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Patent Group

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Attn:	<u>Greg Maffei</u>	Date:	<u>3/17/97</u>
Company/Firm:	<u>MICROSOFT CORPORATION</u>	Pages:	<u>6</u> (Including Cover Sheet)
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From:	<u>Paul D. Carmichael</u>		
Re:	<u></u>		

Comments

Greg, attached are two documents:

- 1) A business case showing the balance of values based on assumed patent royalty rates and assumed coverage of the products of Apple and Microsoft for the period July 1, 1996 to July 1, 2001.
- 2) An outline of the terms of a patent cross license agreement between Apple and Microsoft.

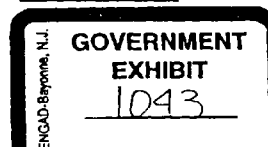
If you have any questions concerning the methodology or what is intended, please do not hesitate to contact us.

cc: Ellen Hancock
 Douglas Solomon

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MICROSOFT/APPLE
PATENT CROSS LICENSE AGREEMENT

IMMUNITY FOR SALE AND USE OF LICENSED PRODUCTS BY
CUSTOMERS AND USERS

RELEASES FOR PAST INFRINGEMENT

TERMINATES WITH EXPIRATION OF LAST LICENSED PATENT

PROVISIONS CONCERNING ASSIGNMENT ACQUISITION, MERGER AND
DIVESTITURE

BALANCING PAYMENT TO APPLE

March 4, 1997

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**Estimated Patent Royalties on Operating Systems
US only, 1996 - 2001**

	1996	1997	1998	1999	2000	2001	7/96-6/01 5_Yr_Total
Apple to Microsoft:							
US sales of MacOS (millions)	2.0	2.2	2.5	2.7	3.0	3.3	13.1
Ave. revenue per copy (\$)	\$36	\$36	\$36	\$36	\$36	\$36	\$36
US Revenue (\$millions)	\$73	\$81	\$89	\$98	\$108	\$118	\$471
Patent Royalty rate against Apple (percent)							3%
Total Patent Royalty (\$millions)							\$14
Microsoft to Apple:							
US sales of Windows 3.1 (millions)	6.4	1.6	0.2	0.0	0.0	0.0	5.0
Ave. revenue per copy (\$)	\$35	\$35	\$35	\$35	\$35	\$35	\$35
US Revenue (\$millions)	\$224	\$58	\$7	\$0	\$0	\$0	\$175
US sales of Windows 95 (millions)	42.0	42.5	40.2	41.2	48.7	53	220.0
Ave. revenue per copy (\$)	\$50	\$50	\$50	\$50	\$50	\$50	\$50
US Revenue (\$millions)	\$2,100	\$2,125	\$2,010	\$2,059	\$2,433	\$2,650	\$11,002
US sales of Windows NT (millions)	6.4	16.3	26.1	31.3	34.0	38.1	129.5
Ave. revenue per copy (\$)	\$130	\$130	\$130	\$130	\$130	\$130	\$130
US Revenue (\$millions)	\$702	\$2,119	\$3,393	\$4,069	\$4,420	\$4,953	\$16,828
Total US Revenue 3.1 + 95 + NT (\$millions)	\$3,026	\$4,300	\$5,410	\$6,128	\$6,853	\$7,603	\$28,006
Patent Royalty rate against Microsoft (percent)							3%
Total Patent Royalty (\$millions)							\$849

Assumptions:
 Patents and revenues outside the US not included. Apple has 54% of its total sales in US. Microsoft has 67% of its total sales in US.
 US sales and revenue estimates from Annual Reports and other public filings, Dataquest and IDC reports, analyst estimates and newspaper reports.
 US sales of MacOS grown at 10% per year, which is average growth rate for last 5 years and agrees with Dataquest 1996-2000 forecast.
 US sales of Windows 3.1, Windows 95, Windows NT grown according to forecasts from Dataquest and IDC.
 5 year total calculated from 7/1/96, so is half year of 1996, full years 1997-2000, half year of 2001.
 For Operating System revenue outside the US, a patent royalty rate of 1% would add patent royalties for Apple of \$4 million, for Microsoft of \$138 million.

