PLAINTIFF'S EXHIBIT 1292 Comes v. Microsoft

Ron H,
we need a meeting
You, me, Steve,
Richard or George
in the room. Thanks

Memo

To:	Larry Edralin, Ron Hosogi
From:	Sheri Vail
Date:	April 16, 1992
Subject:	Phoenix Commercial Business
cc:	Richard Fade

Attached is Steve Kalman's manifesto on the state of his commercial business (ie., shrink-wrapped Phoenix DOS sales). Although obviously MS isn't wholly to blame for low DOS market prices, he does present compelling arguments, which I've corroborated with our new business account managers' experiences. It's clear at the rate we're going with MED added to rampant gray-marketing, it's impossible for Phoenix to stay competitive and thus stay in this business much longer.

MS needs to decide if and how Phoenix may continue to play, and either lower their royalty or find a graceful way to let them out. My view is it is more to our benefit to have Phoenix selling MS-DOS at a lower (competitive) price than it is to not have them selling our product at all, but would like your feedback.

Please copy Joachim K, Brad C, Jeff L. & Peter Mi. (and above-list).

Joachim, this is an interesting paper. Please review and lets discuss. Thanks RonH
I plan to meet w/them end of april.

Pls file
Phoenix Techn.

MS-PCA 2548715

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Phoenix

April 14, 1992

Ms. Sheri Vail
Microsoft Corporation
1 Microsoft Way
Redmond, WA.98052-6399

MS-PCA 2548716

Dear Sheri:

The purpose of this letter is to follow-up on our meeting of February 20th and expand on one of the key topics which we discussed together. My specific focus is on the commercial products segment of Phoenix's packaged goods business which includes those MS products sold under your license 2875-8280. Furthermore, I will discuss the general health of this business for Phoenix, the pertinent facts that lead to our conclusions and some recommendations and actions which I believe can address the problems immediately. I am going into some extraordinary detail for a letter so that you and your associates can analyze our pr oblems and determine potential courses of action and solutions. I would like to propose that, after you have the opportunity to study this letter, we schedule a meeting to take place by early May.

It is our conclusion that the general state of health and outlook for the Phoenix commercial product line is very poor. We arrived at this conclusion after lengthy study for three fundamental reasons:

1) The predictability of the commercial business has greatly deteriorated;

2) the sustainability of minimum business levels has declined and is continuing to decline; ~~and~~

3) The market will not absorb acceptable volumes of product at our current pricing levels. I must remind you that we have no ability to lower prices given our current costs and Microsoft's existing royalty structure.

all agreed.

There is a fourth point to made here; the overall market continues to be significant and growing. This is ironic, because the three fundamental reasons I described above are so negative. We continue to believe as you do, that the market segment being addressed in the U.S. is in the area of several million available sockets per year, is growing at least as fast as the PC market in general and that between MS and Phoenix we have a combined market share ~~less than 25% of the total.~~

agree. same observation? 1:3 are we that low

or, is it just among the base of unlicensed machines?

Phoenix Technologies Ltd., 846 University Avenue, Norwood, MA 02062-3950, 617-551-4000 Telex 710-345-0199 FAX 617-551-3750

Agree!

It is meaningful at this time to discuss some indisputable facts and my own observations that lead to Phoenix's conclusions.

1. The first fact, as a point of reference, is unit volume since the rollout of DOS 5.0.

CALENDAR 1991		CALENDAR 1992	
other periods ('000's units)		4/92-6/92	
3Q (Act)	4Q (Act)	1Q (Est)	2Q (Fcst)
60.4	37.7	26.0	22.0

2. Our customer base has experienced a net shrinkage after adding new customers of over 160 names since October of 1991. As part of this number, it is important to note that we experienced over 135 gross adds before account terminations or fall-offs from the June 1991 rollout of DOS 5.0 through year end. However, since early January we have been experiencing significant account drop-off so that our net active customer list is now smaller than it was pre-DOS 5.0. Our customer gross addition rate for the trailing 6 months is smaller than at any point in our last 3 years. It is appropriate for me to emphasize to Microsoft that our investment and efforts to promote the commercial product area has not diminished at all during this period.

shows how unprotected the per copy OS business really is - loyalty

Given the fact, as I emphasized earlier, that this market segment continues to grow and that we continue to identify and "pitch" new prospects, there must be some other reason for this deterioration in our business. As a result of an extensive review and analysis by my staff, we found some very revealing information, which leads to my following point.

3. Our research of lost accounts (which included interviews with personnel from identified companies) can be characterized as follows:

A. Over 80% of the accounts we lost made a conscious decision to purchase grey market product. Surprisingly enough, only four (4) accounts are now buying Microsoft product directly. The remaining 20% of lost accounts fall into three categories; 1) wouldn't comment; 2) no longer selling DOS and are consciously pushing the decision and acquisition of DOS to the end user at retail; or 3) moving to DR DOS.

representing what % of total units?

The singular reason among these companies for changing to grey market purchases was price. Almost without fail, each company stated that since their competition was purchasing grey market

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get me the names! we go after them!

goods they in turn felt they had no other choice in order to compete. The pricing averaged between $35 and $45. This does not include sub $35 pricing for Microsoft product that upon preliminary investigation, we found was probably counterfeit goods.

BIG PROBLEM! can we change this perception? How?

B. A majority of companies thought that Microsoft was less concerned today with grey marketing than in the past. The overwhelming majority of commercial companies just do not see anything improper with the standalone purchase of an OEM branded DOS. We found the reasons behind this perception are interesting. Here is a sampling of some comments.

