what you want anyway." But we also asked for a guarantee that if anybody else is selling the books cheaper than we are, then we can sell them at the lower price too. So they went to Amazon and said, "You're going to sign an agency contract or we're not going to give you the books."

Within months of signing the agency agreements with Apple, the five Publishers changed Amazon from a wholesale model to an agency model, which allowed the Publishers to control Amazon's pricing. Thereafter, with Amazon no longer able to set below-cost prices, retail prices of ebooks rose. As the District Court found:

> [A]fter the iBookstore opened in April 2010, the price caps in the Agreements became the new retail prices for the Publisher Defendants' e-books. In the five

> months that followed, the Publisher Defendants collectively priced 85.7% of their New Release titles sold through Amazon and 92.1% of their New Release titles sold through Apple within 1% of the price caps. This was also true for 99.4% of the NYT Bestseller titles on Apple's iBookstore, and 96.8% of NYT Bestsellers sold through Amazon. The increases at Amazon within roughly two weeks of moving to agency amounted to an average per unit e-book retail price increase of 14.2% for their New Releases, 42.7% for their NYT Bestsellers, and 18.6% across all of the Publisher Defendants' e-books.

Apple, 952 F. Supp. 2d at 682.

IV. THE ANTITRUST JUDGMENT AND SETTLEMENT

A. Antitrust Judgment

On April 11, 2012, the Department of Justice ("DOJ") and 16 states and territories (the "States") filed the Antitrust Action against Apple and five publishers in the Southern District of New York, titled *U.S. v. Apple, Inc., et al.,* No. 1-12CV-2826-DLC-MHD. The DOJ and States alleged that Apple conspired with book publishers to raise the retail price of ebooks in violation of section 1 of the Sherman Antitrust Act. Seventeen states later joined the case, for a total of 33 states (the "Plaintiff States"), and consumers filed a related consumer class action against Apple. Each of the Publishers settled.

After a three-week bench trial before United States District Judge Denise Cote, on July 10, 2013, the Court held that:

> The Plaintiffs have shown through compelling evidence that Apple violated Section 1 of the Sherman Act by conspiring with the Publisher Defendants to eliminate retail price competition and to raise e-book prices. ... Apple not only willingly joined the conspiracy, but also forcefully facilitated it. ... This price-fixing conspiracy would not have succeeded without the active facilitation and encouragement of Apple.

Apple, 952 F. Supp. 2d at 691 (also referred to herein as the "Antitrust Order").

The Court found that "[i]n negotiating the caps for its pricing tiers, Apple understood that it was setting the new retail prices at which e-books would be sold." *Id.* at 692. The Court also found that "Apple included the MFN … both to protect itself against any retail price competition and to ensure that it had no retail price competition. Apple fully understood and intended that the MFN would lead the Publisher Defendants inexorably to demand that Amazon switch to an agency relationship with each of them." *Id.*

The Court determined that Apple's participation in the conspiracy was "essential" in that Apple "assured each Publisher Defendant that it would only move forward if a critical mass of the major publishing houses agreed to its agency terms. It promised each Publisher Defendant that it was getting identical terms in its Agreement in every material way. It kept each Publisher Defendant apprised of how many others had agreed to execute Apple's Agreements." *Id.*

The District Court found that alone none of the provisions of the written publisher agreements were illegal, but that a combination of factors, including the contract provisions, the coordination among Publishers, and Apple's facilitation of and participation in that coordination, rendered the conduct a *per se* violation of the Sherman Act:

> The Plaintiffs do not argue, and this Court has not found, that the agency model for distribution of content, or any one of the clauses included in the Agreements, or any of the identified negotiation tactics is inherently illegal. Indeed, entirely lawful contracts may include an MFN, price caps, or pricing tiers. Lawful distribution arrangements between suppliers and distributors certainly include agency arrangements. ... That does not, however, make it lawful for a company to use those business practices to effect an unreasonable restraint of trade. And here, the evidence taken as a whole paints quite a different picture -- a clear portrait of a conscious commitment to cross a line and engage in illegal behavior with the Publisher Defendants to eliminate retail price competition in order to raise retail prices.

Id. at 698.

The District Court examined the publisher agreements "in the context of the entire record" and determined that "the caps for the price tiers were the fiercely negotiated new retail prices for e-books and that the MFN was the term that effectively forced the Publisher Defendants to eliminate retail price competition and place all of their e-tailers on the agency model." *Id.* at 699. "The issue is not whether an entity executed an agency agreement or used an MFN, but whether it conspired to raise prices." *Id.*

The District Court found that Steve Jobs[4] provided "[c]ompelling evidence of Apple's participation in the conspiracy." *Id.* at 705. In particular, the Court found that "Jobs's statements to James Murdoch that he understood the Publishers' concerns that 'Amazon's $9.99

[4] Steve Jobs passed away on October 5, 2011, prior to the trial in the Antitrust Action.

price for new releases is eroding the value perception of their products … and they do not want this practice to continue,' and that Apple was thus 'willing to try at the [$12.99 and $14.99] prices we've proposed,' underscored Apple's commitment to a scheme with the Publisher Defendants to raise e-book prices." *Id.* The Court found Jobs' statements at the iPad launch regarding pricing being the same for ebooks as "further evidence that Apple understood and intended that Amazon's ability to set retail prices would soon be eliminated." *Id.*

The District Court later stated that: "The record at trial demonstrated a blatant and aggressive disregard at Apple for the requirements of the law. Apple executives used their considerable skills to orchestrate a price-fixing scheme that significantly raised the prices of E-books. This conduct included Apple lawyers and its highest level executives." *August 27, 2013 Antitrust Action Hearing Transcript* at 17. The Court found that the testimony of Cue, Saul and Moerer lacked credibility. *See, e.g., Apple,* 952 F. Supp. 2d at 661, n.19, & 703, n.66. However, the DOJ did not institute any criminal investigation or proceedings against any individual and no individual was found to be personally liable for any antitrust violations.

The District Court addressed the issue of employee training at Apple, stating that "neither Mr. Cue nor Mr. Saul,[5] his assigned in-house counsel, could remember any training on antitrust issues. They are responsible, with others in Mr. Cue's section, with negotiating the content licenses for Apple's business. They and those on their teams need to understand what the law requires and how to conform their business practices to the law." *August 27, 2013 Antitrust Action Hearing Transcript* at 17.

On September 5, 2013, the District Court entered final judgment and an injunction (the "Final Judgment"). Apple was required to modify its publisher agreements and to have an "External Compliance Monitor" for two years to "evaluate Apple's internal antitrust compliance policies and procedures and additionally … evaluate Apple's antitrust training program." *Id.* at 18.

[5] Mr. Saul passed away in 2015, after the trial in the Antitrust Action.

B. Monetary Settlement

On July 16, 2014, Apple agreed to pay $450 million to the Plaintiff States and to consumer class plaintiffs to settle claims pending the outcome of its appeal of the District Court's liability finding.

C. Appellate Proceedings

Apple appealed the District Court's liability finding and injunction. Apple argued that the liability finding was a "radical departure from modern antitrust law and policy" that "turns the antitrust laws upside down." *Apple's Opening Brief*, at 1-2. Apple argued:

> The district court's own findings show that Apple offered a retail business model to the publishers that was in Apple's independent business interests and was attractive to the publishers, who were frustrated with Amazon. And it was not unlawful for Apple to take advantage of retail market discord by using lawful agency agreements to enter the market and compete with Amazon.

Id. at 13.

The United States Court of Appeals for the Second Circuit rejected Apple's arguments and affirmed the District Court on June 30, 2015, with one extensive dissent. The majority opinion found:

> Apple wanted quick and successful entry into the ebook market and to eliminate retail price competition with Amazon. In exchange, it offered the publishers an opportunity to confront Amazon as one of an organized group … united in an effort to eradicate the $9.99 price point. Both sides needed a critical mass of publishers to achieve their goals. The MFN played a pivotal role in this *quid pro quo* by stiffen[ing] the spines of the [publishers] to ensure that they would demand new terms from Amazon, and protecting Apple from retail price competition.

United States v. Apple Inc., 791 F.3d 290, 305 (2nd Cir. 2015) (internal citations omitted). The dissent noted the unique nature of the case:

> [A]s the government conceded at oral argument, no court has previously considered a restraint of this kind. Several features make it <u>sui generis</u>: (a) a vertical relationship (b) facilitating a horizontal conspiracy (c) to overcome barriers to entry in a market dominated by a single firm (d) in an industry created by an emergent technology.

Id. at 348 (dissenting opinion) (underline in original). The liability finding and injunction were upheld on appeal, causing Apple to pay the previously agreed $450 million settlement.

V. THE MONITOR

The District Court appointed an External Compliance Monitor (the "Monitor") to assess "whether Apple's internal antitrust compliance policies and procedures, as they exist 90 days after his or her appointment, are reasonably designed to detect and prevent violations of the antitrust laws," and "whether Apple's training program … as it exists 90 days after his or her appointment, is sufficiently comprehensive and effective." *Final Judgment* at 11. The Department of Justice requested a ten-year Monitor appointment, but the District Court appointed the Monitor for an initial two years, subject to extension. The District Court authorized the Monitor to make "recommendations reasonably designed to improve Apple's policies, procedures, and training for ensuring antitrust compliance," and ordered that, if Apple objected to any such recommendation, Apple would have to reach agreement with the Monitor on "an alternative policy, procedure, or system designed to achieve the same objective or purpose" or apply to the court for relief. *Id*. at 12.

By the end of the Monitor's two year term, Apple had instituted a best-in-class antitrust compliance program. With the approval of the Department of Justice, on October 13, 2015, the District Court discharged the Monitor.

VI. THE DERIVATIVE ACTION

A. Procedural History

The initial derivative shareholder complaint was filed in August, 2014, over a year before the Monitor was discharged. The Amended Consolidated Complaint ("ACC") was filed on June 8, 2015. The Second Consolidated Amended Shareholder Derivative Complaint ("SCAC") was filed on March 2, 2016 (the "Derivative Action").

The Derivative Action covers allegations of wrongful conduct by Cue and nine former or current director defendants over three distinct time periods: (1) the period from November 2009 to April 2010, during which the publishing agreements were negotiated and signed; (2) the period from April 2010 to September 4, 2013, the day before the Final Judgment; and (3) the period from the Final Judgment on September 5, 2013, through the end of the Monitorship, on

October 13, 2015. As to the first period, the SCAC alleges that Cue's conduct as an Apple "officer" in negotiating and entering into the agreements was a breach of fiduciary duty, that the directors at the time failed to establish compliance practices at Apple that would have prevented the antitrust violation, and that the directors themselves should have known about and stopped the transactions. For the second period, Plaintiffs allege that following the initiation of the action by the DOJ, the directors failed to put in place an appropriate antitrust compliance program by the time of the Final Judgment. For the third period, Plaintiffs allege that the directors affirmatively interfered with the Monitor's efforts to establish a high quality antitrust compliance program and exposed Apple to the risk of contempt in the District Court.

Plaintiffs allege a single claim for breach of fiduciary duty derivatively on behalf of Apple against its Chief Executive Officer and director, Timothy D. Cook, Senior Vice President of Internet Software and Services, Eduardo Cue, Chairman of the Board, Arthur D. Levinson, current directors Albert A. Gore, Jr., Robert A. Iger, Andrea Jung, Susan L. Wagner, and Ronald D. Sugar, and former directors Millard S. Drexler and William V. Campbell.[6]

Apple and the individual defendants demurred to the ACC. The Superior Court issued its ruling on that demurrer on December 21, 2015 (the "Order Re Demurrer"). The Court found that as to the first two periods, Plaintiffs had not sufficiently alleged that demand on the Board to undertake the derivative claim was futile. The Court found that Plaintiffs had sufficiently alleged demand futility only "with respect to the alleged non-compliance with the Final Judgment," which is the third period identified by the Court. *Order Re Demurrer* at 21. Even though the ACC was deficient as to the first two periods, the Court denied the demurrer as to the directors based on the fact that Plaintiffs plead a single cause of action.

The Superior Court, however, sustained the demurrer as to Cue, finding that "Plaintiffs have not stated a viable cause of action … because [Cue] acted with advice from counsel while negotiating the [publisher] agreements and Plaintiffs do not allege that he acted without good

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[6] Mr. Campbell passed away in April, 2016.

faith." *Id.* at 20-21. The Superior Court granted Plaintiffs leave to amend the ACC. On March 2, 2016, Plaintiffs filed the SCAC, which made few changes to the allegations against Cue. For the specific allegations against Cue, see Section VI.C., below.

