

From: Bill Gates
Sent: Thursday, March 05, 1998 6:40 AM
To: Laura Jennings; Steve Ballmer
Cc: Pete Higgins; David Heiner (LCA); Bill Neukom (LCA); Paul Mantz; Jim Allchin (Exchange);
Brad Chase; Cameron Myhrvold
Subject: RE: New BT and Win98 thoughts

Attorney client privileged

I am in complete agreement with what Laura says here. We should proceed to do this.

I feel badly that I am changing my position on this so late in the game.

The benefit to hotmail was going to be small because we need to support OE anyway and let the ISP host

I am unclear now what if anything we are going to ask a customer we refer to to do.

- a. Pay us?
- b. Prefer IE in some way - I guess this is very light
- c. Nothing for start?
- d. Nothing for Hotmail?

—Original Message—

From: Laura Jennings
Sent: Wednesday, March 04, 1998 1:18 AM
To: Steve Ballmer; Bill Gates
Cc: Pete Higgins; David Heiner (LCA); Laura Jennings
Subject: New BT and Win98 thoughts

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Please read if you can: 1) now pursuing a BT "code licensing deal" and 2) I recommend retrenchment on the win98/start relationship.

1. BT: No strategic win there; now trying to use Hotmail technology to keep Netscape out.

We're going to go back into BT with a very different proposal later this week. In the end it boiled down to a simple statement from them that "we're still unsure about what we're doing and we're afraid that partnering with you will limit us in the future in ways we haven't even thought about yet."

So we've instructed Judy to try to win this deal from Netscape anyway as a slight spin on a pure technology license play as follows:

- We will offer BT to host their branded domain (user @millimail.com or user@BTmail.com—no Microsoft in it) at our Hotmail server farm.
- We will do very basic BT customization of the hotmail login, inbox and other screens.
- We will agree to host their mail domain on a server farm in the UK within 12 months (this is a critical issue to them)
- They will pay us a yearly fee per account TBD, likely on the order of \$3/account/year. The price goes up when hosted in the UK unless they subsidize all the connectivity costs. They can sell the advertising and keep 100% of the upside there.
- This is nonexclusive—we reserve the right to offer this deal to other ISPs and also to use this technology ourselves for our own web-based email service in the UK.
- Here's the tricky part: We will suggest that it's a benefit (over the netscape solution and in general) to BT and their user base to be able to "federate" with our Hotmail customers for buddy lists. You can look at this as us losing one of our hotmail advantages over free BT mail in the market, on the other hand, it's a way of building affinity between BT and Microsoft customers which may cause BT mail customers to go to Hotmail if they ever leave the BT service. I need to think more about this, but the idea is that somewhere in here we need to put in a trojan horse, even if it's a weak one.
- We will ask for IE to be the preferred browser client.
- We will throw in a couple of other asks like "exclusive rights to offer calendar and xyz feature" to the BT user base, which we will expect them to negotiate out of the deal.

You should comment if you think it's a bad use of our resources—this isn't a way to make money off of the Hotmail asset, and it's a distraction from our real goals in the UK, but it's a way to keep Netscape out of the account. We will still market aggressively in the UK to get as many people to our branded site as possible.

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2. Win98: Start link to referral server not worth the cost?

Last August Bill explicitly asked us to pull together a plan which maximized portal leverage from the Win98 desktop. After many rounds of internal discussion, in the end we reached consensus on the referral server '98 link. All parties involved have agreed to make pointing to Start a requirement for ISPs to get into the referral server for Win 98.

The environment has changed a lot in the last 6 months. As soon as we tell telcos about this plan, it will become public and highly scrutinized. In the current PR climate, this is likely to be used against us as a very tangible example of Microsoft using its OS position to "dominate the internet." As absurd as that is, it's a great PR soundbite which will be hard to combat.

I'm all for fighting battles that matter, and my position on the danger of using Windows to sign people up for AOL hasn't changed. But when you look at the data, there just isn't a big enough win in the current implementation to make the fight worth taking on right now.

