Anthony is right about the history.

WebTV was told that they could ONLY do G2 if they did WMT before or at the same time. When they were told this was ok they were given no latitude on it.

The level of customer complaints about G2 is not a big enough to act like it is a huge P&L issue – it is a small issue.

They should be forced to delay G2 until they get WMT support done.

The idea that they unilaterally decided to slip WMT contradicts the promise they made when they were told they could do G2.

The board had to pass a resolution relating to indemnifying a specific employee for his work on the Real stuff – the deal with Real is a big problem.

We are going to have Real dictating the media formats for the TV and Music world because of their strength with Liberate and our work is just surrendering here.

This is a case where the rules were clear – black and white. The business reasoning behind the rules were clear

They can download G2 to their customers in the spring release if they can't get WMT done before then.

-----Original Message-----
From: Anthony Bay (Exchange)
Sent: Wednesday, September 15, 1999 11.25 AM
To: Jon DeVaan; Bill Gates; Steve Ballmer
Cc: Jim Allchin (Exchange); Bruce Leak; Will Poole; Rick Belluzzo; Anthony Bay (Exchange)
Subject: RE: WebTV, Real Networks and Windows Media

this whole episode has been pretty disheartening for me. let me lay out why i think we should all feel bad about what is happening and should take steps to fix it. this is a long mail but these are important issues.

1. We are in a platform battle at a corporate level for the next generation of internet technology; namely rich digital media. Losing this would be worse than having ceded control of HTML/http to Netscape, as it not only includes format and protocols but content encryption and there is no least common denominator that a site can choose; its either/or. Just as the company pulled together to drive adoption of our own internet technologies, we are (with one exception) pulling together to do the same for digital media. yes this sometimes makes life harder all around, but the payoff is huge and frankly the effort required is not very large.   the day is not very far away when rich media becomes a standard part of both consumer and business user experience.

2. Supporting our own platform doesn't mean not pragmatically also providing support for competing platform when it makes business sense. users running Navigator need to get a reasonable experience on msn or using office. playing MP3 files makes sense when there is lots of mp3 content out there. QT is a reality on the Mac and needs to be supported by our mac products. No one is suggesting anyone of our product businesses do something really stupid at the expense of their business or customers, but we should prioritize Microsoft's own strategic platforms above competitors.

3. Jon and Rick, you may not know the history of this particular WebTV/RN discussion. When Bruce and Steve Perlman decided early this year that they wanted to upgrade their Real 3 support to G2 jimall and i opposed it. we all discussed both sides of this, including the webtv customer sat concerns mentioned below, with steveb, billg and paulma and the decision from bill was pretty clear the first priority was to add support for windows media, after that it was OK to ALSO upgrade to Real G2. if there was room for only one format on the device, it should be Windows media. Steve Perlman and Bruce agreed to this, even though it was not what they wanted to do. Now there seems to be a convenient memory loss over the whole conversation and agreement. That is BS. we made a decision and unless there is new data to

1

rethink we should stick with that decision (and all the new data more firmly supports WMT viewpoint not WebTV position). i don't understand how WebTV can just unilaterallly decide that this commitment is meaningless.

4. the customer satisfaction issue is a red herring and a two-edged sword.

red herring because there are other ways to solve it. for example, WinCE handhelds need to be able to play MP3 files. customers want digital music on their devices. so we have done WinCE work to put a windows media player on the device and provider an integrated sync tool/transcoder for the PC that moves files from the PC to the CE device, and if they are in MP3 format it simply transcodes them to wma... and saves half the required storage in the process. customers get digital music on their CE device, Microsoft gets format and player adoption. we offered to do something similar for WebTV. i assert that WebTV customers really aren't so much interested in G2 support as they are interested in listening to audio content they like. we offered to go to the top 25 sites that webtv customers complain about not being able to hear and help them also stream in windows media if they already weren't; servers, deployment help, encoding help, tech support. webtv customers would get their audio and microsoft would increase its format adoption. WebTV has refused to ever give us this list even tho they promised to on multiple occasions, nor to seriously explore whether this could solve the requirement to upgrade to G2.