On April 26, 2016, Apple's Board of Directors formed the SLC to investigate the derivative claim (*see* Section VII.B., below). On June 22, 2016, the SLC sought to stay the Derivative Action pending the results of its investigation. The Superior Court denied the motion to stay on August 1. The parties have therefore engaged in discovery, and the Derivative Action has proceeded at the same time that the SLC has investigated the claims.

On December 8, 2016, Cue filed a demurrer to the SCAC. On that same date, the director defendants (not including Ms. Wagner) filed a motion to strike certain allegations in the SCAC "on the ground that in those portions [covering the first two periods], Plaintiffs seek to assert claims based on conduct with respect to which the Court has previously found that Plaintiffs have failed to satisfy the demand requirement."

B. The Non-Director Individual Defendant: Eduardo Cue

Cue earned a bachelor's degree in Computer Science and Economics from Duke University. He joined Apple in 1989. In his early years at Apple, he was a successful manager of software engineering and customer support teams. Cue was integrally involved in creating and launching the Apple Online Store in 1998, the iTunes Store in 2003, and the App Store in 2008.

In January 2010, during the ebook negotiations, Cue's title was Vice President, Internet Services. He was an employee of Apple, not an officer, and reported to Steve Jobs. On August 24, 2011, Cue was promoted to Senior Vice President, Internet Software and Services and on September 2, 2011, he became an officer of the corporation. Cue's current role is to oversee Apple's industry-leading content stores and media, including the iTunes Store and Apple Music, as well as Apple Pay, Siri, Maps, iAd, Apple's iCloud services, and the App Store.

C. The Cause of Action Against Cue

For the breach of fiduciary duty claim against Cue, Plaintiffs allege: "As an officer of

Apple, defendant Cue owed fiduciary duties to the Company. As an officer, defendant Cue cannot invoke the protections of either California's business judgment statute, California Corporations Code section 309, nor the exculpatory provisions in Apple's Articles of Incorporation." SCAC, ¶ 215. "Defendant Cue breached his fiduciary duty by orchestrating and effecting a course of conduct which exposed the Company to liability for violating antitrust laws. Defendant Cue was at least negligent in performing his duties." *Id.*, ¶ 330; *see also id.,* ¶ 123 ("Defendant Cue, as an officer of Apple, owed fiduciary duties to the Company and breached those duties by acting as the central figure in the antitrust scheme, exposing it to liability, as further discussed below. Defendant Cue thus breached his fiduciary duties to the Company such that he damaged the Company and is liable for such damages.").

Plaintiffs allege the following conduct by Cue:

> As it negotiated with the Publishing Group in December 2009 and January 2010, Apple through defendant Cue, among others, kept each Publishing Group member informed of the status of its negotiations with the other Publishing Group members. Apple, through defendant Cue, also assured the Publishing Group members that its proposals were the same to each and that no deal Apple agreed to with one publisher would be materially different from any deal it agreed to with another publisher. Apple, through defendant Cue in particular, thus knowingly served as a critical conspiracy participant by allowing the Publishing Group members to signal to one another both: (i) which agency terms would comprise an acceptable means of achieving their ultimate goal of raising and stabilizing retail e-book prices; and (ii) that they could lock themselves into this particular means of collectively achieving that goal by all signing their Apple agency agreements.

Id., ¶ 184.

The factual allegations pled in support of the claim against Cue specifically allege his position with Apple in 2011, after he became an officer, not in 2009-2010 when he was an employee negotiating the ebooks Publisher agreements. Plaintiffs allege that Cue "is Apple's Senior Vice President, Internet Software and Services and has been since September 2011. Defendant Cue has also held various other positions at Apple since joining the Company in 1989, including Vice President of Internet Services[7] and Senior Director of iTunes Operations." *Id.*, ¶

[7] During the ebook negotiations, Cue's title as an employee was Vice President, Internet Services.

98. Plaintiffs further allege his compensation for the years 2011 through 2014, and not 2009-2010. *Id.*

The Plaintiffs plead that Jobs had a significant role in the conduct that they allege constitutes Cue's breach of fiduciary duty. For example, they allege the following:

- "[B]y November 2009, … Jobs had authorized defendant Cue to pursue a dedicated Apple e-bookstore or the iBookstore, a major new business avenue for the Company." *Id.*, ¶ 22.
- "Jobs stated in a January 14, 2010 e-mail to defendant Cue, while pricing was still being hashed out with the publishers: 'I can live with this [proposed pricing], as long as they move Amazon to the agent model too for new releases for the first year.'" *Id.,* ¶ 166.
- "Jobs and defendant Cue repeatedly reinforced to the publishers that the launch of the iPad would likely be their last chance to eliminate pricing competition and collectively increase e-book pricing for all retailers." *Id.*, ¶ 174.
- "Jobs e-mailed James Murdoch of News Corp., HarperCollins' parent company, to persuade him join [sic] the other Publisher Defendants in agreeing to Apple's terms. Jobs made it clear that Apple's proposal was the only real option that would allow HarperCollins to inflate the $9.99 price point…." *Id.*
- "Jobs, defendant Cue, and Saul understood and intended that the retail price MFN clause was the key commitment mechanism to keep the Publisher Defendants advancing their conspiracy in lockstep." *Id.*, ¶ 191.
- "[D]efendant Cue and Jobs, among others, recognized discussed [sic] the Publisher Defendants' concerns that their scheme presented an antitrust risk." *Id.*, ¶ 194.
- "[I]n early 2010, Apple's most senior officers had numerous internal communications about how they had fixed the 'Amazon' problem, including Saul (an Assistant General Counsel of the Company), defendant Cue, and Jobs." *Id.*, ¶ 228.

The Derivative Plaintiffs also allege that Saul was "Apple's Associate General Counsel," and Cue's "assigned in-house counsel." *Id.*, ¶¶ 11, 158. Saul is alleged to have been part of

Cue's team and involved in the ebook negotiations from their inception. *See id.*, ¶ 158 ("In December 2009, defendant Cue and his team, including Apple's Associate General Counsel, Saul, and Keith Moerer …, Director of iTunes, contacted the Publishing Group to set up separate meetings to discuss an 'extremely confidential' subject."). Plaintiffs allege that Saul developed the MFN clause as an "alternative way to achieve an industry-wide shift to the agency model that was even more effective in protecting Apple's interests." *Id.*, ¶¶ 11, 164; *see also id.*, ¶ 165, ("Saul proposed using an MFN clause for retail prices.") (*quoting Antitrust Order* at 662).

Plaintiffs allege that the District Court made no findings in the Antitrust Order regarding whether Saul was acting as an attorney. *Id.*, ¶ 165 ("There is no indication in the Order that defendant Cue sought legal advice from Saul as to any topic, that Saul was acting as an attorney, rather than in a business capacity, and/or specifically that defendant Cue was advised by Saul that either the MFN clause or Apple's entire scheme in moving the e-book market to the agency model was legal or that it did not violate the antitrust laws.").

Cue is alleged to be one of many Apple employees responsible for Apple's antitrust violation:

- "Jobs, defendant Cue, and senior managers responsible for negotiating content, and particularly for filling the iBookstore with content in time for the January 2010 iPad launch, were engaged in a scheme to fix the prices of e-books." *Id.*, ¶ 231.
- "Jobs, defendant Cue, and other members of senior management as well as the Company's legal department and particularly its senior legal personnel, … were also involved in the perpetuation [sic] of illegal conduct." *Id.*, ¶ 298.

The Plaintiffs also allege that Apple failed to train Cue and Saul regarding antitrust compliance. *Id.*, ¶ 243 ("neither defendant Cue nor Mr. Saul, his assigned in-house counsel, could remember any training on antitrust issues"). Plaintiffs assert that current and former directors on Apple's Board should be liable for failing to supervise and provide adequate training to Cue and others:

> [T]he one general antitrust policy which the Company had in place, was inadequate, too general, did not deal with the specific risks faced by the Company, and was not properly or sufficiently communicated to senior managers, the executive team, or members of the Board. Moreover, there were few, if any, risk assessments of antitrust violations performed, much less by the Board or the Audit Committee which was responsible for enterprise risk management.

Id., ¶ 299. Plaintiffs further allege that the District Court instituted the Monitorship because of the deficiencies it found in Apple's antitrust compliance policies, procedures, and training program, which allegedly led to the antitrust violations. *Id.*, ¶ 247.

Based upon these allegations, Plaintiffs seek judgment against all defendants in favor of Apple "for the amount of damages sustained by the Company as a result of the defendants' breaches of fiduciary duties." *Id.*, Prayer, ¶ A. Plaintiffs allege that Apple's damages include the $450 million paid to settle claims asserted by consumers and the States. *Id.*, ¶ 291. Plaintiffs also seek injunctive relief, restitution from defendants, and "disgorgement of all profits, benefits, and other compensation obtained" by them. *Id.*, Prayer, ¶¶ C-D.

In summary, the Derivative Plaintiffs maintain that Apple should hold its employee, Cue, liable as an officer (for conduct occurring prior to his becoming an officer) for causing Apple to commit an antitrust violation at the same time that they allege that Apple failed to train Cue regarding antitrust compliance and that Cue was following Apple's CEO's directives and relying on legal advice from Apple's in-house counsel.

VII. THE SPECIAL LITIGATION COMMITTEE

A. The Law Governing Special Litigation Committees

Because the corporation is "a legal entity separate from its shareholders … when a corporation has suffered an injury to its property the corporation is the party that possesses the right to sue for redress." *Desaigoudar v. Meyercord,* 108 Cal. App. 4th 173, 183 (2003). *See also Patrick v. Alacer Corp*., 167 Cal. App. 4th 995, 1003 (2008) ("[T]he particular stockholder who brings the [derivative] suit is merely a nominal party plaintiff. It is the corporation that is the ultimate beneficiary of such a derivative suit. Thus, [t]he corporation [is] the real party plaintiff in the action.") (alteration original, internal citations omitted).

When shareholders allege corporate wrongdoing, as is the case here, "the common

practice is for the board to appoint a special litigation committee of independent directors to investigate the challenged transaction." *Desaigoudar*, 108 Cal. App. 4th at 185; *see also Will v. Engebretson & Co.,* 213 Cal. App. 3d 1033, 1040 (1989) ("The business judgment rule has been held … to permit a corporation to appoint a special litigation committee to decide whether the maintenance of a shareholder's derivative suit is in the corporation's best interests"). The special litigation committee concept furthers "the fundamental principle that those best suited to make decisions for a corporation—including the decision to file suit on its behalf—are its directors, not its stockholders or the courts." *Finley v. Superior Court,* 80 Cal. App. 4th 1152, 1163 (2000). Even where a shareholder's demand on a board of directors is excused, the board of directors may appoint a special litigation committee to determine whether pursuing the derivative litigation is in the best interest of the company. *Zapata Corp. v. Maldonado*, 430 A.2d 779, 786 (Del. 1981). As a duly appointed committee of the board, a special litigation committee has "all the authority of the board." Cal. Corp. Code § 311.

The fundamental business judgment issue before a special litigation committee is whether it is in the corporation's best interests to pursue the claims alleged in the derivative lawsuit.

> [T]he decision whether and to what extent to explore and prosecute such claims lies within the judgment and control of the corporation's board of directors. Necessarily such decision must be predicated on the weighing and balancing of a variety of disparate considerations to reach a considered conclusion as to what course of action or inaction is best calculated to protect and advance the interests of the corporation.

Desaigoudar, 108 Cal. App. 4th at 187-88.

Under California law, if a special litigation committee determines in its business judgment that pursuing a derivative claim is not in the corporation's best interest, it may "make a motion in the trial court to dismiss the suit." *Finley*, 80 Cal. App. 4th at 1160 (*quoting Will*, 213 Cal. App. 3d at 1040-41). The SLC's decision to dismiss a derivative claim "must be allowed whenever it is shown that a committee of disinterested directors acting in good faith has determined a derivative action is not in the best interests of the corporation." *Id*. at 1163.

In considering the decision of the SLC, the court does not substitute its judgment for the

SLC's business judgment. *Desaigoudar*, 108 Cal. App. 4th at 189. Rather, a court defers to the special litigation committee's business judgment if it determines (1) the "members of a special litigation committee were independent," *i.e.,* "whether each member was in a position to base his decision on the merits of the issue rather than being governed by extraneous considerations or influences"; and (2) "whether a committee employed proper procedures before rejecting the claim," which "involves an analysis of the committee's good faith" including "the procedures employed." *Id.* (citations omitted).