-- "Microsoft is now selling retail DOS (referring to the Retail Upgrade Product) and therefore my buying standalone DOS is OK."— weak

who did they talk to at MS? can change this Legal?

"— Microsoft called us and we told them what we were doing and they said that we were not the problem. They said that the OEM was responsible for distributing DOS only with its machines and that we (the small integrator) were not in any trouble..." Who

can we change our license language

-- "DOS no longer says "Not for retail sale except with a computer system"

To this last quote, we discovered that since the majority of OEMs today do not ship MS DOS in its own box, the "Not for retail sale.." notation has in fact virtually disappeared. BS need to put this back in.

use language printed on the box?

4. The Retail Upgrade Product "RUP", given its current pricing, is now a very important and influential factor in two ways.

A) It has established a new price point for DOS in the market. Our interviews indicate that this market segment does not see any differentiation between RUP and standard DOS. Furthermore, per an extracted quote that captures the majority sentiment:

Steveb!!!

-- "since Microsoft set the prices to the channel on RUP in the sub $40 area, then the price value of "DOS" is now in fact about $40."

B) As a result of the new price point this channel segment is "incented" to copy an old version of DOS to their system and then install RUP. Our interviews indicated that this is now occurring at an alarming rate. Many companies rationalize that they do not think they are doing anything wrong by

illegal activity.

Ms. Sheri Vail
April 14, 1992
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"initializing" the system with an old and illegal copy of DOS, since they are in turn loading a legal RUP copy of DOS.

5. The program which I believe you call "Easy Distribution Program" allows for an acquisition price of $39 with only a minimal book commitment. Those companies within our target market segment that are aware of this program have concluded (per our telephone interviews) that there is no justifiable reason for the difference between $39 and $52 (our lowest price for our slim version with a significant annual purchase commitment). While this is no problem for Microsoft if the account opts for the EDP, it is a problem when they don't. They appear to be compelled to buy standalone or counterfeit goods because of what they view as an intolerable difference in price. i.e. "why should I buy at $55+ when Microsoft themselves by virtue of the RUP program and the EDP program have established the market price of approximately $40. In addition, the availability of OEM branded DOS on the market supports this low price point." ?

Lawred, there is also difference between per sup + per copy

I would like to suggest at this point in my letter, that Microsoft consider the reasons supporting my general appraisal of the poor health of Phoenix's commercial product business. By virtue of the lengthy analysis that I have undertaken to provide Microsoft with, we should both readily conclude that if Phoenix were to offer a competitive ($4 price, we could turn this situation around to our mutual benefit; reducing grey market DOS and the improper use of RUP by resellers and integrators. NO

really? - I think have we work to do than Phoenix - how do we solve the ... problem? better, but...

Therefore, I would like to recommend the following alternative solutions to our current dilemma: but...

- Lower the Phoenix royalty rate to $24.50, as justified in the attached product proforma. Please note: I have attached this product profitability proforma, in order to save you the time of extracting same from your data and license. No

NO - I object if this is only the same per copy deal w/ cheaper docs

AND/OR

- Design a program that would allow Phoenix to sign-up highly defined account types to the EDP program. Such a program should allow for a similar per product profitability structure as exists today.

can they do a per unit deal for us? Should we make them our MED Sales Agent?

AND/OR

- Define a reasonable basis for Microsoft to acquire this business segment from Phoenix within the next three months.

not interested (at least I'm not interested)

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2

No way

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does NOT impress me. but...

In closing, if we do not address this declining situation within the next 45 days, our commercial business segment most surely will not survive into the next quarter. Furthermore, it is certainly reasonable for Microsoft to analyze the probable impact, if we do nothing and allow this failure to occur. I submit to Microsoft that the impact of Phoenix withdrawing from this segment will be quite negative. I believe that based on our analysis, the vacuum created by Phoenix's absence would result in a significant majority of existing Phoenix commercial customers purchasing "alternative" (grey or otherwise) sources of supply.

I want to be nice.

Hopefully, I have described our situation in sufficient detail and have provided you with compelling and irrefutable background information and material. Again, I apologize for the length of this letter, but I believe that its specific detail will enable Microsoft and your group to undertake an immediate analysis and in turn formulate acceptable solutions for both of our companies.

I will have Cindy call you and coordinate a specific time for us to meet in Redmond. Thank you in advance for your attention, time and consideration to these important issues.

Sincerely;

Steve Kalman
Vice President and General Manager
Packaged Products Division

cc Jack Kay
Ron Fisher
Steve Berns, Esq.
Howard Marson
Scott Maidment

MS product ~~guideline~~

pricing guideline

Under ~~10~~K 5	under 10K	~~$~~ 31/sys
low 29	27	& when +4
med 31	29	
high 33	31	

~~Attachment to Microsoft letter of April 14, 1992~~

PRODUCT PROFORMA

Original Model			Target	
100%	$55.00	Revenue/Price	100%	$42.50
18%	$10.00	C.O.G.S.	24%	$10.00
64%	$35.20	Royalty	58%	$24.50
18%	$ 9.80	Gross Margin	18%	$ 8.00

10K commit

~~$~~ 30

MS prod list $50/copy

EG.DOS

$ 45 cost internal or 18% off our list price

pay as you go plan

1 yr MED agent ~~plus 8%~~. 6% of net receipts

no repeat biz.

$34/sys

all cust systems

MED min commit ~~70%~~

$34/sys X 2500/yr. units

2 yr license

start at 8%

4m/qtr Business requirement over

NO royalty for 2nd yr.