



DOJ - Legal

From: Joachim Kempin  
To: Domestic OEM Sales; International OEM Sales  
Subject: FW: mail to oem  
Date: Wednesday, August 03, 1994 5:33PM  
Priority: High

Pls read the attached documents and follow these directions. It is important to understand that we need to transition OEMs into new arrangements without making it look like that we are doing anything bad. We are following just the government agreements. One of the sticky issues is to amend the contracts in a clear way so that no doubt is left when it comes to our agreements and when we decide to audit people for compliance. We have the right to do volume pricing but it is not 100% clear from the legal language in the government agreements if we can easily add this into the amendments and if we can actually increase prices if we experience a significant drop in volume for these transitional agreements (no problem on brand new agreements), pls do not do any hasty stuff in that regard - contact Your area director or me for advise often (the OEMs might want to negotiate other things than the government decree allows and a fair trade is never a problem in that case it will be good to keep a record, in case somebody complains later). If You have any questions regarding the content pls talk to Your director.

From: Teresa Ducharme  
To: Joachim Kempin  
Subject: mail to oem  
Date: Wednesday, August 03, 1994 4:31PM  
Priority: High

Attached are the documents and a draft mail for you to send to OEM:

Subject: OEM Business Plan and Internal Q&A

As you know, we have been working hard to finalize our go-forward business model in OEM regarding MS-DOS, Windows and Windows for Workgroups. Attached you will find an OEM Business Plan for existing per processor agreements and for negotiating new agreements:  
< <File Attachment: NEWBP3.DOC> >

We will present the new price guideline and license agreements at next Monday's OEM meeting. Follow-up team meetings with Timb/Terasadu will be scheduled to address amendment templates and additional questions/issues.

I have also attached an internal question and answer document:  
< <File Attachment: DOJQAF.DOC> >

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MS-DOS, Windows and Windows for Workgroups  
OEM Per System Pricing Model  
August 3, 1994

**Transitional (i.e. OEM chooses not to terminate license agreement):**

- 1) If an OEM has an active 'per processor' or 'per system' license for the products affected, the OEM receives a copy of settlement document.
- 2) Account Managers with Per Processor agreements contact OEM regarding the status of the systems covered by their agreement.

The assumption is that the OEM will want to continue business as usual.

What should I tell my customer? "MS believes it is in both MS and your interests to amend your current agreement to reflect the changes required by the settlement agreement. I will have several amendment forms (depending on the type of license and OEM) which will accomplish this."

Reason to amend? To avoid dispute in the future over interpretation of the settlement document, and to protect both the OEM and MS in case of an audit.

- 3) License Agreement is amended to eliminate minimum commitments and to designate Customer Systems.

We expect most OEMs will want to continue to license their systems as before. We will ask the OEMs for a listing of their customer systems as part of the amendment. The list of customer systems will allow MS to comply with the agreement we reached with the DOJ. Each Customer System must be identified by a unique model/product line name or model number that is used internally (on the OEM's books and records) and externally by the OEM on the customer system. For example, an OEM may license a line of systems; e.g., "The Promax Line"; or specific model numbers; e.g., The Promax 2410. A simple template will be provided with the amendment to list the customer systems.

The ideal amendment would also include a statement that an OEM estimates it will ship X volume annually of licensed products and that MS has the right to re-negotiate royalties if the OEM fails to ship that volume. In return, MS would add an additional price point to the OEM's royalty structure. For example, if an OEM is licensed at a volume of 100K units annually (25K per quarter), their current royalty is \$25.00 for MS-DOS. For units shipped in excess of 25,000 in a quarter, the royalty would drop to \$24.50 for those units:

Quarterly Volume = 25,000  
Units 1-25,000 = original royalty = \$25.00  
Units 25,001 and above = \$24.50

If you believe that the projected volume of systems an OEM lists will result in volumes that are not at the OEM's former minimum commitment level, we may want to negotiate with the OEM to reset royalties and prepaid balance recoupment at a level consistent with the OEM's projected volume. We need to handle this very carefully and your area director should be consulted in any such case.