B. Appointment of the SLC

Apple has an eight-person Board of Directors (the "Board"), consisting of seven outside directors and Tim Cook, Apple's CEO. On April 26, 2016, the Board formed the SLC by unanimous vote, and gave it full responsibility for the claims asserted in the SCAC. The resolution forming the SLC states:

> [T]o the fullest extent permitted by the Bylaws and applicable law, the Special Litigation Committee shall have the authority to investigate and evaluate any and all claims and allegations asserted in the Actions and to pursue, litigate, settle, or otherwise dispose of any and all claims and allegations asserted in the Actions, in whatever manner the Special Litigation Committee deems reasonable and necessary to enable it to discharge its responsibilities.

On July 17, 2016, Apple's Board approved a resolution confirming the SLC's full and exclusive authority over the Actions. The SLC is composed of two Apple directors, Susan L. Wagner and James A. Bell.

1. Susan L. Wagner

Ms. Wagner joined the Apple Board in July, 2014, one month before the derivative action was instituted and at the time the Monitor was preparing his second of four reports. Ms. Wagner has served on Apple's Audit and Finance Committee ("AFC") since August, 2014. Ms. Wagner graduated with honors from Wellesley College with degrees in English and Economics, and earned an MBA in Finance from the University of Chicago, where she has received a Distinguished Alumni Award. After obtaining her MBA, Ms. Wagner worked at Lehman Brothers in New York City where she became a vice president, supporting investment banking

and capital markets activities of mortgage and savings institutions. She left Lehman Brothers in 1988 to co-found BlackRock. BlackRock is currently the largest asset management firm in the world, managing over $5.1 trillion. At BlackRock she served as Vice Chair from 2006 to 2012. She also served as a member of BlackRock's Global Executive Committee and Global Operating Committee, as Chief Operating Officer, and as head of Corporate Strategy, Corporate Development, Investor Relations, Marketing and Communications, Alternative Investments and International client businesses. She also served as Global Executive Sponsor of, and as a Director continues to support, BlackRock's Women's Initiative Network. Ms. Wagner retired in 2012 but continues to serve on the boards of BlackRock and DSP BlackRock (India). Ms. Wagner also serves on the Board of Directors of Swiss Re, Color Genomics, Wellesley College, and the Hackley School. She was named as one of Fortune Magazine's "50 Most Powerful Women in Business," included on similar lists published by the Financial Times and Crain's New York, and honored by the National Council for Research on Women.

2. James A. Bell

Mr. Bell joined the Apple Board in October, 2015, the same month the Monitor was discharged. Mr. Bell has served on Apple's AFC since January, 2016. Mr. Bell received his bachelor's degree in accounting from California State University, Los Angeles. In 1972, Mr. Bell began working at Rockwell International and ultimately became Manager of General and Cost Accounting. In 1996, Mr. Bell became Vice President of Contracts and Pricing at The Boeing Company. In that position, he oversaw policy direction, acquisition reform, new business opportunities and program performance. In 2004, he became Chief Financial Officer of Boeing, at that time a $52 billion, 157,000-person commercial airplane and defense company. From 2008 through 2011, he served as CFO and Corporate President of The Boeing Company. As CFO, Mr. Bell was responsible for the company's overall financial management, reporting, and transparency. He also oversaw multiple corporate functions, including Controller, Treasury, investor relations, corporate and strategic development, and customer-financing activities. Mr. Bell oversaw Boeing Capital Corporation and Boeing Shared Services during his 38-year career

at Boeing, and was interim CEO of The Boeing Company in 2005. Mr. Bell retired from The Boeing Company in 2012.

Mr. Bell has served since 2005 as a director of Dow Chemical Company. In 2011, Mr. Bell joined the Board of Directors and Audit Committee of JP Morgan Chase. He has served since March, 2015, as a director of CDW Corporation, a Fortune 500 company that provides technology solutions to business, government, education, and healthcare. He is a member of the Board of Trustees at Rush University Medical Center. In 2004, Mr. Bell was honored as a Distinguished Alumnus of the College of Business and Economics by California State University, Los Angeles.

C. Retention of Counsel

Shortly after the SLC was formed, its members interviewed several counsel and ultimately retained the law firm of Shartsis Friese LLP ("Shartsis") to assist in conducting its investigation and evaluation. Shartsis had no role in the ebook negotiations or the antitrust litigation, and has never represented any of the individual defendants. Other than a Shartsis real estate partner who worked on two small real estate transactions for Apple between July 2012 and September 2013 (totaling approximately 45 hours of work), Shartsis has never represented Apple in any matters.

Counsel provided the SLC members guidance regarding the legal standards governing SLCs generally, legal standards regarding the claim alleged, and assisted the SLC in conducting its investigation and preparing this Report. Shartsis Partners Arthur Shartsis, Jahan Raissi, Frank Cialone, Larisa Meisenheimer, and Associate (now Partner) Kajsa Minor have had primary responsibility for assisting the SLC as necessary.

Arthur Shartsis received a bachelor's degree in 1967 from the University of California at Berkeley where he was valedictorian. He pursued graduate studies at Oxford University in 1968, and obtained a juris doctor in 1971 from Berkeley Law (Boalt Hall). In 1975, he co-founded Shartsis Friese LLP. He specializes in complex litigation, including fiduciary, financial, antitrust, and securities litigation. He has represented major corporations, global law firms,

federal and state court judges, public entities, a number of California Constitutional Officers, including the Governor, and the States of California and Hawaii. He has tried cases in state and federal courts and in arbitration forums and argued cases in state and federal appellate courts, including the California Supreme Court, and he successfully opposed a petition for a writ of certiorari to the United States Supreme Court. He has been listed in *Best Lawyers in America* since 1991. The Los Angeles and San Francisco Daily Journal identified Mr. Shartsis in its special American Bar Association Convention Edition as one of the top 14 litigators in California. He is the founding President of the Association of Business Trial Lawyers of Northern California. He was elected to, and served as President of, the BART Board of Directors.

Jahan Raissi is the Chair of Shartsis' Securities Enforcement Defense Group. He obtained his juris doctor from the University of California, Hastings College of the Law *cum laude* in 1993. He was a Senior Counsel in the Division of Enforcement of the Securities and Exchange Commission in Washington D.C., where he handled investigations and litigation involving, among other things, internal corporate controls, public company disclosures and periodic reports, and insider trading. He represents boards, officers, directors and entities before federal and state securities regulators, before self-regulatory organizations and in private litigation. He has represented individuals and corporations with regards to derivative claims. His principal areas of practice are SEC enforcement matters, DOJ/US Attorney investigations, securities litigation, internal investigations, and regulatory compliance.

Frank Cialone co-chairs Shartsis' Litigation Department. He obtained a bachelor's degree from Brown University in 1987 and a juris doctor from the University of California at Berkeley in 1994. His practice focuses on fiduciary litigation matters, including disputes involving the duties of directors and officers. He counsels clients at all stages of disputes, from pre-filing negotiations to litigation through arbitration or trial.

Larisa Meisenheimer co-chairs Shartsis' Litigation Department. She obtained a bachelor's degree *cum laude* from Pomona College in 1999 and a juris doctor from Stanford Law

School in 2003, where she graduated Order of the Coif. She was a Deputy District Attorney in Multnomah County (Portland), Oregon, where she tried more than 20 cases, and regularly argued constitutional motions and civil commitment hearings. She has extensive experience counseling clients on antitrust and unfair competition law and representing clients in antitrust and unfair competition litigation.

D. The SLC is Independent

A properly formed special litigation committee is comprised of board members capable of independently and objectively investigating the underlying claims and making a determination of the company's best interests with regard to those claims. Independence is an issue of fact. *Gaines v. Haughton*, 645 F.2d 761, 772 (9th Cir. 1981) (affirming dismissal of derivative suit because plaintiff "has not raised a triable issue of fact" as to independence). Where a director is subject to "direct and substantial" liability for the claims investigated by a special litigation committee, that director may lack the requisite independence to serve on the committee. *Johnson v. Hui*, 811 F. Supp. 479, 486 (N.D. Cal. 1991).

Ms. Wagner and Mr. Bell are independent board members as to the claim against Cue arising from conduct in 2009-2010. Neither was on the Board at the time of the ebook negotiations and neither is subject to any possible liability for the claim alleged against Cue. Ms. Wagner joined Apple's Board in July 2014, which was more than four years after the events involving Cue and the ebook negotiations, and one year after the District Court's Antitrust Order was issued. Mr. Bell joined the Board later, in October, 2015. Neither SLC member has any risk of liability as a result of the 2009-2010 conduct at Apple.

The Derivative Plaintiffs have asserted that Ms. Wagner is not independent because Plaintiffs sued Ms. Wagner for conduct after July 2014 (over four years after the period involving Cue), and she demurred to their claim. However, uniform case law establishes that the fact that Ms. Wagner is a defendant does not call her independence into question even for the 2014-2015 period. *Moradi v. Adelson*, 2012 U.S. Dist. LEXIS 121092, at *12 (D. Nev. Aug. 27, 2012) ("[M]erely being named as defendants does not establish that [special litigation committee

members] are not independent."). The fact that Ms. Wagner demurred to Plaintiffs' ACC does not compromise her independence. Once sued, a director—particularly a director who has no liability and about whom no specific facts are alleged—is entitled to defend herself, and does not have to choose between losing independence or defending herself. *See Strougo ex rel. Brazil Fund v. Padegs*, 986 F. Supp. 812, 815 (S.D.N.Y. 1997) (rejecting plaintiff's argument that an SLC member who was a defendant lacked independence because he moved to dismiss the claims).

In evaluating the SLC's independence, the court looks not at the allegations of the complaint but at the facts and evidence. *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, 928-29 (Del. Ch. 2003) (in reviewing SLC's motion to terminate, the court is required "to determine whether, on the basis of the undisputed factual record," the SLC was independent). Plaintiffs' allegations against Ms. Wagner relate solely to her status as a board member during the latter half of the Monitorship starting in late 2014, and not Apple's conduct, Cue's conduct, or Board oversight of Cue during the ebook negotiations in 2009-2010. There are no actionable facts alleged against Ms. Wagner in the SCAC either for the period involving Cue or the period Ms. Wagner has served on the Apple Board. Because there are no factual allegations against Ms. Wagner in the SCAC, the SLC made a specific written request of Plaintiffs to provide any actionable facts, and also to provide facts probative of any lack of independence. No substantive response was received from Plaintiffs. *See* Section VIII.D., below.

The Superior Court's Order Re Demurrer addressed the issue of whether directors, including Ms. Wagner, who had been sued in the Derivative Action only for conduct related to the Monitor period (after September 4, 2013) can or cannot act for the corporation to determine whether claims exist against Cue for the period ending in April 2010. The Court concluded that they can. In the Order Re Demurrer, the Superior Court addressed the Plaintiffs' failure to make a demand on the Board to undertake the claims concerning the first period involving Cue. The Plaintiffs had claimed that such a demand was futile because the directors lacked the independence necessary to make an objective determination of the corporation's interest with

regard to the claims commencing with that first period. The Court described demand futility as follows: "A demand is typically deemed futile when a majority of the directors participated in or approved the wrongdoing or are financially interested in the transactions." *Order Re Demurrer* at 6. The Court concluded that as to directors who "became Board members after the Board allegedly failed to implement adequate oversight procedures before April 2010 [the Cue period], Plaintiffs have not pleaded futility based on the fact that these individuals were members of the Board at the time of the filing of this action." *Id.* at 11. The Court concluded that "Plaintiffs have not alleged particular facts to show that [other directors and] Wagner … were members of the Board at the time of the misconduct and when they commenced this action. Plaintiffs have not otherwise alleged facts to raise a reasonable doubt as to their disinterest and independence." *Id*. Based on the analysis of director disinterest and independence in the Order Re Demurrer, the Superior Court has already determined that SLC member Ms. Wagner is an independent director for the purposes of demand futility.

The SLC's counsel is also independent. "'[I]ndependent' counsel" for purposes of a special litigation committee, "means counsel that was not associated with the challenged transactions." *Desaigoudar*, 108 Cal. App. 4th at 195. Shartsis Friese had no role whatsoever in, or related to, the ebook negotiations, the related antitrust litigation, or the Monitorship.

VIII. THE SLC'S INVESTIGATION

As stated above, the SLC had the benefit of a voluminous trial record from the Antitrust Action, which includes sworn deposition testimony, trial affidavits, trial testimony, and documents, as well as the opinions of the District Court and the Second Circuit. The SLC supplemented its review of that material by reviewing additional documents and interviewing relevant witnesses. Below is a summary of the SLC's investigative work.

