15

CONFIDENTIAL

To: Kevin Bohren@Desktop@PCMkt Hou
Cc: Rod Schrock@Desktop@PCMkt Hou
Greg Memo@Desktop@PCMkt Hou
Bcc:
From: Vaughn Rhodes@Desktop@PCMkt Hou
Subject: Marvel response
Date: Friday, November 11, 1994 8:36 AM
Attach:
Certify: N

Kevin,

In preparation for your meeting with Bill Gates, I've prepared this note to help you understand Marvel, the threat to Compaq that it poses, and some points that we should communicate to Microsoft. We are in the process of preparing a comprehensive online strategy, which will address the Marvel issue among others. This note focuses on Marvel.

Marvel overview

Marvel is a new online service created by Microsoft. It is similar to and will compete directly with America Online and Prodigy, offering end users an interactive forum that is accessed via modem. Marvel requires Windows 95, and Microsoft has stated that it will bundle Marvel with every copy of Windows 95. They have asserted in so many words that Compaq, along with every other OEM, has no choice - - we have to take Marvel (if we want Windows 95).

In addition, Microsoft has firmly stated that they will pay NO bounties or revenue sharing of any kind for Marvel. This is in spite of the fact that every other online service pays substantial bounties to Compaq for each customer who connects to their service from a new Compaq PC.

Marvel implications for Compaq
---

* Marvel will hurt Compaq.

  - It allows Microsoft to gain control of our customers, and enables Microsoft to market directly to them without benefit to Compaq.

  - It directly threatens our profitable revenue streams from our existing online service partnerships. We currently receive $200K per month from America Online alone, and that revenue stream is growing quickly. If Marvel procedes as they plan, that revenue is likely to rapidly diminish.

C004023

PENGAD-Bayonne, N.J.
GOVERNMENT EXHIBIT
1001

- It will have a long-term negative impact by reducing competition in the online services market. Microsoft has publicly stated that by 1996, they plan on being 3 to 4 times as large as all other competitors combined. If this comes true, Compaq will have little leverage to get favorable online services terms.

- It further consolidates market power with Microsoft.

- -

Here are some points regarding Marvel that we should communicate to Microsoft:

- -

Compaq is very concerned by the business proposition that Microsoft offers with Marvel.

* While we support Microsoft putting various communications hooks into the operating system, we do not agree with Microsoft that a full-blown online service client should be an integral part of the OS.

* Marvel threatens the existing relationships and partnerships we have with online services such as America Online and Prodigy. These services offer us profitable and substantial bounties and revenue sharing. Additionally, they provide all customer support and supply documentation at no charge. Marvel, in contrast, offers questionable value-add to Compaq. It currently offers neither a bounty nor revenue sharing, and Compaq is likely to end up paying for a large portion of its support and added documentation costs.

* Compaq would like to invite Microsoft to present a compelling business proposal. We welcome the opportunity to evaluate Marvel as a potential online service partner. An key component of this evaluation will be the bounty and revenue sharing arrangements offered by Microsoft.

* Microsoft insists that their financial model does not support bounties or revenue sharing. While it is possible that Marvel will not be profitable for the first year or two, we believe that Microsoft would not build a business that had zero long-term profitability. If larger up-front bounties pose more risk than Microsoft is willing to bear, a smaller bounty with higher revenue sharing would be appropriate and likely acceptable to Compaq.

* A critical issue for Compaq is controlling our product as a marketing vehicle. We are in the process of creating a number of aftermarket businesses. The success of these businesses is heavily influenced by presentation and positioning within our box and on our screens. Microsoft's prominent placement of Marvel (a marketing vehicle) on the desktop compromises our control.