two-edged sword because we are winning lots of content for windows media technologies, none of which will be playable on webtv. we have made huge progress in getting top sites and breadth sites to either stream both formats or just stream in windows media. a growing percentage of our wins are exclusively in our formats (majority of the record label promos for example. .. and #2 radio holding company Clear channel with 500 stations all going exclusively windows media being another). we are building a great media portal for msn (msn media guide aka windowsmedia.com) which is closely integrated with our player and is already at > 5% reach. in fact, in the recent PC Mag scorecard of portals, msn's streaming audio and video feature (provided by SMD) rated as one of only 3 excellent features on msn.. AND rated higher than ALL other portal's streaming media efforts. check out the media guide for the breadth of what is available already, and our momentum is really picking up speed. NONE of the content on msn media guide will play on WebTV. are we just going to wait until customers ask us why we are so stupid before we rank that customer sat issue high enough?

5. Real Networks is a shitty partner and wants to control branding and user experience of streaming.. which will result in an ongoing tense situation given webtv's model of control of the user experience. it was pretty clear from the WTV/RN negotiation over the current deal that RN will be very difficult to deal with and will not have best interests of WTV or its users at heart. on the other hand, using WMT gives webtv complete control over the user experience with no one to have to argue with over branding, etc. Making RN the default streaming technology in WebTV only strengthens their position and makes them harder to deal with in the future

6. WebTV supporting RN over WMT (which the current path clearly is.. lets not BS ourselves) has a number of ripple effects. it hurts us in PR in a bigger way than people other than wpoole and i anticipated (it was amazing to watch the press salivate over this issue and write about its meta meaning for the format competition). microsoft has been schizophrenic in its relationship with RN and have confused the market as to how much they are a partner vs a competitor. we tried to put that behind us when we divested our stock position, but the WebTV announcement of support caused a whole round of confusion again. I had key customers and partners call me up (and ask reps in the field) if Microsoft was abandoning its own media efforts in favor of Real. this will happen again if we stay on current course and honestly does blunt our momentum. Second and actually worse is that because Real is the default format in webTV service.. all licensees of TVPAK will end up wanting/requiring Real support. we are starting to see this happen already, shipping g2 will just cement the decision. that means that we are helping Real establish itself in the new TV platform and disadvantaging our own platform. and worse, since they also have deals with liberate and AOL, they become the defacto winner   encouraging this to happen by favoring Real in WebTV service is incredibly short sighted.

7. it pains me to say so, but other than WebTV, i am managing to work collaboratively and effectively and in good faith with all the other parts of the company; several of whom have their own unique issues just like WebTV.   i described the WinCE work above, on the Mac we are balancing adding WMT support with also supporting QuickTime. despite the temporary pain, others seem to be able to sense the importance and work collaboratively towards a common objective. i have tried hard with WebTV but nothing seems to work.

Recommendation:

I know it would be painful, but i believe the marketplace situation has changed to the point where WebTV could switch to WMT as the default and maintain/improve customer sat.. if we go out and get the top WTV accessed sites to support WMT if they aren't already on track to do so. the contract WTV negotiated with Real gives WTV the flexibility to never ship G2 and only to have to pay a few hundred K$$ to cover some engineering expense. will and i will step up to help make this happen by working with key sites that WTV users visit.

2

If that isn't the path we take, then WTV should do what it agreed and make WMT the default but place Real G2 on whatever devices they can (rather than the reverse which is the current path). or potentially later giving the user a choice. i know its late in the engineering cycle but this is the path they should have been on.

The least palatable option is to ship g2 as the default and WMT on a subset of devices in the november release. this is counter to what was agreed to and frankly i think its BS, but at least we would have support in newer webtv devices. we are still giving far too much power and momentum to Real by doing this, and will be unable to fully leverage the work we are doing with msn for WebTV (since only a subset of WTV users would be able to listen to content off of our media portal). so WTV gets no benefit from the work we are doing to build a great media guide and asset.