A. Documents Reviewed

The SLC and its counsel obtained a large volume of documents from Apple and publically available sources relevant to the claim asserted in the SCAC. In total, the SLC's counsel reviewed more than 17,000 documents. The SLC and its counsel's review included the

following documents:

- Documents regarding Apple's antitrust compliance policies from 2009 to the present
- All documents and emails produced by Apple in the Antitrust Action authored by or sent to Steve Jobs between 11/1/09 and 4/1/10
- All documents and emails produced by Apple in the Antitrust Action authored by or sent to Eduardo Cue between 11/1/09 and 4/1/10
- All documents and emails produced by Apple in the Antitrust Action authored by or sent to Kevin Saul between 11/1/09 and 4/1/10
- All documents and emails produced by Apple in the Antitrust Action authored by or sent to Keith Moerer between 11/1/09 and 4/1/10
- Contracts with the Publishers concerning ebooks
- Deposition transcripts and exhibits for Apple employees in the Antitrust Action:
    - Alcorn, Peter
    - Cook, Tim
    - Cue, Eddy
    - Fortstall, Scott
    - Gray, Eric
    - Kellermann, Beth
    - Lilie, Barbara
    - McDonald, Robert
    - Moerer, Keith
    - Robbin, Jeffrey
    - Saul, Kevin
    - Schiller, Phil
    - Tchao, Michael
- Deposition transcripts and exhibits for Publishers in the Antitrust Action:
    - Dohle, Markus
    - Eulau, Dennis

- Foy, Fritz
    - Gigante, Alexander
    - Heffernan, Richard
    - Hely-Hutchinson, Timothy
    - Hirschhorn, Elinor
    - Hulse, Leslie
    - Kennedy, Susan
    - Lazarus, Alison
    - Makinson, John
    - McCall, Tim
    - McIntosh, Madeline
    - Murray, Brian
    - Napack, Brian
    - Nourry, Arnaud
    - Protti, Casey
    - Reidy, Carolyn
    - Salat, Rudiger
    - Sargent, John
    - Shanks, David
    - Shore, Genevieve
    - Stroh, Jane
    - Thomas, Maja
    - Williams, Coram
    - Young, David
- Pre-trial submissions in the Antitrust Action
- Opening statements and closing arguments in Antitrust Action

- Trial testimony and exhibits (excluding certain third-party internal documents) for all fact witnesses in the Antitrust Action:
    - Cue, Eddy
    - Grandinetti, Russell
    - Horner, Theresa
    - McDonald, Robert
    - Moerer, Keith
    - Murray, Brian
    - Naggar, David
    - Porco, Laura
    - Reidy, Carolyn
    - Sargent, John
    - Saul, Kevin
    - Shanks, David
    - Turvey, Thomas
    - Young, David
- Briefing and Circuit Court opinion related to Apple's appeal of Judge Cote's Final Judgment
    - 7/14/2014 Appellant Apple's Opening Brief
    - 7/14/2014 Appellant Apple's Reply Brief
    - 7/15/2014 Appellees United States and Plaintiff-States Joint Brief
    - 6/30/2015 Second Circuit Opinion
- Briefing, orders, and hearing transcripts relating to the injunction issued by Judge Cote and the appointment of the Monitor
    - 8/2/2013 Plaintiffs' Memorandum of Law ISO Proposed Injunction
    - 8/2/2013 Apple's Memorandum of Law in Response to Proposed Injunction

- 8/7/2013 Settling Defendants' Memorandum of Law in Opposition to Proposed Injunction
- 8/8/2013 Letter from Department of Justice
- 8/23/2013 Plaintiffs' Memorandum of Law In Support of Revised Proposed Injunction
- 8/23/2013 Declaration of L. Buterman In Support of Plaintiffs' Revised Proposed Injunction
- 8/26/2013 Letter from Apple
- 8/27/2013 Transcript of Proceedings Held 8/27/2013
- 9/5/2013 Letter from Department of Justice
- 9/5/2013 Judge Cote Order re Injunction and Final Judgment
- 10/16/2013 Judge Cote Order re Appointing Monitor

- Briefing, orders, and hearing transcripts related to Apple's challenges to the Monitor and efforts to stay the Monitorship
  - 10/16/2013 Order
  - 11/21/2013 Order
  - 11/27/2013 Objections Re Order
  - 11/27/2013 Declaration of Theodore J. Boutrous In Support of Objection to Order
  - 12/2/2013 Order
  - 12/13/2013 Order
  - 12/14/2013 Defendant Apple's Memorandum Of Law In Support Of Its Motion By Order To Show Cause For A Stay Of The Injunction Pending Appeal
  - 12/14/2013 Declaration of G. Levoff
  - 12/14/2013 Declaration of T. Boutrous
  - 12/14/2013 Letter Addressed To Judge Denise L. Cote From Lawrence Buterman Re: Apple's Proposed Order To Show Cause
  - 12/23/2013 Transcript for Hearing on Dec. 13, 2013
  - 12/30/2013 Plaintiffs' Memorandum of Law in Opposition to Apple Inc.'s Motion to Show Cause for a Stay of the Injunction Pending Appeal
  - 12/30/2014 Declaration of Michael R. Bromwich in Opposition to Apple

Inc.'s Motion to Show Cause for a Stay of the Injunction Pending Appeal

  - 1/7/2014 Letter Addressed To Judge Denise L. Cote From Theodore J. Boutros Jr. Re: Objections To The External Compliance Monitor
  - 1/7/2014 Declaration of C. Richman
  - 1/7/2014 Reply Memorandum In Support of Apple's Motion By Order To Show Cause For A Stay Of The Injunction Pending Appeal
  - 1/7/2014 Declaration of K. Andeer
  - 1/7/2014 Declaration of M. Reilly
  - 1/7/2014 Declaration of T. Boutrous
  - 1/8/2014 Letter Addressed To Judge Denise L. Cote From Lawrence E. Buterman Re: Apple's Reply Memorandum
  - 1/10/2014 Plaintiffs' Sur-Reply in Opposition to Apple Inc.'s Motion to Show Cause for a Stay of the Injunction Pending Appeal
  - 1/10/2014 Supplemental Declaration of Michael Bromwich
  - 1/16/2014 Order
  - 2/19/2014 Order
  - 2/20/2014 Letter Addressed To Judge Denise L. Cote From Theodore J. Boutrous, Jr. Re: Monitorship Issues
  - 2/20/2014 Order

- Unredacted versions of the four Monitor Reports, including all exhibits
  - April 14, 2014 - First Monitor Report
  - October 14, 2014 - Second Monitor Report and Exhibits A - F
  - April 14, 2015 - Third Monitor Report and Exhibits A - G
  - October 5, 2015 - Fourth Monitor Report and Exhibits A - Q

- Briefing and orders relating to the discharge of the Monitor
  - 10/5/2015 - Order - Discharge Order
  - 10/6/2015 - Letter Addressed To Judge Denise L. Cote From Michael R. Bromwich In Response To The Court's October 5, 2015 Order Concerning, Among Other Matters, The Fourth Report Of The External Compliance Monitor
  - 10/12/2015 - Letter Addressed To Judge Denise L. Cote From Plaintiffs And

Apple Re: October 5, 2015 Order Instructing The Parties To Provide Positions In Writing On Whether The Monitorship Should Be Extended

    - 10/13/2015 - Order

- All correspondence between the Monitor and Apple or Apple's counsel
- Published articles regarding the Monitorship
- Apple's Bylaws in effect since 2009
- Relevant Board Packages, agendas, and minutes from January 2009 to August 2016
- Board resolutions regarding the SLC
- Relevant Audit and Finance Committee agendas, packages, and minutes from January 2009 to May 1, 2016
- Reports presented by Apple's Antitrust Compliance Officer and her communications with the Board from November 2013 to August 2016
- Reports presented by Apple's Chief Compliance Officer to the Board from January 2009 to August 2016
- Reports presented by Apple's VP of Internal Audit to the Board from January 2009 to May 1, 2016
- Apple Form DEF 14A Annual Proxy Statements filed with the SEC
- PricewaterhouseCooper LLP's Report regarding Apple's antitrust policies
- Apple's Indemnity Agreements with its officers and directors
- *Steve Jobs,* Walter Isaacson (Simon & Schuster 2011) (quoted extensively in the SCAC)

B. Interviews

The SLC, with and through counsel, conducted fifteen formal interviews. The SLC members participated in interviews of Apple directors and key employees, as well as the interview of the Monitor. In addition to those interviews, counsel conducted a number of interviews with Apple's outside counsel and other Apple employees with relevant information. The following individuals were formally interviewed in connection with the SLC's investigation:

- Andeer, Kyle - Apple Senior Director, Sales & Retail/Competition Law & Policy

- Bromwich, Michael - Court Appointed Monitor
- Cue, Eduardo - Apple Senior Vice President, Internet Software and Services
- Drexler, Millard S. - former Apple Board Member
- Gore Jr., Albert - Apple Board Member
- Jung, Andrea - Apple Board Member, Chair of Compensation Committee
- Levinson, Dr. Arthur D. - Apple Board Member, Board Chair
- Moerer, Keith - Apple Director, iBooks
- Moyer, Tom - Apple Chief Compliance Officer, Head of Global Security
- Putnam, Sara - PricewaterhouseCoopers LLP Partner
- Reilly, Matthew - Former Simpson Thacher & Bartlett LLP Partner
- Richman, Cynthia - Gibson Dunn & Crutcher LLP Partner
- Said, Deena - Apple Antitrust Compliance Officer
- Sugar, Dr. Ronald D. - Apple Board Member, Chair of Audit and Finance Committee
- Vetter, Doug - Apple Vice President, Associate General Counsel, Assistant Secretary

The SLC requested but was denied meetings with the attorneys at the Department of Justice who prosecuted the Antitrust Action, with counsel for the class action plaintiffs, and with counsel for the Derivative Plaintiffs.

C. SLC Meetings

In addition to phone calls and emails, the SLC formally met fourteen times, and maintained minutes of those meetings.

D. SLC Requests For Information From the Derivative Plaintiffs

Since its inception, the SLC has requested meetings with and sought information from the Derivative Plaintiffs concerning the legal and factual bases of their claims. Counsel for Plaintiffs did not provide any substantive responses to those requests, or agree to meet with the SLC. The SLC sent the following requests for meetings and information to the Derivative Plaintiffs:

- June 8, 2016 Letter: The SLC requested to meet with the Plaintiffs' counsel in July when all parties were scheduled to be at a conference with the Superior Court and

proposed alternate dates for such a meeting and video conferencing for any additional Plaintiffs' attorneys who might want to attend. The SLC requested that the Plaintiffs provide information to assist its investigation, including: any relevant facts about each defendant; anything not pleaded in the SCAC, but relevant to the SLC's consideration; facts concerning damages; information regarding compliance or non-compliance by Apple with any court orders; and any other information that could be relevant to the SLC's investigation.

- June 23, 2016 Letter: The SLC requested a response to its June 8 Letter and again requested a meeting with Plaintiffs' counsel while they were scheduled to be in town for a conference with the Superior Court.
- July 14, 2016 Letter: The SLC requested a response to its June 8 Letter and again requested a meeting with Plaintiffs' counsel while they were scheduled to be in town for the hearing on the SLC's motion to stay.
- September 26, 2016 Letter: The SLC requested a meeting with Plaintiffs' counsel in either San Francisco or San Diego. The SLC further requested that Plaintiffs provide any evidence or information showing that Cue was an officer of Apple at the time of the ebook negotiations, any evidence that he had actual knowledge or reason to know that the contracts were illegal, and any other information that could be relevant to the SLC's investigation.
- November 16, 2016 Letter: The SLC requested that Plaintiffs provide information concerning attorney Kevin Saul, including the evidence on which Plaintiffs rely to assert that Saul was acting only in a "business capacity" during the ebook negotiations and not as a lawyer for Apple.
- November 29, 2016 Letter: The SLC requested that Plaintiffs provide information to support Plaintiffs' claim that Ms. Wagner lacks independence to serve on the SLC, and any evidence to support any claim against Ms. Wagner.

IX. ANALYSIS AND CONCLUSIONS

A. Plaintiffs' Fiduciary Duty Claim Against Cue Fails Because Cue Was An Employee, Not An Officer, During The EBook Negotiations

The Derivative Plaintiffs allege a single claim against Cue for breach of fiduciary duty as an "officer" of the corporation. To state a claim for breach of fiduciary duty, a complaint must allege the existence of a fiduciary duty, its breach, and damages. *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 68 Cal. App. 4th 445, 483 (1998). "The absence of any one of these elements is fatal to the cause of action." *Pierce v. Lyman*, 1 Cal. App. 4th 1093, 1101 (1991).

