July 3, 1997

Mr. William Gates

Microsoft Corporation
One Microsoft Way
Redmond, Washington 98052-6399

Dear Bill:

This is in response to our telephone conversation on July 1, 1997, concerning the discussions between our companies relative to a business alliance and patent cross license agreement.

At the outset of these discussions, I gave our people guidance as to what we wanted to accomplish in a relationship with Microsoft. These included the following items:

(1) Gain Microsoft's support for Apple's operating system strategy, including Mac OS and Rhapsody, especially with regard to Microsoft Office and Internet Explorer.

(2) Define and agree on areas of technical cooperation with the purpose of facilitating our ability to work cooperatively and of helping to establish industry standards as appropriate.

(3) Negotiate a patent cross-license agreement which respects the intellectual property of both companies and insures an equitable royalty arrangement.

(4) Explore other mutually agreeable areas of cooperation that would serve the interests of both companies and strengthen the overall business alliance.

I suggested to our team that we might be able to gain some momentum by taking these items up separately rather than trying to achieve an omnibus agreement. So, for example, Avie Tevanian and Don Bradford might begin working on areas of technical cooperation while separate teams worked on the other items. It is my understanding that Microsoft did not want to proceed in this manner but rather wanted one, all encompassing agreement. This is fine if this accurately reflects Microsoft's preference even though it is our view that as a matter of pragmatism dealing with these on parallel tracks would lead to a more rapid conclusion.

I offer the following as an elaboration of each of the four points cited above. First, regarding Microsoft applications support of Apple's OS strategy, the goal is simply to support our mutual customers. Our surveys tell us that in the enterprise market segment, for example, a very high

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percentage of our end customers use Microsoft Office. As I have told you before, I consider myself to be a typical professional user and I have used Excel, PowerPoint and Word since their introduction on the Macintosh. For these customers, we want Microsoft applications to look great on the Mac! This means good performance, a rich feature set, file compatibility with the Windows version and other similar compelling attributes. Naturally, we would like to see these applications available on the Mac in approximately the same time frame as the Windows release. I know this is a challenging request but I hope the reasons are obvious. If we could agree on and adopt appropriate technical standards that would make this task easier then we should explore these. This is the primary purpose of item two above. Moreover, if it were possible for some of the Apple engineers to work in harmony with your people during the development of these new applications, it may be possible to shorten the time to market. This would clearly be a win-win outcome.

Since I'm not a software expert, I can't adequately list the technical cooperation areas we should embrace but would probably include such things as a distributed object model, objective-C and Java to name only a few. We should also explore areas where we can help establish industry standards (such as DCOM). In fact, as you will recall we had an agreement in principle to do this type of collaboration earlier this year. Avie would represent us in the necessary technical discussions.

The third element is the need for a patent cross-license agreement between us. This is usually handled through a negotiated royalty rate. We weigh our respective patent portfolios and agree on what it would take to balance the scales. There is ample precedence in the industry as to rates, terms and conditions to make this fairly straightforward. We would be willing to take as partial payment credits to Windows software on terms similar to your other OEMs. Further, because of the importance of the first two items, I've taken the position that in balancing the scales we would take into consideration the level of applications support we ultimately obtain from Microsoft. The objective of all of this is to reduce the cash component in favor of business cooperation.

The thorniest issue is the OTLC patent portfolio. My lawyers advise me that we cannot unilaterally agree to include this portfolio because we are only a 50% partner with IBM in this property. Further, IBM's position, as I understand it, is that this portfolio is not part of their cross-license with Microsoft. So, of necessity, this must be a three way agreement. We are willing to make a good faith effort to work with Microsoft and IBM to achieve a mutually acceptable license to the OTLC patents. To this end if a meeting of our respective legal staffs to fully understand this matter is appropriate we are prepared to proceed cooperatively in that direction.

With respect to the fourth item, we feel it would strengthen the alliance if we could find other mutually beneficial areas in which to cooperate. To this end we have discussed such items as a site license to Apple for Office

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(as a way of encouraging more Apple people to use Microsoft products), Microsoft producing a porting layer for Windows APIs on Rhapsody, Microsoft shipping Apple's portable class libraries with Microsoft Visual Studio, cooperative marketing arrangements, support for the Microsoft Universal Virtual Machine, and making the Mac a client for Windows NT. This is a wide open field and we are open to any priorities you may have. The purpose is simply to strengthen the alliance and bring us closer together.

Before I close, I'd like to comment on the inclusion of Internet Explorer with our release of Mac OS 8. I know that this is a source of great irritation to you. However, at this point, our people feel we have complied with the agreement we made in January (see attached image of CD files — Netscape is not even visible). We were careful to explain to Brad Silverberg the preexisting agreement with Netscape. If Microsoft had offered the same arrangement, we would have included it. I did not feel, however, that I could go back to Netscape and back out of this prior agreement and so we raised the matter with Brad. Until your phone call to me on this, we felt we were in complete alignment with Microsoft. This unfortunate misunderstanding suggests that as we go forward it is important for you and I to be sure there is clarity and steady communication between us as to our agreements. In hindsight, I should have taken it upon myself to document our January understanding and convey this directly to you immediately after MacWorld so any confusion could have been ironed out early. I apologize for this but I want to assure you that it was <u>not</u> a matter of bad faith but rather a very human oversight.

