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April 9, 1990

SECTION WITHHELD ON THE  
BASIS OF ATTORNEY-CLIENT  
OR WORK PRODUCT PRIVILEGE

MEMORANDUM TO:

Mr. R. H. DaFoc  
Mr. R. A. Guarino

Mr. L. R. Reiswig, Jr.

SUBJECT:

Microsoft

Attached please find several items which came out of our Microsoft work sessions on Friday, April 6 and Monday, April 9. They are:

- One chart outlining the key points for JAC to discuss with WHG on April 11.
- A three page "script" which further describes the key points for the JAC/WHG meeting.
- One chart which outlines the principal tasks ahead of us in negotiating a complete "partnership" with Microsoft.
- One chart for each product outlining the "current status" and "IBM's interests and concerns." These charts revise the charts used with Microsoft in our first meeting in Dallas.
- One chart which provides a first cut at an agenda for our next meeting with Microsoft tentatively planned for the week of April 16, 1990.

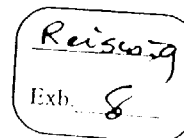
Let me put one caveat on all of this material. It all assumes we continue to dialog with Microsoft on the complete "partnership" we have been discussing. Should different direction come out of the April 11 meeting, a new strategy, agenda, and "IBM interests and concerns" position for each product will have to be developed.

I have reserved time for the full team of us to meet prior to the JAC review on Tuesday evening. Also, I am hopeful the full team will be able to meet Wednesday afternoon while standing by to join JAC and WHG.

I will be in an off-site class on Tuesday, April 10. However, I will call in for messages should you need to talk with me about any of the attachments prior to our 5:30 p.m. prep for the 6:30 p.m. Cannavino meeting.

R. Seymour

RS/ccr  
Attachment  
a:0409cr06.



5:03

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KEY ISSUES FOR JAC/WHG

0 COMDEX GOALS

- SINGLE VOICE
- COMMON PRODUCT GOALS
- OS/2 PRIORITY
- STREAMLINED DEVELOPMENT PROCESS

IMPLIES A PARTNERSHIP, NOT A VENDOR/CUSTOMER RELATIONSHIP

0 DLA vs JDA

- MUST INCLUDE DOS, WINDOWS, OS/2, LAN, ES
- 5-10 YEAR TERM vs REL-BY-REL AGREEMENTS
  - o TECHNOLOGY ACCESS
  - o BUSINESS ARRANGEMENT
- JOINT MANAGEMENT PROCESS
  - o ESCALATION RULE: P.O.R. vs DEVELOPER DECIDES
- RIGHTS TO -SOURCE CODE AND DERIVATIVE WORKS

0 1990 CRUISER PRODUCT PLAN *os/2 2.0*

- AGREED-TO PLAN
- MS HAS CHANGED PLAN W/O IBM AGREEMENT
- MUST HAVE GROUND RULE FOR MUTUAL AGREEMENT

0 OS/2 BUSINESS DEAL

- \$0/0 ROYALTIES
- DEVELOPMENT EXPENSE

0 WINDOWS BUSINESS DEAL

- WINDOWS WITH HARDWARE
- WINDOWS WITH DOS
- HANDSHAKE AT LESS \$10/COPY PRIOR TO COMDEX

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## SUMMARY OF KEY ISSUES

### COMDEX GOALS

At COMDEX last year we agreed to a significant expansion of our partnership. We agreed to some key principles. We wanted to streamline both our development and decision-making processes. We wanted to consolidate our development efforts in fewer sites with a single site for each product. We have started down that path with the understanding that we would have equal influence in making major decisions. We agreed to speak with a common voice about the projects we're jointly developing. We agreed to put our development priority on OS/2. We agreed to develop common product goals. All these things support an expanded relationship.

But these things aren't occurring. We're not speaking with a common voice. Microsoft has publicly re-positioned OS/2 for developers and for LAN servers rather than the desktop. They are telling our European marketing groups that OS/2 2.0 will never be viable in 4 megabytes. In a partnership, decisions on plans and strategies are made jointly, but Microsoft has unilaterally embarked on major changes to the agreed OS/2 2.0 plan.

### PARTNERSHIP FUNDAMENTALS

At COMDEX we envisioned a partnership that encompassed the development, management and ownership of a broad range of system software. Specifically, our goal was to extend and adapt the JDA to include OS/2, DOS, Windows, LAN Server/Manager, Database Manager and Communications Manager. The current JDA provides for joint decision making and code rights equivalent to ownership for OS/2.

So far, our negotiations have moved backward, not forward in this area.