At the time of the ebook negotiations in 2009-2010, Cue was an employee of Apple with the title of Vice President, Internet Services. He was not made an officer of Apple until September 2, 2011. Under California law, an individual can only become an officer through selection by the board of directors or as provided for in the corporation's articles of incorporation or bylaws. Cal. Corp. Code § 312(b) ("Except as otherwise provided by the articles or bylaws, officers shall be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment.").

Apple's Bylaws in effect as of May 2009 expressly provided that the Board of Directors selects the officers of Apple. Section 3.1 states that "[t]he Corporation may also have, at the discretion of the Board of Directors, … one or more Vice Presidents … and such officers as may be appointed in accordance with the provisions of Section 3.3 of these Bylaws." Section 3.2 provides that, except for officers appointed under Section 3.3, the Board shall choose the officers of Apple and that such officers shall serve at the pleasure of the Board. Section 3.3 provides that the Board can either appoint, or empower the CEO to appoint, a number of other officers. However, where the CEO appoints an officer, the appointment must be disclosed to the Board at the next meeting and noted in the minutes pursuant to Section 14. Accordingly, a person can only become an officer under the Bylaws by selection by the Board or by selection by the CEO that is shortly thereafter disclosed to the Board and noted in the minutes.

On August 24, 2011, Cue was promoted to the position of Senior Vice President, Internet Services of Apple. On September 2, 2011, Apple's Board ratified Cue's appointment as Senior Vice President, and voted unanimously to designate Cue "an 'officer' of the Corporation for purposes of the California Corporations Code, an 'executive officer' for purposes of the Exchange Act and an 'officer' for purposes of Section 16 of the Exchange Act…" The appointment was duly reflected in the Board's November 2011 meeting minutes.

There is no evidence that the Board appointed Cue as an officer, or was notified of an appointment of Cue as an officer, at any time prior to 2011. Accordingly, because Cue was an employee during the ebook negotiations, not an officer, the derivative claim asserted against Cue for breach of fiduciary duty of an officer fails. *Pierce*, 1 Cal. App. 4th at 1101 (to plead a cause of action for breach of fiduciary duty, there must be a fiduciary relationship).

Nevertheless, even if Cue was subject to the fiduciary duties of an officer of Apple during the ebook negotiations, his good faith reliance on counsel at the time precludes a claim for breach of fiduciary duty. The Superior Court in its Order Re Demurrer found that the Derivative Plaintiffs' allegations concerning attorney Kevin Saul's involvement in the ebook negotiations precluded a breach of fiduciary duty claim against Cue as a matter of law.[8] *Order Re Demurrer* at 21-22 (Sustaining demurrer to breach of fiduciary duty claim against Cue as an officer "because he acted with advice from counsel while negotiating the [publisher] agreements and Plaintiffs do not allege that he acted without good faith."). The SLC's investigation has confirmed that Cue relied on counsel during the ebook negotiations.

Moreover, the SLC's investigation did not reveal any evidence that Cue violated the fiduciary duty of an officer during the ebook negotiations. Officers of California corporations, like directors, owe a duty of "highest good faith to the corporation and its stockholders." *Burt v. Irvine Co.*, 237 Cal App. 2d 828, 850 (1965); *see also Wolf v. Superior Court,* 107 Cal. App. 4th 25, 29 (2003) ("A fiduciary relationship is any relation existing between parties to a transaction

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[8] The fact that Cue was an employee at the time of the ebook negotiations, and not an officer, was not before the Superior Court when it considered Cue's demurrer to the ACC.

wherein one of the parties is in duty bound to act with the utmost good faith for the benefit of the other party.") (internal quotations and citation omitted).

Officers of California corporations generally owe the same fiduciary duties of care and loyalty as directors. *See* Harold Marsh, Jr., et al., Marsh's California Corp. Law, § 11.02 (4th Ed. 2000); *In re Walt Disney Co. Derivative Litig.*, 2004 Del. Ch. LEXIS 132, *14 (Del. Ch. Sept. 10, 2004) ("the fiduciary duties of officers have been assumed to be identical to those of directors"). The duty of loyalty generally requires an officer to put the interests of the corporation always above his or her own personal interest.

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing throughout the years, derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.

Bancroft-Whitney Co. v. Glen, 64 Cal. 2d 327, 345 (1966) (*quoting Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939)); *In re The Walt Disney Co. Deriv. Litig.*, 2004 Del. Ch. LEXIS 132, at *24, n.49 (Del. Ch. Sept. 10, 2004) (noting that the "duty of loyalty ... imposes an affirmative obligation to protect and advance the interests of the corporation."). The majority of cases regarding an officer's duty of loyalty involve transactions between an officer and the corporation and the conditions and requirements applicable to such a transaction. *See* Harold Marsh, Jr., et al. Marsh's California Corp. Law, § 11.06 (4th Ed. 2000). The SLC has found no evidence that Cue intentionally acted against Apple's interest, or acted in his own self-interest, to support a claim for breach of an officer's duty of loyalty against him.

The duty of care requires that officers act with good faith and on an informed basis in making a business decision. *See* Edward Brodsky and M. Patrici Adamsky, Law of Corporate Officers and Directors: Rights, Duties and Liabilities (2016-7) at 2:13. The SLC has found no evidence that Cue violated an officer's duty of care. As explained further below in Section

IX.B.2., the SLC determined that Cue had no reason to believe his conduct violated antitrust laws, and he relied on Apple's counsel, Saul, from the inception of the ebook negotiations, consistent with a corporate officer's obligation to act with the utmost good faith and with care.

B. Apple Is Unlikely To Succeed On a Claim Against Employee Cue

The SLC has examined whether to pursue a claim against Cue for his conduct as an employee during the ebook negotiations. Under California law, while not fiduciaries, "[e]very employee owes his or her employer duties of undivided care and loyalty." *Janken v. GM Hughes Electronics*, 46 Cal. App. 4th 55, 74 (1996). The SLC has determined that the facts here do not support a claim against Cue for either a breach of the duty of loyalty or care.

1. Cue Did Not Violate His Duty of Loyalty to Apple

An employee's duty of loyalty refers to the duty not to compete or act contrary to the employer's best interest. "[A]n employer has the right to expect the undivided loyalty of its employees. The duty of loyalty is breached, and may give rise to a cause of action in the employer, when the employee takes action which is inimical to the best interests of the employer." *Stokes v. Dole Nut Co*., 41 Cal. App. 4th 285, 295 (1995). "'Inimical' means 'being adverse often by reason of hostility or malevolence,' or 'having the disposition of an enemy.'" *Blackbird Techs., Inc. v. Joshi,* 2015 U.S. Dist. LEXIS 136505, at *12 n.3 (N.D. Cal. Oct. 6, 2015) (citing Merriam-Webster's Collegiate Dictionary, 643 (11th ed. 2003)).

Generally, an employer's claim against an employee for breaching the duty of loyalty involves allegations that an employee competed or planned to compete with his or her employer during employment. For example, the court in *Stokes* dealt with the issue of employees who had made significant efforts during their employment toward establishing a competing business. *Stokes*, 41 Cal. App. 4th at 295. The court explained that an employer's "right to undivided loyalty is compromised when an employee's outside activities give rise to a possibility of personal influences." *Id*. at 296. *See also, Ikon Office Solutions, Inc. v. Rezente,* 2011 U.S. Dist. LEXIS 40053, at *8 (E.D. Cal. Apr. 13, 2011) (duty of loyalty claim stated where employer alleged that employee "sabotaged" her work during employment, while preparing to leave and

compete with employer); *Blackbird Techs.*, 2015 U.S. Dist. LEXIS 136505, at *15-16 ("Defendant took actions 'inimical' to his former employer when he made significant progress toward organizing a competing business, in secret," while employed). Therefore, an employee's duty of loyalty is breached when the employee intentionally takes actions adverse to the employer's interests.

Cue's conduct during the ebook negotiations does not support a claim for breach of Cue's duty of loyalty to Apple. Plaintiffs do not allege that Cue engaged in self-dealing at Apple's expense, or intentionally engaged in actions that were inimical to Apple's interests. Plaintiffs do not allege that Cue intended to violate any laws or even knew that he was violating any laws, or that he intended to harm Apple. To the contrary, Plaintiffs allege that Cue was motivated by a desire to "have the Company enter the e-book market as a final thanks to Jobs." SCAC, ¶ 3. The District Court described Cue's motives as follows: "Cue knew that Jobs was seriously ill and that this would be one of his last opportunities to bring to life one of Jobs's visions and to demonstrate his devotion to the man who had given him the opportunity to help transform American culture." *Apple,* 952 F. Supp. 2d at 655.

The SLC's investigation did not reveal any evidence that Cue acted with an interest adverse to Apple's interests. Cue's goal was to negotiate and execute agreements that, as he understood at the time, were in Apple's interest—to acquire significant content on a profitable basis to ensure a successful iBookstore as a feature of the new iPad. There is no evidence that Cue believed at the time that his conduct, or that of anyone he was working with, violated the antitrust laws (*see* Section IX.B.2.d., below).

In summary, the SLC has discovered no evidence to support a direct or derivative claim that Cue breached his duty of loyalty to Apple.

2. Cue Did Not Violate His Duty of Care to Apple

An employee's duty of care to his or her employer is prescribed by California Labor Codes. An employee has a duty to use ordinary care and diligence in performing his or her job, following his or her employer's directives, using the skills he or she possesses. Cal. Lab. Code

§§ 2854, 2856, 2859. "An employee who is guilty of a culpable degree of negligence is liable to his employer for the damage thereby caused to the employer." Cal. Lab. Code § 2865. "Ordinary care" is defined as that degree of care that ordinarily prudent people can be reasonably expected to exercise under similar circumstances. *Hilyar v. Union Ice Co*., 45 Cal. 2d 30, 36 (1955). Thus, employees are subject to a negligence standard. *See also Dahl-Beck Electric Co. v. Rogge,* 275 Cal. App. 2d 893, 907 (1969).

Employers cannot recover from a negligent employee if the employer authorized or participated in the employee's conduct. *Pacific Indem. Co. v. Truck Ins. Exchange*, 269 Cal. App. 2d 420, 426 (1969) ("In California an employer may recover from his employee for loss to the employer which has been caused by the employee's negligence, which the employer has not authorized and in which he has not participated."); *see also Continental Casualty Co. v. Phoenix Constr. Co*., 46 Cal. 2d 423, 428 (1956) ("Where a judgment has been rendered against an employer for damages occasioned by the unauthorized negligent act of his employe[e], the employer may recoup his loss in an action against the negligent employe[e].").

Employers also cannot recover from an employee if the employer is found to share blame for the losses it seeks to recover from its employee. *Joses v. Navistar Int'l Transp. Corp.*, 1996 U.S. Dist. LEXIS 12064, at *23-24 (N.D. Cal. Aug. 5, 1996) (Illston, J.) (rejecting employer's claims for equitable indemnity and violation of the Labor Codes because the employee and employer were equally at fault).

The SLC has determined that the facts do not support a claim for breach of duty of care against Cue. Plaintiffs allege that Cue was "at least negligent in performing his duties" but they do not allege facts demonstrating that an ordinarily prudent person in Cue's position would reasonably have known that his conduct constituted an antitrust violation. SCAC, ¶ 330. Plaintiffs' allegations that Cue's conduct was "authorized" by Apple's CEO, Steve Jobs, and that Apple executives, including "senior legal personnel," were also involved in the illegal conduct was confirmed by the SLC's investigation, and likely bars recovery against Cue for negligence under California law. *See e.g*., *id.*, ¶ 182 ("Apple senior executives, including defendant Cue,

understood and intended that the final Apple agency agreements ensure that the Publishing Group members would raise their retail e-book prices ….”); *Pacific Indem.*, 269 Cal. App. 2d at 426; *Joses*, 1996 U.S. Dist. LEXIS 12064, at *23-24.

As described below, the SLC has determined that Cue's conduct was authorized and approved by Apple's CEO, Cue was at all times advised by Apple's counsel, Cue did not violate Apple's then-existing Antitrust Policy, and Cue reasonably believed that his conduct and the transactions were legal. These facts would preclude Apple from succeeding on a claim against Cue for breach of any of his duties as an employee.

