From billg Sat Apr 21 19:32:02 1990
To: billn frankga jeremybu joachimk jonl jons mikehal paulma russw
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Subject: IBM discussions
Date: Sun Apr 22 19:54:42 1990

Date: Sat Apr 21 19:31:59 1990

Our discussions with IBM have taken a new turn. A week ago Jim C.
said he wanted a deal that gave them the same rights to Windows as
they get to Os/2 -- in other words they didnt want one deal for
windows and the other for Os/2 -- part of the reason for this is that
they dont want us to change our client Os straegy because of the
strucuture of the deal with them - for example favoring windows over
os/2 because we make more from IBM for windows.

In general our philosophy with IBM has been to get their marketing help
in establishing our standards whatever it takes. This has meant:

1. We make basicly $3m a year from them net at most
2. They like to help develop which hurts our speed, moral and quality.
 Amazingly enough their $100M/year of help is net quite negative.
3. They influence the specification without too little regard for market
driven issues -- SAA is critical and requirements like national
language support are not pragmatic.
4. They get rights to the source code of our future Os (os/2) and can
compete selling it onto non-IBM machines after 3.5 years without paying
us any royalty.

Our new deal attempts to fix these problems.
1. They will pay half of our client os development costs and a per
system royalty of $15M to $25M per year. The development costs new should
be around $25M per year in addition.
2. They will let us develop the client oses with less than 15 of their
people here. Testing will even be done here.
3. Their "customer team" is structured to be market driven and their
"control" is greatly reduced.
4. We are saying they have to pay us a royalty of %12.5 of the client
os SRP from us for any sales from them onto non-IBM systems. As long
we are working together we have to pay the same for our sales onto
their systems. Divorce comes 2 years after one party asks for divorce
(no fault) -- at this time they stop paying us the money in #1 and
we stop paying our royalty for sales onto their systems. We are still
negotiating the period of time they pay us for sales onto non-IBM
systems. We want at least 5 years but all we have said to them is
perpetuity.

The reason I am sending this to you is not to tell you this is a done
deal. Rather it is to get you think about some of the concepts in here.
We would hire an accounting firm to go out and measure the cross-sales
so we can computer who is leaking onto whom more. Our oems leaking
onto IBM count against us. Likewise our retail sales of windows onto
their new and old machines would count against us. We would insist that
they label their stuff for their systems and ask for a techical check -
they will want a symetrical provision for us and our oems (new contracts).

Issues include:

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a. Define client os work. They get what we do. We get what they do if we want (if so we have to deduct half their development cost). How do we communicate to know exactly what they are doing?
b. If they stop pushing our stuff and start pushing AIX or bundling our only remedy is divorce.
c. Define SRPs and make sure percentage is right.
d. Define measurement process.
e. Think about upgrades and how they will work.
f. Think about our cost to support them. What is the documentation and localization relationship?
g. Do we leak onto them today with DOS? How much will we with Windows?
h. Should we wait for a net relationship to do this deal? We think not but that part wont be easy.

We need to do at least a letter on intent before May 22 so Jim will come to New York and speak. He likes the idea of his doing the "keyboard" for me and then coming forward and saying he is doing some aggressive bundling type stuff (they have not figured out what they want to do).
j. Is the management process clear? How much should be in the contract? (areas like multimeda, handwriting and network software get into the question of which development costs do they pay half of).

We are excited about this because we think it improves our position in every way -- even money. It will make IBM our friend again and get their help in promoting windows strongly. It makes it possible to negotiate a networking deal next. The main issues are thinking thru how this "channel conflift royalty" thing will work and make sure there are no loophole. Keeping the timeframe they have to pay us these royalties after divorce is critical otherwise we create a competitor with our own source codes.

We are interested in any feedback.