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To: Lori Day
cc: Mike Heil, Gary Stimac, Tim Lothe, Myles Owens, David Cabello, Steve Flannigan, Jim Kelly, Maurice Voce, Monica Keenan Laurence, Chuck Meyer, Jennifer Morris
From: Celeste Dunn
Date: Wednesday May 29, 1996 01:22 PM
Subject: MS Internet MOU

Lori: Attached is our response to the Microsoft Internet MOU. Please call me if you have any questions. Thanks. cd

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Lori:

As we acknowledged prior to the signing of the Microsoft MOU, the Consumer Division has contractual obligations which will prohibit compliance with the terms of the MOU. In support of the Consumer Division goal for return to profitability, a strategic initiative is to generate revenue from royalty sharing with third party partners on the Presario platform. In order to comply with the MS-Compaq Internet/Intranet MOU, CSBU would have to significantly alter the current Predator product, revise its business model and jeopardize two profitable, revenue generating contracts.

AOL AND NETSCAPE RELATIONSHIPS.

Our current arrangement in North America with AOL has produced 6.4 M revenue this year from AOL signups and participation, at a run rate of approximately 400,000.00 a month. In order to increase and maximize the revenue streams, the Predator Product software image was structured to fully integrate AOL and encourage more end users to subscribe to and use AOL. We are in the final phase of closing a deal with Netscape and Sprynet with revenue provisions similar to AOL (estimated at 2.6M for second half of 96) and the Predator product has also been modified to feature Netscape. In EMEA, AOL was recently named a preferred partner and we understand that EMEA is generating some revenue for featuring AOL.

MS does not have the market share or consumer mindshare of AOL or Netscape in the Internet and on-line services market and has stated it will not share revenue with Compaq for its Internet/Intranet products. Favored treatment for the MS browser and MS network would violate the AOL agreement and may prevent us from featuring the Netscape browser, all with no replacement for the revenue lost.

DESKTOP POSITIONING.

The MOU conflicts with the requirements of the AOL agreement. In regard to on-line services, the AOL agreement requires us to position AOL services above all other on-line services on the user interface of our products and that we will highly recommend AOL to our customers. The AOL agreement provides that AOL will be the primary mentioned service whenever a consumer information network is mentioned as part of the overall communications message. The agreement specifically states that MSN may be mentioned but AOL will be mentioned more and more prominently and that we can only recommend that buyers experiment with MS Network. The AOL agreement requires us to feature AOL and GNN as the online services and specifically states that the AOL icon is the only on-

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line service icon that can be displayed on the desktop. Displaying the MSN icon on the desktop is not permitted (MSN is mentioned specifically).

In regard to browsers, our goal is to feature the brand leader Netscape and AOL GNN. Setting MS browser as the default is not in line with that goal and may violate the agreement with AOL to feature GNN.

Both Netscape and AOL have agreed to provide end user support for their products and the On-line/Internet services. Traditionally Compaq has provided end user support for MS products and nothing in the MOU states differently. The cost of such support is estimated to be quite high. It would also compromise our strategy which is to offer featured positions on our desktop based on revenue share and joint promotion opportunities.

The MOU states that we will focus the majority of our Internet/Intranet announcements and marketing activities on MS technologies. Netscape and AOL have a much more significant market share than MS and we cannot predict to what extent may want to explore opportunities with other Internet vendors or products. This MOU may restrict us from exploring such opportunities.

OTHER PROVISIONS.

The MOU contains other terms that are not in Compaq's best interests. For instance, Section 3 states that we will ship new versions of MS Internet Explorer within 8 weeks from release—to comply with this we would have to arrange our release schedule around the MS release schedule and incur the cost of providing upgrades. It also states that we will strongly support the upcoming MS Internet/Intranet products and strategy announcements but does not make this contingent upon early access to and approval of the MS products. In addition, we have not yet been engaged in detailed talks with MS to understand their Internet strategy so we do not know exactly what we would be endorsing.

CSBU RECOMMENDATION.

CSBU recommends a separate discussion with MS regarding Consumer Internet/Intranet products and opportunities. If this is not practicable, we would like to clarify with MS those items that we cannot comply with and set an expectation that is contingent upon a mutual agreement to strategic direction and revenue sharing on terms and conditions similar to the existing agreements. We would also like to insure that MS recalls that this MOU is nonbinding and compliance will be at Compaq's discretion. MS has already contacted CSBU to notify us that we are in violation of the "Internet Agreement."