Microsoft now is unwilling to have a partnership on DOS and Windows at all. IBM is simply to be another OEM. Microsoft does not want IBM to participate in managing these products. Throughout the history of our relationship, IBM has always played an important role in planning DOS. We cannot agree to abdicate that role now for such an important product. As Microsoft requests IBM to promote Windows as a key part of our personal computer strategy, IBM must be able to agree with Microsoft on a plan for that product, and then be able to rely on that plan in making commitments to IBM customers. A partnership relationship is required.

Microsoft now also wants to manage OS/2 in a way that is inconsistent with the existing JDA. The JDA does not allow Microsoft to change the product plan without IBM's agreement. Microsoft wants to have the right to change the plan unilaterally. The diversion of effort from

## SUMMARY OF KEY ISSUES

2.0

the agreed Cruiser plan to Hydroplane without IBM agreement indicates that Microsoft is implementing a new management process before we have reached agreement on what that process should be.

At COMDEX we discussed a long term partnership that provided for each company to have access to the other's technology in core software. Microsoft now wants to proceed on a release-by-release basis, with no assurance that each of us can rely on the other to participate in future projects. Microsoft also does not agree to provide the derivative rights that IBM requires for a product that is so important to our strategy.

In order to successfully conclude these negotiations, we need Microsoft's agreement to these fundamental principles of partnership.

2.0

### 1990 CRUISER PRODUCT PLAN

This is an example of a major content/schedule disagreement requiring resolution by Jim and Bill. IBM and Microsoft had an agreed plan for the function and schedule of OS/2 2.0 in Cruiser. Microsoft has abandoned the agreed plan for a "better" (significantly more function, significantly later schedule) plan without agreement by IBM.

We have to have some groundrules governing plan changes. IBM believes the groundrule for Cannavino/Gates issues must be that the agreed plan can not be changed without the consent of both partners. Microsoft believes that in cases of disagreement the developer should make the final decision.

We've both tried to compromise on the specific issue of Cruiser vs. Hydroplane. A Limited Availability/Expanded Beta Test of Cruiser was suggested; now we're deadlocked over whether this should be System Test Entry or Exit level code. IBM would need to ship to about \_\_\_\_\_ large accounts. IBM believes we have to meet our COMDEX commitment for a 1990 32-bit release.

We must have an agreed mechanism for resolving these disputes that satisfies the needs of both companies.

### BUSINESS AGREEMENTS

By any reasonable measure, IBM and Microsoft are equal partners in OS/2 notwithstanding the audit. IBM has put \$500 million into the development of OS/2, done all the System Testing and most of the marketing. Microsoft's expressed desire is to get to general OEM pricing of approximately \$20 on a per-system basis. At Microsoft's current \$21/9 offer, IBM would be paying the same price as any other OEM after having made these major investments.

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## SUMMARY OF KEY ISSUES

Microsoft put \$0/0 on the table as an alternative to \$21/9 but two weeks ago in Redmond that offer was withdrawn. This leaves us in an untenable position: we have offered \$40/40, \$20/20 and \$15/15; Microsoft offered \$21/9 and \$0/0; every time we start to get within striking distance of a deal, Microsoft backs off and withdraws an offer.

IBM has a number of issues with Microsoft's current business proposals for Windows and OS/2. Microsoft's most recent offer requires bundling Windows with 286 systems (aside from the 65% discount on packaged product). That will be difficult to accomplish in all cases because of the lack of hardfiles on several models. IBM also has long history with unbundling that may limit our flexibility. From the beginning of our negotiations, Microsoft has had offers on the table that included option for bundling with DOS as well as with hardware; the with-DOS offer has now been withdrawn. IBM has been looking at the DOS/Windows proposal and felt we were close to agreement, but asked for lower royalty if we were to bundle with hardware. Now a significant element has been withdrawn.

## WINDOWS ANNOUNCEMENT

This will be a major event in light of our joint statement of direction at COMDEX. Both IBM and Microsoft need to reinforce our joint S.O.D. with joint and individual actions. First we need to agree on the above issues. Second, IBM needs the flexibility in the Window business deal discussed above. IBM and Microsoft both need to make positive statements at the Windows announcement; Microsoft with a new product; IBM reinforcing our common strategy and the fit with OS/2.