Why are we amending all agreements? To make certain that there is a very clear understanding between MS and the OEM as to what systems are licensed and what systems are not licensed.

- 4) Status of prepaid balances:

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The OEM is allowed to recoup existing prepaid balances over the remaining term of the agreement to the same extent it could have done so had the original minimum commitments remained in effect (i.e. if reported royalties for a period exceed the previously scheduled minimum commitment for that period).

Why are we doing this? This is the fairest approach to a prepaid balance. The OEM will receive the same benefit of existing ppb as they would have notwithstanding the DOJ settlement.

5) Multi-product agreements:

If MS-DOS, Windows and/or WFW are included with "other" systems products (specifically Windows NT and Windows NT AS), terms and conditions and min commits associated with those "other" systems products will continue as is. If minimum commitments exist which combine MS-DOS, etc. with Windows NT, then the minimum commitments for these other products such as Windows NT will need to be separated from minimum commitments for MS-DOS, Windows and/or WFW. . The account manager should work with their Group Manager and Director in determining the separation of mixed product minimum commitments. The amendment form will restate the Exhibit B minimum commitments for the "other" products so that minimum commitment obligations are clear going forward.

Why? Licensing procedures for products not covered under the DOJ settlement will continue as before.

**IMPORTANT NOTE: THE PURPOSE OF THIS AMENDMENT IS TO INCORPORATE THE REQUIREMENTS OF THE AGREEMENT WITH DOJ. THIS IS NOT A SITUATION IN WHICH OTHER TERMS SHOULD BE ADDRESSED, UNLESS THE OEM RAISES OTHER ISSUES FOR NEGOTIATION. IF THE OEM REQUESTS ANY CHANGE TO ITS LICENSE AGREEMENT OTHER THAN EXCLUDING CUSTOMER SYSTEMS, YOU SHOULD KEEP A WRITTEN RECORD (e.g. letter, email, note) OF ANY SUCH OEM REQUESTS SO THAT WE CAN SHOW MS DID NOT REQUIRE THOSE CHANGES AS PART OF THIS AMENDMENT.**

Why? We want to make it clear that MS is not requesting license changes unrelated to the DOJ settlement.

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**License Renegotiation (i.e. OEM chooses to terminate current agreement):**

- 1) OEM receives copy of settlement document.
- 2) If OEM notifies MS in writing that it wishes to terminate current agreement:  
Current prepaid balances are forfeited.

*Why? The agreement is terminated and prepaid balances are not refundable under the terms and conditions of the agreement.*

3) Pricing

See price guideline. Pricing is based on an annual volume divided into monthly shipment amounts. The pricing is based on progressive volume price breaks. OEMs will be quoted three progressive volume breaks: one break below their estimated volume ("Break 1"), a break at their estimated volume ("Break 2"), and a break above their estimated volume ("Break 3"). For example, an OEM shipping 120K units annually would license MS-DOS at \$22.00 for the first 6,000 units shipped during a month; \$21.75 for the next 6K shipped in that month; and \$21.50 for all units in excess of 12K in that month. The AM should not quote any more than three price breaks.

*Why are we using progressive volume price breaks? To avoid artificial inflation of OEM volumes to reach the next price break.*

*Why only three price breaks? It is too complex to administer more than three and it is also a means for bracketing price negotiations.*

The AM must be very thorough in the qualification process and as a rule should base volume prices on no more than an OEM's last 12-months of volume of licensed systems plus 20% as "Break 2".

*Why? An OEM could potentially enjoy up to three months of an unrealistic price for their actual volume.*

OEMs licensed for less than 50K units annually (Break 2) will automatically be licensed on a per copy basis. No per system agreements will be available. OEMs licensed in excess of 50K will be licensed on a per system or per copy basis. Agreements in excess of 50K units will always include a per copy option for systems not included in the license. This option is equal to the per copy price for annual volumes of 28-48K.

*Why Per Copy only for under 50K? In general, this is closer to this customer segment's current business model.*

The only pricing incentive that remains is the preinstallation incentive for MS-DOS and Windows.

4) New License agreement terms and conditions

**Term:** One-year term with no language for extensions. Language permitting an extension (but only at the OEM's option, and for a maximum of one year) will require Area Director approval and will probably not be granted.

