

PLAINTIFF'S
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Comes v. Microsoft

From: DUBINSKY--AUSVM6 Date and time 04/06/95 01:25:06
To: BCLAFLIN--RHQVM02 Bruce L. Claflin
cc: HNICOL --RALVM8 Harry Nicol PHEATH --RALVM6 P.E. Heath
DILEO --RHQVM12 Jean M. Dileo FKO --RHQVM12 Fran O'Sullivan

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Subject: Letter to Gerstner

Attached you will find my response to your request for a letter to be sent from Rich Thoman to Lou Gerstner, requesting the background, status, and direction for the Windows 95 negotiations.

Please note that in my latest discussions with Microsoft they are planning to close out MDA discussions on April 20th.

I will also send this to you in a file, WINDOW95 SCRIPT. *attached*
Let me know if this needs any additional work.

Thanks
Dean

The purpose of this letter is to document the history, current status, and future direction of IBM's negotiations with Microsoft with respect to Windows 95.

Background:

Last summer after my meeting with Bill Gates, Bruce Claflin and Tony Santelli met with Microsoft's Joachim Kempin, Sr VP of OEM Sales. The output of this meeting was a document defining the guidelines for a potential 'Alliance' between IBM and Microsoft. This initiative was not approved by the IBM CEC.

The next series of meetings were at COMDEX in November. During these meetings, I along with Bruce Claflin and Tony Santelli met with Joachim Kempin and Bill Gates. IBM clarified its commitment to "IBM Products First", and outlined the PC Companies plan to preload OS/2 WARP on all systems. IBM also stated that it would limit activities with Microsoft to activities that guaranteed the customer a good end user experience once they had purchased IBM Hardware and Microsoft Software. As for Windows 95, IBM requested consideration for the total expenditure of dollars to Microsoft; 1. In sales of Microsoft products by the PC Company; 2. In the cost of development, test, and support in porting Windows/NT to the PowerPC; and 3. In royalties paid to Microsoft in the sales of IBM Software products such as OS/2, LAN Server, etc.

Windows 95 Licensing Discussions:

From the start, Microsoft informed IBM that the royalty rate for Windows 95 would be \$75. Microsoft outlined that the Licensing of Windows 95 would consist of a Market Development Agreement, MDA, as well as Licence Agreement. The initial MDA provided to IBM outlined activities that would allow IBM to reduce the royalty by \$25. Evaluation of these activities, which were mostly promotional activities in support of Windows 95, left the IBM PC Co in conflict with the overall objective of "IBM Products First .

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Only about 1/3, or \$8, of these reductions could be realized while remaining within the "IBM Products First" guidelines.

Microsoft decided against a "revenue based" license agreement for IBM as discussed at Comdex. Instead Microsoft has stated that they intend to treat IBM as 'any other OEM', and have provided IBM with the standard Windows 95 License Agreement. This license agreement is currently under review by IBM Legal and Contracts.

IBM has been in negotiations with Microsoft for several months in an attempt to agree upon acceptable MDA activities that meet both the "IBM Products First" initiative, as well as criteria acceptable to the Windows 95 Product Development team. To date, IBM and Microsoft have agreed upon items that net out to a royalty of anywhere from \$65 to \$51 based upon preload volumes of 1K/mo to 300K/mo respectively.

~~IBM is continuing to negotiate additional MDA activities with Microsoft, and if agreed to by Microsoft, could result in a best case royalty rate of approximately \$45 at volumes of 300K/mo. Best guess is that Compaq's rate for Windows 95 is approximately \$30, leaving IBM at an approximate \$15 disadvantage.~~

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Changing Market Place:

While the IBM PC Co has been focused on the Spring roll out of the Select-A-System dual boot preload of DOS/Windows and OS/2 WARP, Windows NT and Windows 95 support activities has taken a lower priority. In the same timeframe, our competitors are engaging with Microsoft in promotional activities in support of these Operating Systems.

Our customers, Merril Lynch, Freight Liner, Philip Morris, Duke Power, are experiencing compatibility problems with IBM hardware and questioning IBM's commitment to Windows NT. With this track record, it is easy to predict what will happen when Windows 95 becomes available in August. Already one customer, Dow Chemical has chosen Windows 95 and has approached IBM to determine IBM's commitment to Windows 95.

Finally, in the consumer space, Windows 95 will be critical to the success of our Aptiva line. In a market space where consumers know little about the products their buying, most major OEMs have already announced their intentions to ship Windows 95 as soon as the product is available.

Future Direction

I plan to re-engage with Microsoft at the executive level to determine what is required to close the gap with our competitors. Our customers will demand that IBM provide Windows 95, and IBM cannot compete fairly with such a disadvantage in royalties. IBM must be prepared to share with Microsoft the fact that we are in the process of rethinking the goals of the IBM - Microsoft relationship as outlined in the Comdex meetings last fall. ~~Your support in these meetings may be required.~~

IBM must also be prepared to step up it's current support position with respect to Microsoft products, particularly in the areas of Windows 95 and Windows NT on Intel Based systems. This is nothing more than what our customers will expect from IBM. I recommend that IBM expand it's relationship with Microsoft in the areas of development,

test, support of large accounts and trade show activity.

Working with Microsoft in development of new technologies such as MWAVE, Advance Power Management, INFRARED, will ensure that IBM leading edge technologies, become industry standards, as opposed to legacy hardware. Testing of IBM systems and adapter configurations with Microsoft Operating Systems and increased support of Large Customer Accounts will ensure customer satisfaction at evaluation and installation time. Demonstration of support at Trade Show events will demonstrate to IBM customers our commitment to provide the customer a 'choice' of operating system environments. Such activities can be used in barter with Microsoft to reduce the Windows 95 royalties and thus become self funding efforts. In this way, IBM benefits with reduced royalties and our customers benefit with better support.

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