Bill, in summary, I'm seeking a partnership based on reciprocity and recognition of the priorities of each partner. I believe the above outline represents a win-win opportunity for us. It represents an opportunity to exhibit bold industry leadership. It represents an opportunity to put behind us once and for all the animosity that has existed for too long between our companies. If Microsoft were to withdraw Office and other application support for the Mac it would be a lose/lose situation. But if you and I can agree on this basic framework, we can provide the necessary executive leadership to our teams. While I cannot be the lead negotiator for Apple, I will personally shepherd the ongoing detailed discussions and communicate with you regularly as to progress and issues. The discussions to date have defined a number of areas of cooperation and substantial agreement. Let's build on this.

Very truly yours,
APPLE COMPUTER, INC

Gil

Gilbert F. Amelio

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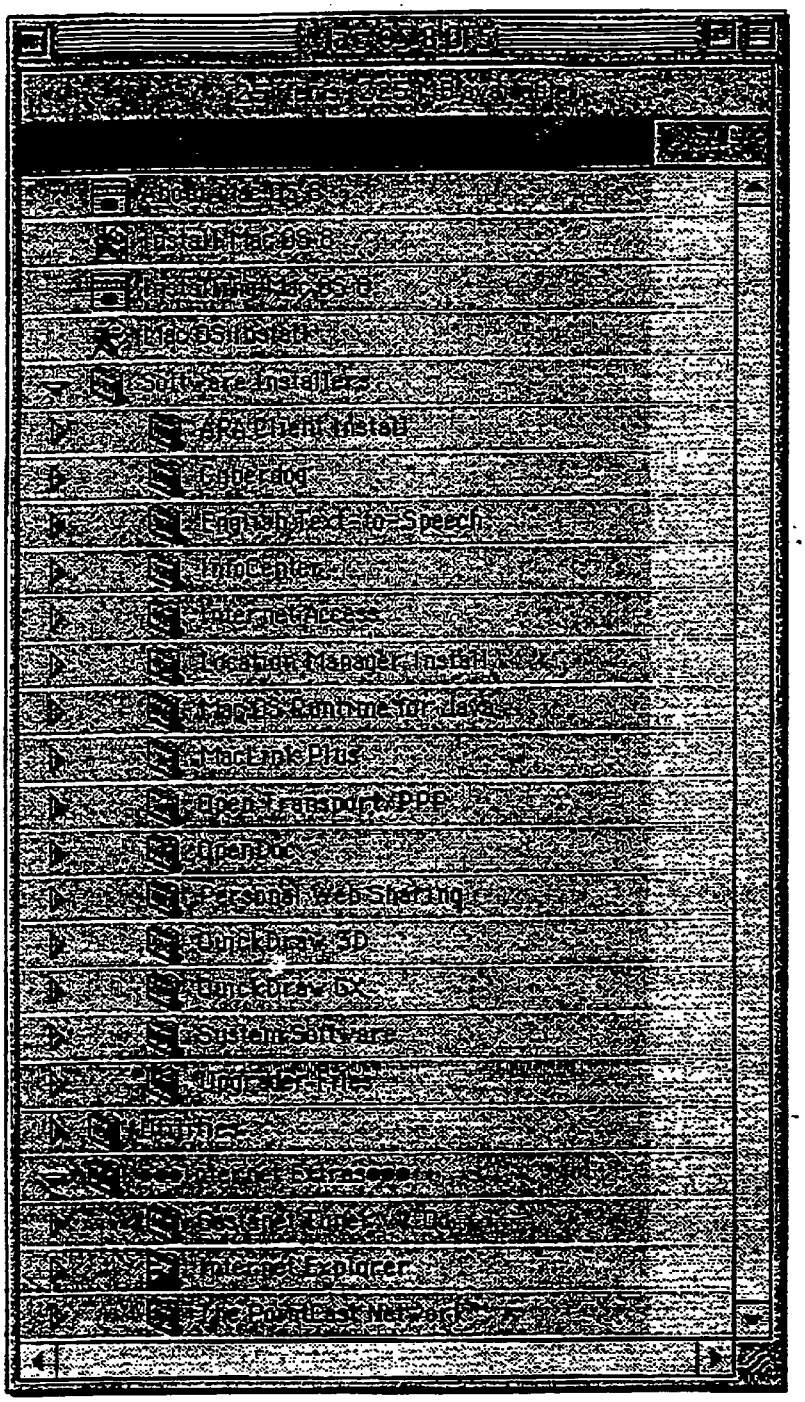

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