*Why only one year? This is required by the DOJ settlement. It will also allow both the OEM and MS the maximum flexibility in adjusting license agreements and prices as needed.*

**Per system = per line/model with a clean structure for adding new models/lines.**

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**New Reporting/Payments:**

- Royalty reports for a month will be due on the 15th of the following MONTH and will be sent electronically or via Fax. In the case of late reporting, MS reserves the right to bill (electronically or via Fax) on the

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basis of Authorized Replicator reports. Once an OEM has been billed on the basis of AR reports, MS will continue to bill from AR reports for the remaining term of the agreement (effective from January 1, 1995 on). MS will no longer send out notices of late royalty reports, but will continue to send notices of late payment.

- Payment will be Net 30 days and due at the end of the month immediately following the month for which royalties are being paid (non-negotiable). If not received in the 30-day period, the OEM will incur an automatic 10% late payment fee on the amount due, and the full royalty plus late payment fee will begin accruing 12% per annum interest from that point (non-negotiable). These fees and charges reflect our administrative and business costs in the event the OEM is late in payment.

Why are we changing the reporting and payment requirements? MS no longer has the minimum commitment as a financial "backstop" in our licensing agreements. In order to effectively forecast and manage OEM business we must move to a monthly model with more hooks for reporting and payment performance.

- All agreements will include a statement that the OEM estimates it will ship X volume annually of licensed products and MS has the right to re-negotiate royalties if the OEM fails to ship to the "Break 1" volume in any three months during the license term.

**Advance Royalty:** For new agreements, MS will require an advance royalty payment equal to 25% (or three months' worth) of the annual volume used to calculate "Break 2" royalties. All of this amount will be refundable to the extent not earned (i.e. if all amounts owed MS have been paid), with the exception of a \$10,000 administrative fee which would be retained only if an OEM fails to ship product under the agreement. Unpaid royalties, fees such as finance charges (see above) and a royalty uplift on unbundled product (see below) may be deducted from the advance royalty.

Why an administrative fee? There are many costs associated with negotiating and signing an OEM agreement. This is a recovery mechanism for those costs in the case that an OEM decides not to ship product.

**Standalone Shipments:** OEMs who ship MS-DOS or Windows standalone (i.e. ship without licensed hardware) will be retroactively charged a 30% royalty uplift for any such standalone product. MS also will reserve the right to terminate/renege the agreement if an OEM ships standalone product in violation of its license agreement. The current underreporting provisions of the audit clause will also apply.

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2. We agreed that we would no longer offer OEMs the opportunity to license these products on a "per processor" basis (under which an OEM pays Microsoft a royalty for each PC shipped with a microprocessor specified by the OEM).

3. We agreed that we will not include in our OEM contracts for these operating system products minimum commitment terms (under which an OEM agrees to pay a minimum amount of royalties for the licensed software during the life of the contract).

**Q. How will your NDAs change as a result of this settlement?**

**A.** We agreed to modify the duration of our NDAs for pre-commercial release versions of MS-DOS and Windows (including *Chicago*) so that they do not exceed one year.

**Q. What happened to all the other rumored allegations the DOJ was also looking at - like incompatibilities, hidden code in the Win 3.1 beta?**

**A.** We have long believed and stated that these allegations were without foundation, and are pleased that these were not pursued in the settlement of this investigation.

**Q. It's unprecedented for two government bodies to join forces in this way, why did it happen?**

**A.** You should ask the DOJ and DG IV for their perspectives. From our perspective, we welcomed the opportunity to resolve these investigations together. The software industry is worldwide in scope. Many of our customers do business on a global basis, and this joint settlement will enable them to continue to license software from us easily and inexpensively throughout the world

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**Q. Does the settlement agreement require that Microsoft cease using per system licenses?**

**A.** No. OEMs can license our operating system products on a per system basis. Microsoft did agree to adhere to its present contractual practice, under which an OEM customer can create new computer system models and is not required to license Microsoft software for those models.