KEY ISSUES FOR TASK FORCE

- o JAC DISCUSSION POINTS
- o DLA vs JDA
  - LONG TERM vs REL-BY-REL AGREEMENTS
  - RIGHTS TO FUTURE TECHNOLOGY ... SCOPE, DERIVATIVES, ROYALTIES
  - PAID UP LICENSE AFTER 3-1/2 YEARS
  - RIGHTS TO SOURCE CODE AND DERIVATIVE WORKS
  - RIGHT OF FIRST REFUSAL ON NEW RELEASES AND SUCCESSOR PRODUCTS
  - APPROVAL RIGHTS ON PUBLIC STATEMENTS PRIOR TO GA
  - PROPRIETARY RIGHTS ON HARDWARE SPECIFIC CODE
  - JOINT ATTRIBUTION ... DEFINITION, SCOPE
- o JOINT MANAGEMENT PROCESS
  - PRODUCTS COVERED
  - ROLE OF JOINT ASSURANCE
  - FINE TUNING OF PROCESS DESCRIPTIONS
- o BUSINESS DEALS
  - DOS ... SUBSTANTIAL AGREEMENT
  - OS/2, PORTABLE ... ROYALTY, PHASE II AGREEMENTS, DEVELOPMENT EXPENSE SPLIT
  - WINDOWS ... PER COPY ROYALTY
  - LAN, ES ... TBD
- o WORK SPLIT
  - DOS ... SUBSTANTIAL AGREEMENT
  - OS/2, PORTABLE ... SHELL (IBM PROPOSAL DUE 4/16)
  - WINDOWS ... SUBSTANTIAL AGREEMENT
  - LAN ... TBD
  - ES ... SUBSTANTIAL AGREEMENT

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DOS SUMMARY

## \* CURRENT STATUS

- STANDALONE AGREEMENTS
  - RELEASE BY RELEASE
  - NO AGREEMENT FOR FUTURES
  - USUALLY ONE PARTY DEVELOPS
- RIGHTS
  - OWNED BY PARTY THAT WROTE CODE
  - IBM HAS RIGHT TO DISTRIBUTE OBJECT CODE ONLY
  - IBM DOES NOT HAVE RIGHT TO DISTRIBUTE SOURCE OF ORIGINAL OR DERIVATIVE WORKS
  - MS HAS RIGHT TO DISTRIBUTE SOURCE TO OEM's INCLUDING IBM DERIVATIVE WORKS
- ROYALTY
  - RECENT RELEASES: ONE TIME PAID UP FEE (NOMINAL)
  - \$15/DOS LICENSE IF MS BASIC DISTRIBUTED OUTSIDE ROM
  - ONE-TIME PER PLATFORM CHARGE TO DISTRIBUTE FOR NON-INTEL x86 HARDWARE
- NO LOGO RIGHTS
- PATENT COPYRIGHT INDEMNITIES ARE TOO LIMITED

## \* IBM'S INTERESTS &amp; CONCERNS

- DOS SHOULD BE UNDER DLA; PHASE I/II CONCEPT LIKE OS/2
- MICROSOFT PRIMARY DEVELOPER
  - WOULD AGREE ON TARGET RESOURCES (SMALL EFFORT)
  - SOME IBM SYSTEMS SHOULD BE REFERENCE HARDWARE
  - OEM ADAPTATION WOULD BE SEPARATELY RESOURCED
  - DEVICE DRIVERS FOR REFERENCE HARDWARE SHOULD BE INCLUDED IN BASE DEVELOPMENT
  - DOS MUST BE ROM-ABLE
- ELIMINATE ROM-BASIC ROYALTY
- NOMINAL ONE-TIME CHARGE FOR NEW VERSIONS, < \$350K
- GUARANTEE IBM RIGHT TO FUTURE RELEASES UNDER SIMILAR TERMS
- REQUIRE ATTRIBUTION

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WINDOWS SUMMARY

## \* CURRENT LICENSE AGREEMENT

- MICROSOFT DEVELOPS
- VERSION 2.x: \$12-9 COMMERCIAL ROYALTY, \$3 EDUCATION
- IBM HAS RIGHT TO DISTRIBUTE ORIGINAL AND DERIVATIVE WORKS IN OBJECT CODE ONLY
- LICENSE TO SOURCE CODE FOR IBM INTERNAL USE ONLY
- BOTH HAVE RIGHTS TO PRODUCE DERIVATIVE WORKS
- FUTURE RIGHTS TO 3.x EQUAL TO MOST-FAVORED CUSTOMER