(a) Apple's CEO Authorized and Actively Participated in Cue's Activities

Apple CEO Steve Jobs directed Cue to negotiate agreements with Publishers, gave him a very short timeframe to complete those negotiations before the iPad launch, received detailed updates regarding the status of the negotiations, directly negotiated with one of the Publishers, and understood and approved the transactions negotiated by Cue.

- In November 2009, Jobs directed Cue to "pursue an ebookstore" for Jobs to announce in January 2010.
- Cue emailed Jobs twice on December 9, 2009, regarding two Wall Street Journal articles concerning ebook windowing by HarperCollins, Simon & Schuster and Hachette, one of which noted that "the debate over the timing and pricing of e-books" was "heat[ing] up."
- Cue emailed Jobs on December 9 that he had spoken to the CEOs of Random House and HarperCollins, "They are all really unhappy with the $9.99 from Amazon but all their responses suck." He asked Jobs to call him to discuss.
- Cue emailed Jobs regarding "Books update" on Saturday, December 12, "On Tue and Wed, I will be meeting with the biggest book publishers and their CEO's in NY. This includes Random House, Hachette, Penguin, MacMillan, Harper and Simon & Schuster. I will be taking Keith Moerer and Pat Fitzgerald, from my team, with me.

Both of them will be my points to get all the deals done. I want to go meet with them myself first to understand their current positions on ebooks and get the basic framework for our deal."

- Cue emailed Jobs regarding "Books-Publisher Update" on December 16, while in New York, stating "Here is what I have found after meeting with 3 publishers today. Tomorrow, we see 3 more. … Clearly, the biggest issue is new release pricing and they want a proposal from us." He provided detailed notes of each meeting.
- Cue emailed Jobs another "Book Publisher Update" on December 21, writing, "I had good meetings with 3 publishers. All the talks went well and everyone understood our position and thought it was reasonable. They saw both the plus (solves Amazon issue) and negative (little less than they would like). … They are all going to call me back by Wed."
- Cue emailed Jobs on December 31, writing that "Amazon is now claiming to have 390,000 ebooks. … Once we have deals with the 6 majors, it should be relatively easy to get the other publishers."
- Cue emailed Jobs on January 11, "All 6 major publishers will get our agreement by noon today. Keith Moerer, on my team, will be in NY tomorrow meeting with all of them to discuss any issues. The goal is to get at least 2 of them to sign this week. Either way, I will go to NY next week to try to close them all."
- Cue and Jobs emailed on January 12 about meeting with James Murdoch, CEO of Europe and Asia for News Corp, and Jon Miller, chief digital officer for News Corp, which owns HarperCollins. Cue wrote: "Their interest is from hearing all the tablet rumors and is there any opportunity for their content."
- Cue emailed Jobs on January 13, "We met with 3 book publishers (Penguin, Hachette and HarperCollins) yesterday. … They want to work with us and think we would be great for the industry and customers but if the only choice is take $5-6 less for an ebook than today, they would prefer to holdback on Amazon and play that out." He

wrote that Penguin and Hachette were both "willing to do an agency model" and "go agency model for new releases with everyone else."

- On January 14, Cue emailed Jobs about the meeting with Murdoch that day, including as an agenda item, "discuss books as they own HarperCollins (they are the worst of the 6 as to what they think ebooks should sell for; they want agency and are holding back)."
- Cue emailed Jobs his "Book Prices Thoughts," on January 14, providing a list of proposed price tiers based on list price of physical books, and stating "Here is the pricing I think will push them to very edge and still have a credible offering in the market. These are the highest individual iTunes prices as each publisher can choose a lower price if they want."[9]
- Jobs emailed Cue on January 14 regarding his keynote presentation for the iPad launch, writing that the ebook prices on the presentation were $9.99. "Is that what we want? Please get with Greg and sort this out."
- Cue emailed Jobs a "Book Publisher Update" on January 21, "I'm confident we have 2 even though not yet signed. … If I get a no from them then I think you should call them to make a final attempt. … If there was anything reasonable for us to give on, I would have called you but the more I talk to them and learn about their business the better and more fair I think our deal is." He noted that both MacMillan and Hachette had "legal concerns over price matching."
- Cue emailed Jobs on January 22, with an update on HarperCollins: "they want to work with us but only if we take new releases 90 days after release or we reduce our agency fee from 30% to 10%. His real motives are to either drive ebook prices sky high to $17.99-19.99 or for us to make nothing at $12.99/14.99 so it is the equivalent

[9] Five emails that appear to be drafts written by Jobs in response to this email, but not sent to Cue or anyone else, were introduced at trial in the Antitrust Action. Those draft emails show that Jobs was not only closely involved in Cue's negotiations with Publishers and aware of their status, but also directed Apple's position regarding material terms.

for him. … HarperCollins is owned by Fox so a call to James Murdoch might help. You can tell him we have 3 signed so there is no leap of faith here either."

- On January 22, Cue emailed Jobs twice regarding Hachette, saying that he would give Jobs an update after he spoke with their CEO, and later reporting that he had had a "great meeting." Cue also reported on the status of the remaining publishers, including that Penguin wanted "assurance" that four of the big six publishers were signing with Apple before it would sign.
- On January 22, Jobs emailed Cue that he had "a nice talk with James Murdoch. He will call Brian [CEO of HarperCollins] and get back to me soon." Cue emailed Jobs later that day that, "Unfortunately, your call to Murdoch didn't work. His proposal gets worse each time."
- On January 23, Jobs forwarded to Cue the email that he had sent to James Murdoch that day, wherein he attempted to persuade Murdoch to have HarperCollins accept Apple's terms, writing, "So, yes, getting around $9 per new release is less than the $12.50 or so that Amazon is currently paying. But the current situation is not sustainable and not a strong foundation upon which to build an ebook business. And the amount we pay should be gross margin neutral. Apple is the only other company currently capable of making a serious impact, and we have 4 of the 6 big publishers signed up already. Once we open things up for the second tier of publishers, we will have plenty of books to offer. We'd love to have HC among them."
- Cue emailed Jobs another "Book Publisher Update" on January 23, that no contracts were signed that day. "At this point, there are no material issues with the agreement but that can obviously change until they get signed." He blamed the "very slow" pace of the negotiations on the publishers and their counsel, "The process is very slow because they have never done an agreement like this and given all the issues they have had with their existing partners, they want to make sure they don't make a huge

mistake. In addition, all these guys use external lawyers to review what their internal ones do so it makes everything slower."

- On January 24, Cue emailed Jobs, "1 signed, 3 to go … TOMORROW IS BIG DAY!!!" and included details on the status of each publisher.
- On January 24, Jobs forwarded to Cue another email he sent to James Murdoch, where Jobs attempted to persuade Murdoch to accept Apple's proposed price tiers, "[W]e're willing to try at the prices we've proposed. We are not willing to try at higher prices because we are pretty sure we'll all fail."
- On January 26, Cue emailed Jobs that four publishers had signed. That same day, Jobs forwarded Cue his email exchange with Murdoch, where Murdoch agreed to Apple's terms and Jobs thanked Murdoch for "taking the leap with us."
- On January 27, Jobs announced the iPad, the iBookstore, and announced that, between Amazon and Apple, the prices for ebooks would "be the same."

These emails are consistent with Cue's testimony during the Antitrust Action that he "updated Mr. Jobs frequently on any discussions or updates that [he] had." *3/12/2013 Cue Antitrust Action Deposition* at 259:16-17. *See also id.* at 267:10-12 ("I go through the process and the details. And I keep Steve updated on what I think are the key terms around it.").

These emails are also consistent with what Cue told the SLC. He explained that he discussed all major negotiation positions, key contract terms, and strategy changes with Jobs. Cue's experience, based on many years working with Jobs, was that if Jobs did not like something he let Cue know in no uncertain terms. Cue confirmed that he followed all directives that he received from Jobs throughout the negotiations.

Jobs authorized and participated in Cue's conduct. Jobs was aware of the price tiers, caps, and MFN from emails he received that referenced them, and Cue testified that he also discussed the price tiers, caps, and MFN with Jobs. *Id.* at 264:25-265:2 and 266:17-267:2 ("I'm a hundred percent positive I told him about the MFN on pricing"). Jobs was aware that the agency contracts required the Publishers to ensure that the retail price for any specific ebook was

the same on the iBookstore as on Amazon. Jobs also knew that Publishers were requiring assurances that other publishers were signing on with Apple and he knew that Cue was providing the same assurance to others.

Jobs personally participated in the conduct that the District Court found to be illegal. In particular, Jobs negotiated directly with James Murdoch, and provided Murdoch assurance that other Publishers were signing agreements. Jobs' statements at the iPad launch confirm (as the District Court found) that he was fully aware of the material terms of the Publisher agreements, and the ultimate effect that "the prices will be the same." That the CEO of Apple publically announced the price matching is further confirmation that Cue's employer, Apple, had authorized and participated in the conduct that gave rise to the liability finding, and that Cue had reason to believe that Apple was not doing anything improper. The District Court ultimately concluded that "[c]ompelling evidence of Apple's participation in the conspiracy came from the words uttered by Steve Jobs, Apple's founder, CEO, and visionary." *Apple,* 952 F. Supp. 2d at 705.

As a defense to the derivative claim, regardless of whether the claim is brought by Plaintiffs or by Apple, Cue will be able to assert that he was following directives from the highest authority at Apple, which he had no reason to suspect were unlawful. Jobs' direction, active participation in, and ratification of, Cue's activities makes it very unlikely that a claim against Cue could be successful. *See Continental Casualty Co.*, 46 Cal. 2d at 428; *Pacific Indem. Co.*, 269 Cal. App. 2d at 426 ("In California an employer may recover from his employee for loss to the employer which has been caused by the employee's negligence, which the employer has not authorized and in which he has not participated.").

(b) Cue Relied On Counsel Provided By Apple

Cue's reliance on his Apple-assigned counsel is a separate reason that a claim against him as an employee for violating his duties to Apple is very unlikely to be successful. Cue was advised throughout the negotiations by the Apple Associate General Counsel assigned to Cue's

team, Kevin Saul, with whom Cue had a long working relationship. Apple's legal counsel played a key role in the conduct found to violate the antitrust laws:

- Saul was present with Cue at the meetings with the Publishers;
- Saul drafted the Publisher contracts;
- Saul conceived of, proposed, and drafted the MFN provision;
- Saul was responsible for addressing legal issues related to the contracts;
- Saul met with and negotiated directly with the Publishers' counsel without Cue present; and
- Saul consulted with Apple's General Counsel and outside counsel about the Publisher contracts.

Saul performed work that was typical to his lawyer role, and the role of virtually any transactional lawyer, including the in-house and outside lawyers for the Publishers. Saul's role as counsel to Cue on the ebook negotiations is supported by the SCAC, evidence reviewed in the SLC's investigation, the District Court's findings, the evidence presented at trial in the Antitrust Action, and Apple's legal position in the Antitrust Action.

Plaintiffs allege that Saul was among "Apple's highest senior officers" in early 2010, as "an assistant general counsel of the Company." SCAC, ¶ 22. They allege that Cue's ebook negotiation team included "Apple's Associate General Counsel, Saul." *Id.*, ¶ 158. They allege that Saul devised "an alternative way to achieve an industry-wide shift to the agency model that was even more effective in protecting Apple's interests, the MFN clause." *Id.*, ¶ 164. Saul is alleged to have "proposed using a MFN clause for retail prices which would guarantee that the e-books in Apple's e-bookstore would be sold for the lowest retail price available in the marketplace." *Id.*, ¶ 168. Plaintiffs allege Saul sent the Publishers "identical agency contracts containing the MFN clause." *Id.*, ¶ 169. While Plaintiffs added to the SCAC a single reference to Saul acting in a "business capacity," this does not negate Plaintiffs' extensive pleading identifying Saul as the company's lawyer on the ebook negotiations. The Superior Court also found that Plaintiffs alleged that Cue acted with advice of counsel, based on allegations that

Plaintiffs repeat in the SCAC. *See Order Re Demurrer* at 20-21. Plaintiffs' counsel did not respond to the SLC's direct request to provide it facts that showed Saul was not acting as counsel.

In Cue's interview with the SLC, he identified Saul as his lawyer on the ebook negotiations and on a number of earlier Apple transactions. Cue relied on Saul to prepare the agency agreements, to negotiate directly with the Publishers' counsel, and to resolve legal issues in a way that protected Apple's interests and achieved the business terms that Cue had negotiated. When Publishers raised legal concerns regarding any term of the agency agreement, Cue referred them to Saul to resolve those issues. Cue knew that Saul was consulting with other Apple counsel, including Apple's General Counsel, Bruce Sewell, and outside counsel. Cue also knew that the Publishers each had in-house counsel (as well as outside counsel, in at least some instances) who were directly negotiating with Saul outside of Cue's presence. Cue believed that the attorneys involved were investigating and resolving legal issues as they arose. Cue also believed that Saul was a very good lawyer.