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**Q. How will this affect our standard agreements for new customers?**

**A.** We will create a new standard agreement for MS-DOS, Windows and WFW. We will have three basic kinds of product licenses:

- 1) MS-DOS, Windows, WFW - 1 year term, no minimum commitments
- 2) Applications - Same as today
- 3) All other licensed products (Windows NT, etc.) - Same as today

**Q. By removing minimum commitments, DOJ has removed the check that we use to ensure that an OEM's volumes actually warrant the per system or per copy royalties they get. How will we ensure this without mins?**

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- A. We will publish a new PGL and license agreement for MS-DOS, Windows, and WFW within two weeks. The pricing and licensing will include progressive volume price breaks and agreement terms and conditions to ensure that OEMs pay at the appropriate per system or per copy royalty rate(s) for their volumes.
- Q. *What about existing licensees? Are the old terms "grandfathered" or are we forced to renegotiate all of our licenses?*
- A. OEMs with existing licenses have the option of amending their current license to eliminate any provisions which are inconsistent with the settlement or the option of terminating their agreement.
- Q. *Do all customers receive the DOJ settlement (except DSP and SVED) or is this only for Per Processor customers? What about MED customers?*
- A. We will send a copy of the DOJ settlement to all active per-system and per-processor licensees of MS-DOS, Windows, and WFW, including MED. We will not send notices to SVED, per-copy or DSP licensees.
- Q. *When we remove the min commits, can we also insert a sentence that allows us the RIGHT to re-negotiate the price if the OEM's volumes slip below its projected volume?*
- A. We have rights under the settlement to base unit royalties on estimated projected shipments of units (whether those are systems or copies of the software). New agreements will include language regarding a non-binding mutual understanding of the OEM's volume and MS' right to renegotiate.
- Q. *If an account has a prepaid balance (PPB), and minimum commitments go away, what happens to the PPB?*
- A. The PPB would continue to be recoupable under the agreement, with no change in the recoupment rate.
- Q. *In the NEW standard agreement, is it possible for us to re-negotiate price after the first year? Or will it just renew (assuming the OEM does not want out) with existing price and terms?*
- A. The DOJ agreement does not allow automatic renewal. It does allow Microsoft to give the OEM an option to renew the agreement for up to one additional year on the same T's & C's, but we do not currently plan to include the optional renewal language in the standard agreement.
- Q. *How will we handle existing agreements that contain min commits for MS-DOS/WFW and Windows NT, since NT is not part of the DOJ settlement?*
- A. If the OEM exercises its option to renegotiate or terminate the existing agreement, we would enter into new license negotiations and have two agreements with the OEM: one for the covered products and one for other products such as Windows NT. Otherwise, the likely process would be to amend the existing agreement to remove obligations to pay minimum commitments for MS-DOS/WFW (and the

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associated mins) and to restate Exhibit B to clarify minimum commitment obligations for products other than MS-DOS/WFW/Windows.

**Q. How will we handle agreements that have both per processor and per system on the same license ?**

**A.** All of the systems that are covered by the per-processor portion of the license will be treated as though they are subject to a per-system license. The OEM can choose to exclude any model from the per-processor portion by notifying us in writing, but all other systems as defined by the processor will continue to be subject to a per system royalty. Exclusions are effective as of the beginning of the calendar quarter following the notice specifying the excluded systems.

**Q. Under the new per-system requirements, can't an OEM with a per-system license just create new internal part numbers for their computers, one with SW and one without?**

**A.** No. New systems (i.e. those that are not included) must have a unique model number on the computer, not just on paper.

**Q. What about min commits that we have invoiced but the customer has not paid for yet? Do they still owe us?**

**A.** Yes. All previous min commit billings are due and payable per the existing license agreement. Future min commit payments will not be invoiced

**Q. What about embedded systems products? How are they affected?**

**A.** The system definition in the decree is clear: "Personal Computer System" means a computer designed to use a video display and keyboard (whether or not the video display or keyboard is included) which contains an Intel x86, or Intelx86 compatible microprocessor. Thus, if the system is an industrial controller, for example, that does not utilize either a video display or keyboard, then the agreement for that system is unaffected by the settlement.

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