IBM PCCo

Plaintiff's Exhibit

2513_B

Comes v. Microsoft

Memo

To: Rick Thoman

From: Harry Nicol

CC: R Stephenson

B Claflin

Date: September 21, 1995

Re: Lotus Sizing and Impacts

Rick,

Unfortunately I will not be able to be at today's review of case 3.. The PCCo team will be represented by Dave Johnson and Nick King, and will present as discussed the PCCo impacts resulting from the case 3 scenario.

I have attached my personal perspective of what could happen with Microsoft and their key OEM partners in reaction. I have asked Jim Alic's team to take this into account as best as possible, these consequential reactions / scenarios.

Harry Nicol

Director - Technical Strategy

Case C Scenario

OEM Pre-Load and Retail Pricing of Lotus Smartsuite forces Microsoft to offer " Microsoft Office for Windows 95 " at equivalent pricing.

- PCCo offers Smartsuite and segments by brand
- Consumer : Wordpro, Lotus 123, Organizer
- Th inkpad : Wordpro , Lotus 123 , Organizer
- Commercial : Wordpro, Lotus 123, Approach, Freelance , Organizer , Notes
- Fulfillment is not done by pre-load except Consumer, as majority of pre-load would get wiped. Initial thought could be CDROM customizable similar to the way you install an operating system like Windows95. We would need to explore this with Lotus.

Possible Outcome

Microsoft Reaction to IBM / PCCo

- Outstanding MDA Credits on Win95 of $5 will not be granted
- $5M Audit rebate would be nullified
- M/Soft are Auditing DOS and OS/2, they could be very awkward if there are any hints of any issues. In addition they will be relentless in ensuring that our distribution of Win95 is carried out to the strict definition of the contract.
- Development Tool Kits, like Direct Draw SDK for Aptivia, would not be provided, and not allow that Brand to exploit games api's during 1996
- Beta Version of WinNT 4.0 that provides 486 Emulation for Power will not be provided
- Porting of Power Apps for Power or RS/6000 will be not occur for M/Soft products, this could nullify case 3B for the Power Proposal to move to RS/6000 Client
- WinNT impacts on x86 Client
  - Current License is for small volumes, as volumes increase we would want to re-negotiate T/C's. M/Soft would stall all negotiations possibly to force us by at similar terms to Win95
  - Certification and driver support to exploit our hardware would become extremely terse, requiring us to invest in writing drivers to support the PC700 and Thinkpad products
  - WinNT 4.0 is expected to be released June 96, this will contain te Win95 user shell, I would anticipate that M./Soft will attempt to impose similar and most likely severe T&C's vs Win95
  - Visibility of Cairo will be curtailed

- Win95 Impacts on x86 Clients
  - M/Soft will release upgrade packages / fix packs. Our visibility of this program will be significantly reduced
  - We would expect to start discussions to negotiate Win96 in April 1996, for shipment Oct 96. I would envisage that License T&Cs will become standard OEM that they will impose the original IP Clause. This could result in patent income being severely impacted.
  - I would project that MDA reductions would not be realized and additional competitive impact would be incurred vs Compaq.
  - Participation within the industry would be severely handicapped, and ability to work with Standards Bodies, eg Open PC Alliance , Compaq would be at a minimal level. Therefore our ability to regain "Leadership" by 1997, both product and how the industry perceives us would be significantly curtailed.
  - Exploitation of our hardware would be limited, and indeed could limit our ability to exploit Lotus applications. You could envisage an outcome that this would drive us more into the Intel camp. Buying planars or products from Intel would have a higher chance of compatibility with M/Soft and their directions.

<u>What would te Industry do ?</u>

This is by no means certain, but it is likely in my view :-

- Prices do collapse to force M/Soft encourage OEMs to pre-load.
- Their major partners will not risk a break with Microsoft , especially Compaq. Compaq have just announced a major alliance with Microsoft on Back Office for their Server Products. I would assume that Packard Bell, Dell, DEC and maybe HP will follow suite and pre-load M/Soft Office if forced to do so.
- This will generate significant volumes for M/Soft, admittedly at lower margins.
- This volumes will create a substantial install base for Microsoft to go after the upgrade market. Microsoft have openly stated that the upgrade market will be a major source of revenue. Encarta 96, Word 96 etc will become common. If we create an install base of Office 95, then you can see an opportunity being created for Microsoft to exploit.
- The market place will be leveled very quickly , no OEM will gain incremental volumes for a sustained period.
- Retail will just follow, but M/Soft Brand pushed by Win95 will be a major obstacle to overcome. I went to Egghead this weekend, and about half the shelve space is M/S Products and shelve space for Smartsuite was down to 4 copies. Major investment would be required to generate demand in retail. Retail will resist prices coming down , you see little "quality software" priced below 100$. Admin and shelve space is the same for a 49$ game vs 450$ Smartsuite. I don't see either Microsoft or Lotus wanting to lower retail prices.

- Microsoft could integrate Office functions further within the Operating System, particularly Win95 to nullify Lotus. Further integration of Exchange could be possible by providing more add-on modules to link into enterprise software free of charge. Currently Exchange ships with Win95 only bridges to CompuServe E-Mail, MSN and MSMAIL.

Result

1) Major impact to PCCo and other divisions needing a working relationship with Microsoft
2) Additional loss in customer confidence, as a public rift could be an outcome, at best would be known within the industry.
3) At best a small impact to Microsoft, but not sustainable
4) Most probably, we create a substantial upgrade base for Microsoft to gain future revenues
5) Strengthen relationships with Microsoft Front-line Partners and key OEM's

Recommendations

I would not recommend Option C, as discussed on Wednesday.

We need to focus on levering a relationship where we are explicit about being competitive in the market with Microsoft with applications, while the hardware divisions focus on being an open systems provider. That would more the middle ground case B.