Moerer likewise described Saul to the SLC as the "lead attorney" who provided Moerer and Cue legal advice during the negotiations. He recalled Saul discussing legal issues with the Publishers and providing legal advice to Cue regarding how to structure the ebook contracts.

The District Court in the Antitrust Action repeatedly referred to Saul as Cue's "in-house attorney," and his role as counsel was not disputed by the Department of Justice. Saul testified that he participated in the negotiations with Publishers "in [his] role as legal counsel and acted in a legal capacity," and confirmed on cross-examination that he provided legal counsel to Cue. *Saul Antitrust Action Declaration*, ¶ 4; *6/3/2013 Antitrust Action Trial Transcript* at 168. Penguin's CEO identified Saul as Apple's counsel in trial testimony.

Consistent with these facts, Apple asserted in the Antitrust Action that Saul was acting as an attorney when he communicated with Cue. Apple asserted the attorney-client privilege as to Saul's communications with Cue and other employees of his client, Apple. During the proceedings, Apple's attorney argued to the District Court: "the record is pretty clear that to the

extent Mr. Saul was advising Mr. Cue during the course of the negotiations about potential contract terms and agency agreements and the like, he was doing so in his capacity as a lawyer, providing legal advice and … answering legal questions from his client." *6/4/2013 Antitrust Action Trial Transcript* at 211:13-19. Apple cannot change that position, which was entirely truthful and accurate, in order to pursue claims against Cue.[10] Cue will be able to assert advice of counsel as a defense to the derivative claim regardless of whether the claim is brought by Plaintiffs or by Apple.

(c) Cue Did Not Violate Apple's Then-Existing Antitrust Policy

Cue's conduct in the negotiations was not prohibited by Apple's then-existing Antitrust Policy, which did not directly address the unique situation that arose in the ebook negotiations. The antitrust violation found by the District Court was not a typical price-fixing scheme among horizontal competitors that would have been obvious to a non-legal professional or that was in apparent violation of Apple's then-existing Antitrust Policy. The Second Circuit dissenting Judge characterized the arrangement as unique: "Several features make it sui generis: (a) a vertical relationship (b) facilitating a horizontal conspiracy (c) to overcome barriers to entry in a market dominated by a single firm (d) in an industry created by an emergent technology." *Apple*, 791 F.3d at 348 (dissenting opinion) (underline in original).

Apple's Antitrust Policy in effect during the ebook negotiations detailed prohibited conduct and provided specific requirements for all interactions with competitors. It stated:

> • **Price-Fixing Agreements**. Price-fixing, which is illegal in addition to being against Apple policy, involves competitors agreeing among themselves on the prices they will charge. This includes any agreement on 1) final price to customers, 2) components of price, 3) a process to set price, or 4) whether to bid

[10] Cue asserted in his December 8, 2016, Demurrer to the SCAC that Apple is judicially estopped from asserting that Saul was not acting in his capacity as an attorney during the ebook negotiations. "In the litigation before Judge Cote, Apple asserted the attorney-client privilege over Mr. Saul's communications and testimony regarding legal advice he gave in the course of the e-book negotiations, and the court accepted as true that those communications were between attorney and client. [citation]. Apple cannot now take a contrary position—that Mr. Saul was not acting as an attorney during the e-book negotiations—before this Court." *Cue Demurrer* at 11 (*citing Jackson v. City of Los Angeles,* 60 Cal. App. 4th 171, 183 (1997)).

or not bid in a competitive market. Avoid any discussions with a competitor involving price, price setting, or bidding.

- **No Market Allocation Agreements**. Agreements among competitors not to compete, based on the allocation of certain markets or market segments, are illegal. These illegal agreements may include the allocation of customers, territories or product markets. A good example is an understanding that one company will only sell in the northern half of a country, state or city, and the other company will only sell in the southern half. Avoid any discussions with competitors that could be perceived as an attempt to allocate markets and reduce competition.

- **No Group Boycotts**. Group boycotts involve two or more competitors deciding that they will not deal with (boycott) a particular customer, reseller, or supplier in order to affect price of competition. Avoid any discussions with competitors related to restrictions on doing business with specific customers, resellers or suppliers unless you have cleared the matter with the Legal Department in advance.

- **Communications with Competitors**. Avoid any unnecessary contact or communications with competitors. When there are interactions with competitors, such as at a trade association or standards body meeting, be extremely careful in what you say and never participate in even casual discussions regarding matters such as price, terms of sale, bids, discounts, promotions, costs, inventories, product plans, marketing plans, resellers, suppliers, or any confidential information.

- **Comments Regarding Competitors**. When selling Apple products and services, Apple employees may comment accurately on the advantages of Apple's offerings relative to those of competitors. False or misleading remarks about competitors or their products must not be made. Make sure all comments of this nature are accurate, honest, fair, factual and defensible.

- **Additional Restrictions Based on Large Market Share**. A company that has a significant share of the market for a product or service in a particular geographic region may be viewed as having a monopoly or a dominant market position. Those with a dominant market position may be subject to additional scrutiny by government officials to ensure that illegal predatory or exclusionary conduct, such as excessively high prices, below-cost discounting or a refusal to supply, is not taking place. Any sales or marketing activities that could potentially be viewed as predatory or exclusionary must be reviewed with the Legal Department in advance if the activities relate to matters where Apple has a significant share of the relevant market.

- **Additional Geographic Considerations**. Within the U.S., various states may impose their own additional competition rules. Outside the U.S., there may be country-or region-specific competition requirements or restrictions. Contact the Legal Department to determine how these requirements or restrictions might impact Apple's activities.

The policy also detailed prohibited conduct with channel members, which was defined as "third-party companies and individuals involved in the authorized sale and distribution of Apple

products and services." The policy stated:

> - **Price Maintenance/Price-Fixing**. Channel Members ultimately must be free to determine their own resale prices. Apple may suggest resale prices, but we may not have an agreement with a reseller to raise, lower, or stabilize its prices, or coerce the reseller to adhere to our pricing suggestions. Apple employees should avoid any discussions of pricing with resellers, unless the Legal Department has pre-approved the communication. Apple employees also should never facilitate or encourage the comparison of pricing between Channel Members.
>
> - **Non-Price Restrictions**. In some countries, restrictions placed on resellers that are not related to price, such as customer restrictions, territorial or market restrictions, or product restrictions, are subject to competition and antitrust laws. Any such restrictions must be supported by a legitimate business need and pre-approved by the Legal Department. In addition, non-price restrictions must be imposed uniformly on all similarly situated resellers and must be enforced in a uniform and consistent manner.
>
> - **Price Discrimination**. In some countries, laws prohibit companies from charging different prices to different customers (including to different Channel Members) for essentially the same products and quantities. Certain exceptions may apply to price discounts and allowances that are based on objective criteria and generally available to customers. Charging different prices also may be permitted in certain circumstances based on cost savings to Apple. Review price discounts and allowances with the Legal Department in advance to ensure that they are appropriate and defensible.
>
> - **Tying Arrangements**. Tying arrangements involve conditioning the sale of a desirable product on the purchase of a second product or service. Tying arrangements can be illegal, so any proposals of this nature must be reviewed with the Legal Department in advance.

The policy further encouraged Apple employees to seek advice from Apple's legal department: "Antitrust and Competition law is very complex and often fact specific. This policy is only intended to provide general guidance and is not a complete review of all of the risk areas under antitrust laws. You are encouraged to seek advice from the Legal Department."[11]

The SLC has determined that Cue's conduct during the ebook negotiations did not violate Apple's then-existing Antitrust Policy. The Antitrust Policy prohibited discussing prices with

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[11] Apple's Business Conduct and Antitrust Compliance Programs were overseen by its Chief Compliance Officer ("CCO"). Apple's CCO from March 2006 to September 2009 was Eric Pressler. Prior to working at Apple, Mr. Pressler was the Chief Compliance Officer of Pacific Gas & Electric, a publically traded electric utility company. Mr. Pressler developed Apple's business conduct policy, including instituting a helpline, developing training programs, and identifying areas of regulatory risk. In early 2009, Apple instituted the Antitrust Policy. Apple employees had access to this policy through Apple's internal employee website, where it was first posted in March 2009.

Apple's competitors and other conduct more typical of antitrust cases, but did not address the possibility that Apple could be found liable for facilitating horizontal price-fixing based on a vertical relationship with suppliers.

The SLC discussed with Cue his understanding of Apple's policies during the ebook negotiations. While Cue does not recall participating in antitrust-specific training, he did have an understanding of certain conduct prohibited by Apple's policy and the antitrust laws. None of Cue's actions during the ebook negotiations violated his understanding of what was prohibited by the antitrust laws.

Consistent with Apple's Antitrust Policy, as discussed above, Cue involved Apple's legal counsel in the negotiations from the very beginning. There is no evidence that Saul or any other attorney told Cue during the negotiations that the transactions risked violating the antitrust laws.

(d) Cue Reasonably Believed His Conduct Was Legal

Cue reasonably believed that the agreement terms he negotiated and his negotiating tactics were legal, and an ordinarily prudent person in his position would have believed that his conduct was legal. The District Court found: "The Plaintiffs do not argue, and this Court has not found, that the agency model for distribution of content or any one of the clauses included in the Agreements, or any of the identified negotiation tactics is inherently illegal. Indeed, entirely lawful contracts may include an MFN, price caps, or pricing tiers." *Apple,* 952 F. Supp. 2d at 698. Each term of the agreements that the District Court found to constitute elements of the price fixing scheme was authorized by Apple's CEO and legal counsel, so Cue had no reason to believe the agreements he negotiated or his conduct was illegal.

Cue reasonably believed that the MFN was legal. Cue knew that his Apple-assigned attorney, Saul, had proposed and drafted the MFN. He knew that Apple had an MFN provision in its iTunes contracts. Cue's belief that the MFN proposed by Apple's lawyer was legal was confirmed by his email of January 21, 2010, to the President of Hachette: "There seems to be some concern on your team on the wording of [the MFN]. Kevin, our attorney, is available to

meet with your counsel to discuss this but we know this is not an issue as we have this in all other deals not just in books but other media." Cue also knew that the Publishers' own internal and outside legal counsel were reviewing the agreements, and reasonably expected that those teams of attorneys also would address any legal issues with the MFN. *See, e.g*., 1/23/2010 Cue email to Jobs: "all these guys [publishers] use external lawyers to review what their internal ones do …."; *see also 3/13/2013 Cue Antitrust Action Deposition* at 343 ("So my suggestion to [the Publishers] was always when they expressed any kind of legal concern was talk to your counsel and figure out a way. I don't believe it's a legal concern, and if you think it's a legal concern, then call our -- you know, Kevin Saul and you guys handle it, because … law is definitely out of my expertise."); *6/17/2013 Cue Antitrust Action Trial Testimony* at 1892-1893 ("when I'm doing negotiations … I rely on my general counsel to give me advice, and I certainly wouldn't ask them to do anything that was illegal. And so our view around this was there was nothing illegal about what we were asking them, and I directed him to talk to his GC or our counsel or anybody else he wanted to ….").

Cue's belief that he was acting in Apple's best interest by negotiating the price caps was reasonable under the circumstances. He knew that the price caps were reviewed by Apple's legal counsel, by Apple's CEO, and by each of the Publishers' legal counsel. His role was to persuade the Publishers to accept lower retail prices than they wanted, so that Apple would not have "embarrassing" high ebook retail prices. He consulted with Jobs regarding the price caps, and Jobs authorized them. Cue saw Jobs' communications with James Murdoch, where the founder and Chief Executive Officer of Apple was persuading the Chairman and Chief Executive of News Corp to accept the same deal that Cue had already struck with four other publishers. Cue had no reason to believe that his same conduct was illegal.

Cue also reasonably believed that the agency relationship structure was legal. Cue knew that Apple already used the agency structure to sell apps through its App Store. Cue discussed the agency structure with Jobs and Saul, and had no reason to believe that using the agency structure to sell ebooks would raise antitrust concerns.