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**Estimated Patent Royalties on Application Software
US only, 1996 - 2001**

7/96-6/01
5-yr Total

	1996	1997	1998	1999	2000	2001	
Apple to Microsoft:							
US sales of App. SW by Claris Corp. (\$millions)	\$127	\$159	\$198	\$248	\$310	\$388	\$1,173
Patent Royalty rate against Apple (percent)							3%
Total Patent Royalty (\$millions)							\$35
Microsoft to Apple:							
US sales of App. SW by Microsoft (\$millions)	\$3,055	\$3,972	\$5,183	\$6,712	\$8,725	\$11,343	\$31,771
Patent Royalty rate against Microsoft (percent)							3%
Total Patent Royalty (\$millions)							\$953

Assumptions:

Patents and revenues outside the US not included. Apple has 54% of total sales in US. Microsoft has 87% of total sales in US.
 US sales estimates from Annual Reports and other public filings, 1992-1998.
 US sales of App. SW by Claris Corp. grown at 25% per year, which is average growth rate for last 2 years in which Claris has distributed Apple and Claris branded software.
 US sales of App. SW by Microsoft grown at 30% per year, which is average growth rate for last 5 years.
 Assumes that royalty is calculated on full US sales, i.e. that all Application Software products infringe.
 5 year total calculated from 7/1/96, so is half year of 1996, full years 1997-2000, half year of 2001.
 For Application Software revenue outside the US, a patent royalty rate of 1% would add patent royalties for Apple of \$10 million, for Microsoft of \$156 million.

Summary of Estimated Patent Royalties, US only
5 year total, 7/96 - 6/01

	<u>US Royalty at 3%</u>
Apple to Microsoft:	
Application Software (Claris Corp.):	\$35 million
Operating System (MacOS):	\$14 million
Apple total royalty:	\$49 million

	<u>US Royalty at 3%</u>
Microsoft to Apple:	
Application Software (Office, Word, Excel, etc.):	\$953 million
Operating System (Windows 3.1, 95, NT):	\$840 million
Microsoft total royalty:	\$1,793 million
Microsoft sales at 70% Direct, 30% OEM:	\$1,200 million
Microsoft total direct royalty:	\$1,255 million

¹ For revenue outside the US, a patent royalty rate of 1% would add \$14 million to the Apple total royalty bringing it to \$63 million, and would add \$294 million to the Microsoft total royalty bringing the Microsoft total direct royalty to \$1,461 million.

MICROSOFT/APPLE
PATENT CROSS LICENSE AGREEMENT

LICENSED PATENTS

- ALL PATENTS LICENSABLE BY EITHER PARTY
HAVING OR ENTITLED TO A FILING DATE
PRIOR TO JULY 1, 2001

LICENSED PRODUCTS

- DESIGNED TO MEET THE CURRENT AND ANTICIPATED
NEEDS OF BOTH PARTIES
 - ALL PROGRAMS INCLUDING OS, MIDDLEWARE,
APPLICATION PROGRAMS, TOOLS,
COMMUNICATIONS, ETC.
 - EXCLUDE CLONE PROGRAMS (?)
 - ONLINE SERVICES
 - CONTENT MEDIA
 - INPUT DEVICES TO MICROSOFT
 - INFORMATION HANDLING SYSTEMS TO APPLE

LICENSE GRANTS

- FOR PRODUCTS MADE, USED, SOLD OR OTHERWISE
TRANSFERRED BY APPLE OR MICROSOFT
- NO RIGHT TO SUBLICENSE OTHERS (INCLUDING OEMS) TO
MAKE, USE, SELL, OR OTHERWISE TRANSFER
- EXTENDS TO MORE THAN 50% OWNED SUBSIDIARIES
- LIMITED HAVE MADE WHERE SPECIFICATION AND OVERALL
DESIGN COMES FROM APPLE OR MICROSOFT