The reality is that Hotmail is currently signing up more new accounts in a few days than Windows does in a month. These are not apples to apples—hotmail is free, ISP accounts are not, hotmail sells into the entire installed base, etc. And once we put internet sign-up into the welcome/registration wizard, the numbers should go up. But today the breakdown in the US is roughly as follows:

MSN icon – 20k new account sign-ups/month
IE referral server – 30k signups/month, 6k of which go to MSN
OLS folder – 70k signups/month, the bulk of which go to AOL

We unfortunately don't collect very good data from the desktop today (that's why I'm sticking to US-only #'s), so we've cobbled these numbers together from various information sources. They're undoubtedly off by a little, but not enough to skew the basic facts:

- AOL already gets the bulk of US sign-ups from Windows due to their brand and marketing spend. The current Win98 proposal should further increase their share of Windows sign-ups because we add them to the referral server/registration wizard (without requiring them to play by the same rules as the other ISPs due to min-type language in their existing contract.)
- Windows isn't generating enough sign-ups to cause ISPs to jump through many hoops in order to play on it. Windows is the originating source for less than 25% of all new internet sign-ups in the US today, nearly 60% of which go to AOL, 80% going to either AOL or MSN.

Even if the reg wizard positioning made the referral server numbers go up in the US by a factor of 10 (unlikely), and AOL took only 30% of these vs. their "fair market position" of 50-60%, we'd gain ~170k more Start customers/month—or roughly 2.5 good days of current Hotmail sign-ups. And in the Start case, we still may not have won the email business yet since our plan is to allow ISPs to offer their own email if they don't want to use Hotmail.

We can make a case that diverting the legal and PR money we'd have to dedicate to defending our position on this issue would gain us more actual Hotmail customers than making Start a requirement for the referral server.

Here's what I suggest:

- We remove the Start provision from the Win'98 referral server contracts, but write the initial contracts for a period of no longer than 12 months.
- We spend the next 12 months working on the primary problem: how can we make Windows the acquisition vehicle for the majority of new internet sign-ups?
- We continue to pursue Start and Hotmail deals with ISPs by building a better start page and business proposition.
- We revisit the decision in 12 months' time, and market Hotmail and Start aggressively during the interim.
- We pursue a series of smaller gains:
 - add MSN to the OLS folder in lieu of making Start a referral server requirement;
 - add a hotmail offer behind the IE mail button;
 - we've already told telcos that those that point to Start "will be advantaged" in the IE referral server. We should stay with this plan and look for a "seal of approval" type of thing which is within the bounds of the AOL contract but gives a little bit of an incentive for working more closely with us.

Maybe I'm just wimping out after watching too much cspan coverage today, but this one smells like the negative hysteria it might generate could far outweigh any actual gains we can achieve. Comments?

—Original Message—

From: Steve Ballmer
Sent: Monday, March 02, 1998 11:18 AM
To: Laura Jennings; Bill Gates
Cc: Pete Higgins

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Subject: RE: Hotmail and PTT proposals

As I told Laura I think we should win these deals at all costs. It is better for us to take an accommodation but have our name in the account and our technology than to lose these to Netscape. In discussing with Bill he reminded me though how bad the exclusive might be and we agreed they must agree to really promote our joint pain for it to work. Bill's idea is great. Why not ask them to list people's hot mail addresses in their directories if the customer wants that. What think

—Original Message—

From: Laura Jennings
Sent: Monday, February 23, 1998 1:13 AM
To: Bill Gates; Steve Ballmer
Cc: Pete Higgins
Subject: Hotmail and PTT proposals

I want to get feedback from you on the business/partnership strategy for free email, particularly as it relates to PTTs. We have two hot discussions under way right now with NTT and BT, with I suspect many more right behind them. Let me use these two as examples to get your input on general strategy as well.

BT background:

- As part of the British government's millennium project, the government plans to make several announcements on 2/28. One of these will be an initiative to get all UK citizens connected to the internet for email. BT will be announced as the provider of this service.
- BT are now looking at two alternatives: Netscape and Microsoft. The Netscape offer gives BT 100% of the revenue upside over time, while our offer has no money upfront but we split the revenue 50/50. They came in very late to the discussion, so we don't have all the details of their proposal but they seem willing to give almost anything to get the deal.
- BT has made it clear that the only acceptable offer from us is one in which BT has joint ownership of all free email offered by Microsoft in the market. We could not be their supplier and also offer our own Microsoft-branded free email or partner with other ISPs.
- Even at that, BT is hesitant about Microsoft because we will ultimately compete in the portal space, which is in conflict with BT's own online services. We have tried to make this a portal partnership rather than just an email partnership, but after quite a bit of initial success down this path, they then decided to go another direction when the Netscape email-only offer came in late last week.
- The UK MSN team have been running these discussions and doing a credible job. However, I think if we're going to win this, we'll need to call as high as we can—possibly even involving you Steve.