However, it is just not OK for WTV to upgrade its entire userbase to G2 and not add Windows Media until some release next year - schedule TBD. it sends the wrong message to the world and to WTV customers and to the rest of Microsoft.

frankly, if WTV stays on its current path i can't justify continuing to invest much in working together on the promise of some marginal support someday. i don't see much future in being a second class partner for Bruce, the experience so far sucks. we just can't afford to be a second class platform in TV space. once WebTV is prepared to work seriously with us and we can get some return on our efforts then we can re-engage   it is sad, but to gain platform share in the TV space it seems I should go focus our efforts now on partners who would value and prioritize working with us.. Liberate, TiVO and ReplayTV are obvious places to start.

-----Original Message-----
From: Jon DeVaan
Sent: Monday, September 13, 1999 5:53 PM
To: Bill Gates; Steve Ballmer
Cc: Jim Allchin (Exchange); Bruce Leak; Will Poole; Rick Belluzzo; Anthony Bay (Exchange)
Subject: RE: WebTV, Real Networks and Windows Media

For the record, WMT will ship in the spring update. This was a tough decision by the team. The constraints are Christmas selling season spikes which require a certain amount of absolute rock solidness in the operations of any new release so that the spike can be handled. This isn't a WMT issue, just a hard wall of time.
G2 is one of the very top customer issues for WebTV. Sadly, WMT is not. The holiday spike and the real customer driven data are the two major factors that landed us where we are.

-----Original Message-----
From: Anthony Bay (Exchange)
Sent: Monday, September 13, 1999 3:48 PM
To: Bill Gates; Steve Ballmer
Cc: Jim Allchin (Exchange); Jon DeVaan; Bruce Leak; Will Poole; Anthony Bay (Exchange)
Subject: WebTV, Real Networks and Windows Media

I hate to have to do this, but we have reached an impasse with WebTV over the implementation of support for streaming media formats and your guidance is needed.

WebTV's current plan is to ship an update this fall that includes updating all WebTV service clients to RealNetworks G2 but includes no support for Windows Media. Windows Media support was on the list to ship to a subset of WebTV client devices, but has recently been cut.

This is specifically counter to the direction from both of you earlier this year that WebTV could add support for Real Networks only if they first supported Windows Media. WebTV agreed to this prioritization but hasn't followed thru. I believe this is the wrong decision for several reasons and ask that you intervene to change this.
If required, i ask that they slip their release to ensure that it supports windows media in addition to G2 Ideally windows media would have been the default (as you both said was the directive) and g2 only on a subset of platforms, but they chose to go with the opposite approach. At this point, shipping WMT on the planned devices (everything but the original classic) needs to be the minimum bar.

In addition to the damage it will do to Microsoft's efforts to establish its own streaming media platform, shipping only G2 support on WebTV has a good deal of negative impact on Microsoft customers We are heavily promoting windows media formats and are making lots of progress with Internet content providers, many of whom are betting on Microsoft's platform (Clear Channel Radio network is the most recent.. migrating 500 stations to exclusively Windows Media).   windowsmedia guide, the radio, music and video channel on msn is becoming one of the largest media guides on the web. it points traffic exclusively to

3

windows media based content. webtv users who use msn will get pointed to content they can't listen to. That makes no sense.

the result of webtv's decision is that microsoft is giving very mixed messages to press, analysts and customers. the initial announcement of G2 support was a significant negative PR hit and literally caused many major customers and ICPs to ask if we had lost faith in our format and were rebuilding our relationship with RN. we countered this by saying that WebTV would be supporting both formats. Having them support only G2 will raise this issue all over again.

We have bent over backwards to help WebTV incorporate support for windows media. i don't know what else i can do at this point. I understand WebTV's desire to upgrade to G2 for customer satisfaction reasons.. although i believe there were other ways to achieve the same goal. However, I cannot support them shipping G2 support without Windows Media. The rest of Microsoft's product businesses are supporting our efforts to establish our digital media platform; WebTV service is the only one who is not. We are investing > $120M a year to establish our media platform, actions like this are inconsistent with that objective.

4