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RELEASES FOR PAST INFRINGEMENT

**TERMINATES JULY 1, 2001 EXCEPT FOR PRODUCTS THEN IN THE
MARKETPLACE**

**PROVISIONS CONCERNING ASSIGNMENT ACQUISITION, MERGER AND
DIVESTITURE**

BALANCING PAYMENT TO APPLE

Patent Royalties Calculated On The Full Computer System

Apple's patent royalties to Microsoft based on Macintosh computer systems (Mac HW + MacOS SW).
 Microsoft's patent royalties to Apple based on Windows computer systems (PC HW + Windows SW).

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>5 yr. Total</u>
US sales of Macintosh computer systems (millions)	2.04	2.22	2.42	2.64	2.88	12.21
Ave. revenue per system (\$)	\$2,000	\$2,000	\$1,900	\$1,900	\$1,800	\$1,911
US Revenue (\$millions)	\$4,080	\$4,447	\$4,605	\$5,020	\$5,183	\$23,335
Patent Royalty rate (percent)	3%	3%	3%	3%	3%	3%
Total Patent Royalty (\$millions)	\$122	\$133	\$138	\$151	\$155	\$700
US sales of Windows computer systems (millions)	26.1	28.4	31.0	33.8	36.8	156.1
Ave. revenue per system (\$)	\$2,000	\$2,000	\$1,900	\$1,900	\$1,800	\$1,911
US revenue (\$millions)	\$52,152	\$56,846	\$58,864	\$64,161	\$66,255	\$298,278
Patent Royalty rate (percent)	3%	3%	3%	3%	3%	3%
Total Patent Royalty (\$millions)	\$1,565	\$1,705	\$1,766	\$1,925	\$1,988	\$8,948

Assumptions:

Sales and revenues from outside US not included. Apple has 54% of total sales in US. Microsoft has 67% of total sales in US.
 Sale and Ave. revenue estimates from International Data Corporation, 1996.
 US sales of Macintosh computer systems (millions) grown at 9% per year.
 US sales of Windows computer systems (millions) grown at 9% per year.

Microsoft Patent Licensing

History

- 1993-1995 - Early Meetings
- July 1, 1996 - Charge Microsoft with infringement of 13 Apple Patents
- July 23, 1996 - Other Microsoft Products identified
- October 18, 1996 - Meeting at Microsoft
 - Microsoft answers Apple patent claims and raises Microsoft patents relative to Apple/Claris Products
 - Apple calls additional 10 patents to Microsoft's attention
- November 1996 - Apple requests additional information and Microsoft declines to furnish
- November 1996/March 1997 - Apple attempts to schedule meeting - Microsoft unresponsive
- Meeting now scheduled for March 17, 1997 in Redmond

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Need to know

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- EXTENDS TO MORE THAN 50% OWNED SUBSIDIARIES

CALL STRATEGY

Get Patent Issues Behind Us

- Send Responses Today

Discuss Additional Facts Since Last Meeting

- Apple Needs Shrinking
- Additional Microsoft Interests

Business Case

License Agreement Outline

Next Step

March 11, 1997

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MICROSOFT ISSUES

Apple Initial Requests

- Application Support For Mac OS and Rhapsody
 - Reasonable Parity In Release, Performance And Functionality
 - Threats To Withdraw If Apple "unreasonable"
- Development And Support Of Tools For Mac OS And Rhapsody
- NT Clients For Mac OS And Rhapsody
- Paid-Up Licenses To Windows Operating Systems
- Games And Content
- Public Announcement And Support

Other Items Added To Discussions

- Universal Virtual Machine
- Internet Explorer
- Win 32 Port To Rhapsody
- Apple Class Libraries Shipped With Virtual Studio
- Site License To Office