NTT background:

- Prior to our acquisition of Hotmail, NTT had been close to signing a \$3 million licensing deal for Hotmail technology which they would use to run a free email service in Japan. Because Hotmail isn't localized, it underperforms in the Japanese market today and Hotmail saw this as a low-risk source of needed operating cash. I had (carefully and respectfully) terminated the NTT/Hotmail negotiations as soon as we discovered them during the negotiating phase of the Hotmail acquisition.
- Last week when I was in Tokyo to meet with NTT, they proposed that a joint venture of Microsoft, NTT and Dentsu be created (35/35/30) for the purposes of providing free email in Japan. The Dentsu angle is very interesting in this market—as you know, without Dentsu on our side any advertising revenue is going to be hard to come by in Japan.
- This free email service would be heavily promoted as part of NTT's Phoenix project (high bandwidth to corporations) and other ISP services (of which MSN is by far the most successful right now), but would also be offered free to anyone on the web.
- Like BT, NTT also wanted this to be the only free email service for Microsoft in this market. You should also know that although we're looking for common ground, NTT also intends to compete aggressively in the portal space.

Other background data:

- Hotmail is the only web-based email technology known to have scaled beyond a couple million users.
- The operating costs of this business are very low—less than \$3/account/year.
- Hotmail is on a run rate of 2 million new account sign-ups/month right now, prior to localization and any major marketing efforts kicking in.
- We currently have 250,000 Hotmail accounts in the UK, and around 50K Hotmail accounts in Japan.
- 20% of current Hotmail subscribers don't own their own PC.
- Hotmail is currently not localized at all, although we just assigned Tom Reeve to kick-start this with Ireland resources for the next 2-3 months.

Here's how I'm currently thinking about these deals in general:

- ISP deals are good and we want them. As part of these deals we will heavily co-brand the site and share ad revenue. If we can expand beyond email into portal/Start itself, that's preferable, but we'll take email-only relationships as well.
- We should be willing to give up the lion's share of email-based ad revenue in order to secure other deal points which really matter. These are:
 - 100% control of the user domain name (e.g. user@hotmail.com or user@Start.com vs. user@bt.start.com). This is key because of our vision of universal ID, because doing otherwise will

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- confuse the hell out of users who switch ISPs, and because we can't technical or perceptually fragment our user base without losing much of the benefit of "sticky" services down the road
- Ownership of the underlying member directory asset, and the sole rights to provide communications applications and PC-maintenance services to these customers down the road. We would allow the PTT, however, to provide directory, content and telecommunications services to the customers they bring to us
- Exclusivity in most markets will be hard to justify. If for example, as part of the British government initiative the government was going to sponsor the creation of "official" accounts for all citizens and then help support programs which get people to actually use the accounts, it would be crucial that we get this business no matter what. But no one dealing with BT gets the sense that either the government or BT really understand what exactly they're going to do yet.

As an alternative to doing the BT deal, we plan to have a "fully UK localized" Hotmail running within 60 days-- this would include a Hotmail.co.uk url and UK-based web counter deals and other content. (We are already promoting Hotmail above-the-fold on our <http://msn.co.uk> site and other intl sites but not doing any big marketing promos.) I think with a million or so in heavy marketing spend, we might be able to triple the number of UK-based Hotmail accounts before BT ever gets their service up and running. And we leave the door open to work with other ISPs who don't demand exclusivity.

My feeling is that we should try very, very hard to get the BT deal, but not give in on the URL or exclusivity points even if it means losing this to Netscape. We should simultaneously prepare an aggressive market expansion plan for the UK and perhaps 10 other top markets, and come to you for additional funding for these programs. Getting to critical mass in a particular market is the best negotiating lever we can possibly have with a PTT or other potential partner.

Same for NTT, although a 35/35/30 JV is a joke, given that we have \$400 million in to this business and the ongoing operating costs are so low. We'd have to structure this carefully so that it's only about ad revenue split, not joint ownership of the underlying subscriber asset. Dentsu may actually add more value as a partner than NTT. At this point, we'd be cutting NTT in on our revenue mostly to keep them from competing with us. I won't have a good schedule for another 3-4 weeks, but my guess is that it will take at least 6 months, maybe more, to get the service localized for Japan. That would give NTT enough time to put together an alternative and beat us to market with a localized service. We're not in as strong position here as in the UK.

Sorry for the long email but I wanted to provide enough background for you to give informed opinions. If you think I'm off-base or I've missed something, please let me know. And Steve, I expect that you'll end up being involved in a few of these--we have at least one RBOC discussion heating up in the US now as well. Thanks

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