Cue reasonably believed that he was acting in Apple's best interest by employing the negotiating tactic of informing the Publishers of the status of his negotiations with others. This tactic would facilitate having more Publishers sign agreements to ensure a broad selection for consumers. Cue's long established practice when launching a content store at Apple was to negotiate with the relevant parties in the industry simultaneously and tell them how many had signed contracts but not who had signed them. He had used that negotiating tactic successfully and with Apple's counsel's knowledge, and was never informed that it raised antitrust concerns. For example, he had negotiated concurrently with the major content providers in launching iTunes, and television and movies. Cue believed that concurrent negotiations were essential to launching a new store with many contributors and competitors. Cue knew that both Apple and the Publishers needed and wanted a critical mass of Publishers in order to make the iBookstore commercially viable and attractive to consumers.

Because Cue reasonably believed that the provisions in the ebooks contracts were legal, it was reasonable for him not to have recognized at the time that an increase in ebook retail prices as a result of Apple's entry into the market raised antitrust concerns. From Cue's perspective, Apple was entering into a market with one dominant reseller, Amazon, which was selling ebooks below its wholesale cost. Apple was only interested in a business that would be profitable, and Cue believed he was negotiating terms for Apple to be able to enter a new market without having to sell below cost. Cue reasonably believed that Apple's entry into that market was pro-competitive, since Apple was poised to provide consumers an alternative ebook store and Publishers wanted another significant competitive reseller in the market. Given that Apple's counsel and CEO also knew that as a result of Apple entering the market ebook prices would increase, it is unreasonable to expect Cue, a non-lawyer, to have recognized an antitrust violation was occurring.

C. The District Court's Comments and Findings Regarding Cue's Credibility Are Not A Basis To Pursue A Claim Against Him

As part of its investigation, the SLC considered the District Court's statements regarding

Cue's credibility during trial of the Antitrust Action. The SLC has determined that the Court's comments do not provide any basis on which Apple should pursue a legal claim against Cue.

The District Court found that testimony from several witnesses during the trial of the Antitrust Action, including Cue, lacked credibility. *See e.g., Apple,* 952 F. Supp. 2d at 703, n.66 (referencing as not credible testimony from Cue, Moerer, Saul and the CEOs of Macmillan and Simon & Shuster). The Court found that Cue's testimony "was not credible" regarding whether Apple intended "a new industry wide price schedule" rather than being "concerned only with the pricing that would prevail in the iBookstore." *Id.* at 661, n.19. The Court also found that Cue's testimony was not credible when Cue denied at trial that he had told Macmillan's CEO that Macmillan was required to put Amazon on the agency model, denied knowing the CEO was meeting with Amazon in Seattle shortly after signing with Apple, and denied knowing that the Publishers would move Amazon to an agency model. *Id.* at 672, n.38 and 678, n.47. The Court found that Cue had "urged" the Publishers to "have discussions with one another to clarify aspects of the Agreements or to convince others to sign on." *Id.* at 706. Cue denies knowing that the Publishers were communicating about their agreements with Apple during the negotiations.

The District Court's comments and findings regarding Cue's testimony in 2013 would not be admissible or binding against Cue in any litigation between Apple and Cue. *See e.g., Clemmer v. Hartford Ins. Co.,* 22 Cal. 3d 865, 875 (1978) ("In the context of collateral estoppel, due process requires that the party to be estopped must have had an identity or community of interest with, and adequate representation by, the losing party in the first action as well as that the circumstances must have been such that the party to be estopped should reasonably have expected to be bound by the prior adjudication."). The District Court's comments, while serious, do not provide any separate basis for Apple to assert a meritless breach of duty claim against Cue, directly or derivatively.

D. The Amount of Damages to Apple Would Be Subject To Dispute

The claim that Derivative Plaintiffs assert in the SCAC against Cue seeks to hold Cue

liable for Apple's damages arising out of the antitrust violation, including the $450 million that Apple paid to settle claims asserted by private consumer plaintiffs and the Plaintiff States. If the company or the Derivative Plaintiffs were to pursue the claim against Cue, the amount of damages would likely be subject to dispute.

Apple could not rely only on the amount of the settlement—to which Cue was not a party—as evidence of its purported damages. *Western Steamship Lines, Inc. v. San Pedro Peninsula Hospital*, 8 Cal. 4th 100, 118 & n.15 (1994) (Due process requires that a party to a settlement give prior notice and an opportunity to defend to non-party that it seeks to hold liable for settlement amount.); Cal. Code Civ. Proc. § 877.6(a); *see also Gackstetter v. Frawley*, 135 Cal. App. 4th 1257, 1273 (2006). Because the settlement does not automatically establish Apple's damages from Cue's conduct, Apple would be required to prove the amount of its damages proximately caused by Cue's conduct. *Western Steamship Lines,* 8 Cal. 4th at 119 ("Court of Appeal erred in concluding that substantial evidence of a reasonable settlement adequately established the proper amount of [plaintiff's] recovery.").

A complicated damages analysis would be involved in any dispute with Cue. Economic factors would include evaluating both Apple's profits and losses caused by Cue's conduct. *See Maben v. Rankin*, 55 Cal. 2d 139, 144 (1961) ("In determining the damages suffered as a result of a tortious act, consideration may be given, where equitable, to the value of any special benefit conferred by that act to the interest which was harmed."); Restatement (Second) of Torts, § 920 ("When the defendant's tortious conduct has caused harm to the plaintiff or to his property and in so doing has conferred a special benefit to the interest of the plaintiff that was harmed, the value of the benefit conferred is considered in mitigation of damages, to the extent that this is equitable.").

The economic consequences to Apple from the ebook negotiations are different than the economic consequences to consumers and States who received settlement payments to resolve their claims. Any losses to Apple might be offset in whole or in part by Apple's profits from its entry into the ebooks market, which has generated and will continue to generate significant sales

of ebooks and may have positively affected the sale of iPads. The changes in pricing of ebooks in the iBookstore resulting from the ebook negotiations might also have to be considered. All of these factors, and more, would inevitably be part of any determination of whether, and to what extent, Apple ultimately suffered damages from Apple's entry into the ebooks market in 2010.

E. Cue Is Entitled To Indemnification To The Maximum Extent Permitted By Law

In deciding whether to bring a claim against Cue, the SLC considered the impact of Apple's indemnity agreement with Cue ("Indemnity Agreement"), which provides that Apple will indemnify Cue to the maximum extent permitted by law. The Indemnity Agreement, which was executed when Cue became an officer in September 2011, states that it "shall apply to acts or omissions of [Cue] which occurred prior to such date if [Cue] was serving in any Corporate Status at the time such act or omission occurred." *Indemnity Agreement*, § 12. Corporate Status is defined to include a person who was acting as an employee or agent of Apple. *Id.*, § 13(a). The Indemnity Agreement therefore applies to the derivative claim against Cue relating to the ebook negotiations.

For claims brought by or on behalf of Apple (the "Company") against Cue (the "Indemnitee"), the Indemnity Agreement provides that:

> [T]he Company shall indemnify Indemnitee against any and all Expenses and, to the fullest extent permitted by law, amounts paid in settlement … unless the Company shall establish, in accordance with the procedures described in Section 3 of this Agreement, that Indemnitee did not act in good faith and in a manner Indemnitee reasonably believed to be in the best interests of the Company and its shareholders, except that no indemnification shall be made in respect of any claim, issue or matter as to which Indemnitee shall have been adjudged to be liable to the Company … unless and only to the extent that the court in which such Proceeding is or was pending shall determine … Indemnitee is fairly and reasonably entitled to indemnity for Expenses or amounts paid in settlement….

The Indemnity Agreement also requires Apple to advance expenses incurred by Cue in defending against the claim:

> The Company shall advance all Expenses incurred by Indemnitee in connection with [a claim brought by Apple] (but not amounts actually paid in settlement of any such Proceeding). Indemnitee hereby undertakes to repay such amounts advanced only if, and to the extent that, it shall ultimately be determined that

> Indemnitee is not entitled to be indemnified by the Company as authorized hereby. … Advances shall be unsecured and interest free. Advances shall be made without regard to Indemnitee's ability to repay such amounts and without regard to Indemnitee's ultimate entitlement to indemnification under the other provisions of this Agreement. Advances shall include any and all Expenses incurred pursuing an action to enforce this right of advancement ….

Id., § 3(a). *See also* Cal. Corp. Code § 317(c).

In short, pursuant to the Indemnity Agreement and applicable California law, if Apple were to bring a claim against Cue, then Apple must advance all expenses incurred by Cue in defending against Apple's claim. If Apple prevails on its claim against Cue, then Cue would not be indemnified for the amount of the judgment, and Cue would have to repay the expenses advanced to him unless a court determines that the repayment of expenses was not warranted based on the totality of the circumstances. If Apple were to lose a claim asserted against Cue, Apple would not be reimbursed for the expenses it advanced to Cue to defend against the claim.

X. FACTORS TAKEN INTO CONSIDERATION BY THE SLC

The SLC's extensive investigation and consideration of all allegations in the SCAC related to Cue, as described in detail in this Report, focused on determining whether it is in Apple's shareholders' best interests to pursue any claim against Cue. To make this determination, the SLC considered numerous factors, including but not limited to:

- Whether Cue's conduct gives rise to a cause of action by Apple;
- The extent to which Cue's conduct was directed, authorized, and ratified by his superior, CEO Steve Jobs;
- The extent to which Apple's legal department and outside counsel were involved in the ebook negotiations;
- The extent to which Cue relied on legal counsel provided by Apple;
- Whether Cue believed that he was violating any laws during the ebook negotiations and the reasonableness of such a belief;
- The extent to which Cue's conduct was consistent with his prior conduct on other Apple transactions;
- The extent to which Apple provided training that would have alerted Cue to the

specific antitrust risk he encountered;

- The legal and practical difficulties associated with pursuing any possible cause of action against Cue;
- The complexity of determining damages, if any, to Apple;
- The cost to Apple in resources of time and money of pursuing any claim against Cue;
- The existence of Cue's indemnity rights;
- The effect that dismissal, settlement, or pursuit of the asserted claim against Cue would have on morale among Apple's employees;
- The effect that dismissal, settlement, or pursuit of the asserted claim against Cue would have on Apple's reputation and standing in its industry; and
- The disruption to Apple's business that would result from litigation against Cue.

These factors are among those considered by the SLC, and are not necessarily listed in order of importance.

XI. THE SLC'S DECISION REGARDING EDUARDO CUE

In concluding that the corporation should not seek to hold Cue personally responsible for some or all of the possible losses associated with Apple's antitrust violation, the SLC accepts the District Court's determination that Apple and the Publishers engaged in conduct that violated Section 1 of the Sherman Act by joining together "to eliminate Amazon's power to set retail prices and then to raise prices to the point Apple would permit." *Apple,* 952 F. Supp. 2d at 704-05. Apple established and required the uniform contract terms for the Publishers that gave rise to antitrust liability. Apple made clear to all the Publishers that a minimum number of Publishers had to agree to Apple's terms in order for the iBookstore to go forward, and informed the Publishers of its progress in signing participants. Apple's lawyer designed the mechanism−the MFN−that drove the Publishers to require Amazon to switch to agency and thereby lose its ability to set retail prices. With Cue working closely with CEO Steve Jobs, Associate General Counsel Kevin Saul and other Apple personnel, Apple achieved its objective of entering the ebooks market and eliminating the risk of competing against below-cost retail pricing.

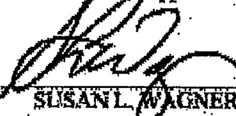
The SLC has concluded that a claim seeking to hold Cue liable for the antitrust violation would be unlikely to succeed for at least the following separate reasons: (1) Apple's CEO, counsel and other employees directed, ratified and participated in the conduct that led to the antitrust violation; (2) Cue acted on advice of counsel; and (3) Cue reasonably believed that his conduct was legal.

The SLC has also concluded that pursuing a claim against Cue would negatively impact and disrupt Apple's business. The consequences of the District Court's verdict are not the responsibility of a single Apple employee. Seeking to hold one employee responsible, under circumstances where the employee complied with Apple policies and acted with the advice of Apple counsel and the approval of Apple's CEO, would be harmful to the company.

The SLC has now completed its eight month investigation of the allegations against Eduardo Cue as described in this Report. Based upon the SLC members' independent business judgment, the SLC has concluded that it is not in Apple's best interest to pursue the claim asserted against Cue by the Derivative Plaintiffs. The SLC, through counsel, will communicate this conclusion to the Derivative Plaintiffs and the Apple Board of Directors and will seek dismissal of the derivative suit against Cue.

The Special Litigation Committee of the Board of Directors of Apple Inc.

Date: January 19, 2017



SUSAN L. WAGNER

Date: January 19, 2017

JAMES A. BELL

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Date: January 20, 2017

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