MICROSOFT ISSUES

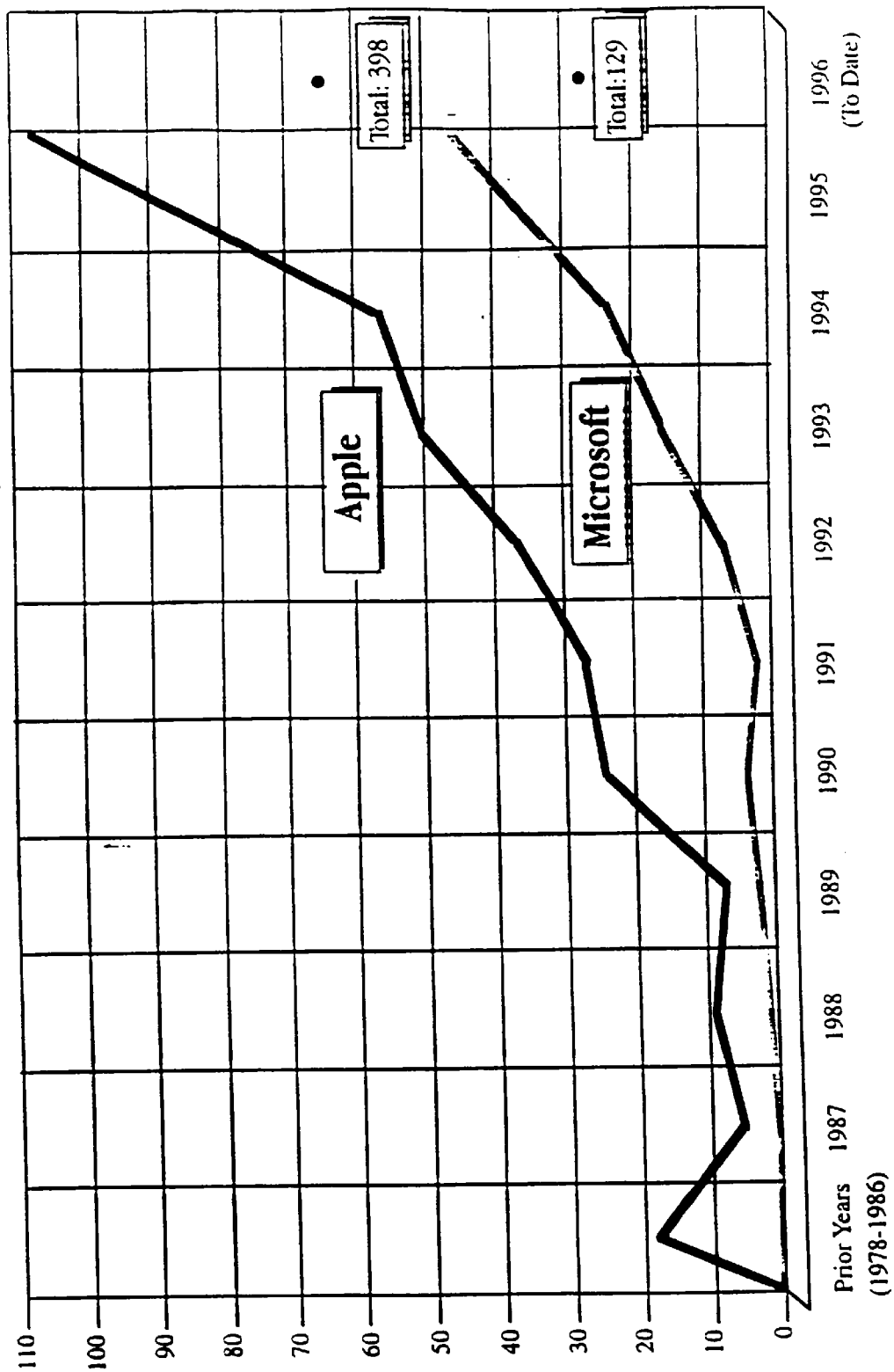
Financial Matters

- Preferred Stock Investment
- Credits For Windows License

Patent Cross Licensing Matters

- Inclusion Of OEMs
- Object Technology Licensing Corporation License
- 50 / 50 IBM / APPLE Patent Licensing Venture
- Taligent And Kaleida Patent Assets
- Object Software
- Microsoft Needs A License