## \* CURRENT VERSION 2.x VPA

- IBM DISTRIBUTES MS MANUFACTURED PACKAGES
- IBM PAYS \$25 FOR 286, \$45 FOR 386
- MS CAN RAISE PRICE ON 45 DAY'S NOTICE

## \* IBM INTERESTS &amp; CONCERNS

- INCLUDE UNDER NEW DLA
- MICROSOFT PRIMARY DEVELOPER
  - TARGET RESOURCES (SMALL EFFORT)
  - REFERENCE HARDWARE
  - DEVICE DRIVERS
- ROYALTIES (LICENSE)
  - \$3/UNIT EDUCATION
  - \$9/UNIT COMMERCIAL SHIPPED W/DOS
  - \$6.50/SYSTEM IF BUNDLED WITH 286 SYSTEMS
  - \$3M/7.5M 1 & 2 YEAR FLAT FEE BUNDLED WITH 386/486's
  - MOST-FAVORED CUSTOMER PROVISION
  - PAID-UP LICENSE FOR EACH RELEASE AFTER 3 1/2 YEARS
- FUTURE RELEASES

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OS/2 (16 & 32 BIT)

\* CURRENT JDA

- IBM & MICROSOFT JOINTLY DEVELOP
- COMMIT RELEASE BY RELEASE
- ROYALTIES
- IBM PAYS \$30.50
- MS CREDITS \$15.50 (ZERO NET FLOW FROM MS)
- BOTH PARTIES HAVE RIGHTS TO DISTRIBUTE OBJECT
- SOURCE CODE DISTRIBUTION SUBJECT TO RESTRICTIONS

\* IBM INTERESTS & CONCERNS

- SE AND PORTABLE UNDER DLA
- DEVELOPMENT SPLIT
- MS DEVELOPS AND TESTS
- UNIQUE HARDWARE ADAPTATION AND TESTING IS SEPARATE
- ROYALTIES
- ELIMINATE ZERO FLOW
- \$0/0 PER-COPY ROYALTY
- MS BEARS DEVELOPMENT EXPENSE
- JOINT ATTRIBUTION

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LAN SUMMARY

\* CURRENT LAN MANAGER LICENSE AGREEMENT

- MS DEVELOPS BASE CODE
- IBM SEPARATELY DEVELOPS ENHANCEMENTS
- MS LICENSES ITS BASE TO IBM
  - SEPARATE AMENDMENT FOR EACH RELEASE
  - NO RIGHT TO FUTURE WORK
  - SOURCE CODE: IBM INTERNAL USE ONLY
  - DERIVATIVE WORKS: IBM CAN PREPARE AND DISTRIBUTE IN OBJECT CODE
  - IBM NOT REQUIRED TO LICENSE ENHANCEMENTS TO MS
- ROYALTIES
  - IBM PAYS MS \$350/250/200 BASED ON VOLUME (\$15K/25K CUMULATIVE)
  - IBM ALSO PAYS A ONE TIME PAYMENT PER RELEASE, e.g. \$200K

\* IBM INTERESTS & CONCERNS

- LAN UNDER DLA
- DEVELOPMENT SPLIT
  - IBM DEVELOPS AND TESTS LAN
  - UNIQUE HARDWARE ADAPTATION AND TESTING IS SEPARATE
- ROYALTIES
  - TBD
- JOINT ATTRIBUTION

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ES SUMMARY

- \* CURRENT AGREEMENT
  - NONE
  
- \* REPACKAGED EE (MINUS SE & CLIENTS)
  - ES SINGLE USER...PRE-REQ'S SE
  - ES SERVER...PRE-REQ'S SE & LAN MGR
  
- \* IBM INTERESTS & CONCERNS
  - ES UNDER DLA
  - DEVELOPMENT SPLIT
    - IBM DEVELOPS AND TESTS ES
    - UNIQUE HARDWARE ADAPTATION AND TESTING IS SEPARATE
  - ROYALTIES
    - TBD
  - IBM BEARS DEVELOPMENT EXPENSE
  - JOINT ATTRIBUTION

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AGENDA  
(WEEK OF 4/16/90)  
ASSUMING CONTINUATION OF TRACK WE'VE BEEN ON)

o FIRST DAY

- REVIEW/DISCUSSION OF JAC/WHG MEETING
- CORRECTIONS ON AUDIT
- WRAP-UP OF MANAGEMENT PROCESS
- IBM SHELL PROPOSAL

o SECOND DAY

- BUSINESS DEALS
  - o WINDOWS (INCLUDING CONTRACT)
  - o OS/2 (INCLUDING PHASE II AGREEMENT ON 32 BIT OPERATING SYSTEM - CONTRACTS AND TECHNICAL PLAN)
- DLA/JDA TERMS AND CONDITIONS
- WORK SPLIT - PLAN FOR ES/LAN REVIEWS

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