Issued U.S. Utility Patents



Calendar Years

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ISSUED U.S. UTILITY PATENTS

TECHNOLOGY AREAS OF MUTUAL INTEREST

Technology Area	Apple	Microsoft
Operating Systems, including file system and memory management	30	24
User Interface	28	10
Input Devices, including mice, keyboards and pens	24	9
Personal Digital Assistants	21	1
Networking	29	9
Video, including QuickTime	30	5
Graphics, including Quickdraw GX and 3D graphics	43	18
Compression	11	4
Speech	4	0

The above list is not intended to be exhaustive or limiting in any way. For example, the patents have each been placed in a single category while in fact a patent may relate to multiple categories. Additionally, the placing of a patent in a particular category is a judgment. Pending patent applications are not included in this comparison.

Critical Path Items

- Apple executive support and participation
- Rationalization with other business needs
- Continued urgency to resolve since time works in Microsoft's favor

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Status

- Howrey & Simon Review is complete
- Business case complete
 - Substantial balance in Apple's favor
- Reviews of Microsoft patents complete
- Response to Microsoft position on Apple patents complete
- Agreement outline complete

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Other Patent Matters


- Object Technology Licensing Corporation
 - Microsoft Needs
 - Byorick/OTLC Suit

Other Actions

- Proceeding Against Packard Bell

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Other Business Matters

- Object Model Rationalization
- Mac/OS Rhapsody Strategy
- NT Issues
- Tool Collaboration
- Quicktime Aboption by Microsoft
- Applications
- Internet Explorer
- Public Support

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MICROSOFT /APPLE
PATENT CROSS LICENSE PARTNERSHIP DISCUSSIONS

- September, 1993 Microsoft Suggests Cross License Discussions. Preliminary Analysis Of Mutual Fields Of Interest. Unable To Evaluate Each Others Portfolios Since Few Issued Patents.
- May, 1995 Microsoft Refuses To License Apple For Windows 95 Unless Patent Immunity Clause 12(d) Is Included. Clause Requires Apple Not To Assert Its Patents Against Microsoft Or Its OEMs For The Licensed Products.
- June - August, 1995 Microsoft Suggests Cross License As A Way To Resolve The Windows 95 12(d) Issue. Apple Agreed To Discuss But Decoupled From Windows 95 Discussion. Discuss Various Approaches And Exchange Draft Provisions. Microsoft Did Not Pursue.
- May, 1996 Note From Bill Gates Concerning An Apple NT License.
- June, 1996 Apple Leadership Team Meets - Identifies Wants and Needs.

- July 1, 1996 Apple Initiated Meeting To Discuss Cross Licensing. Puts Microsoft On Notice Of Patent Infringement Of Windows 95, NT, Windows 3.1 And Internet Explorer. Fourteen Apple Patents Involved.

- July 23, 1996 Apple Places Microsoft On Notice Relative To Office, Word, Excel And PowerPoint. Same Basic Group Of Apple Patents Involved.

- October, 1996 Meeting With Microsoft. They Rebut Our Allegations And Call 11 Patents To Our Attention Relative To Apple Products. Apple Calls An Additional 10 Patents To Microsoft's Attention.

- March, 1997 Repeated Attempts To Meet With Microsoft Unsuccessful. Apple Responds To Microsoft On Patent Issues. Also, Provides Outline Of Cross License Terms And Business Plan Showing Balance Of \$1.2 B In Apple's Favor. No License For OEMs Or OTLC (Taligent) Patent Portfolio. Microsoft Wants To Couple Business Deal With Patent Cross License And Apple Agrees If Balance Of Values Are Adequate.

- April, 1997 - Present Negotiations At Various Levels With Microsoft. Still Far Apart On Values Involved.