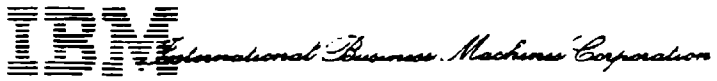

Office of the Senior Vice President and Group Executive
Corporate

Route 100, P.O. Box 100, Somers, NY 10589

July 20, 1995

Mr. Bill Gates
Chief Executive Officer
and Chairman
Microsoft Corporation
One Microsoft Way
Redmond, WA 98052-6399

Dear Bill,

I have spent a lot of time recently with Bruce Claflin and Tony Santelli discussing areas in which IBM and Microsoft could work more closely together and improve our relationship. I had planned to call you to see if you were interested in discussing this matter.

Bruce Claflin has just informed me that our relationship may be in even worse shape than I thought. Our teams have been negotiating the license to pre-load Windows 95 for quite a while. IBM's team has been very frustrated with the pace of these discussions as well as Microsoft's reluctance to accept proposals which appear to be in our mutual best interests. In spite of that, the IBM team believed that we would close an agreement, albeit in an excessive matter of time.

Today, Microsoft introduced a new issue, the pace of an existing contract audit, the settlement of which your team wants as a condition of finishing the contract and shipping product. This is a complete reversal of Microsoft's prior position. There are no conditions under which this complex audit can be closed immediately.

The audit does appear to be taking a long time, and we too would like it closed quickly. I am told, however, that we are working to a sequential schedule agreed to by your auditors and that your auditors believe the length of time is caused by the complexity of our arrangements not by any intransigence on the part of IBM. In fact, the auditors have told IBM that we have cooperated fully.

The net is, I would like to discuss this matter so that we can bring these contract negotiations and this audit issue to a close. And if we can do this, I would also like to begin a dialogue on improving our overall relationship. I will call you tomorrow.

Sincerely,

G. Richard Thoman

/bb

** TOTAL PAGE.001 **

GOVERNMENT EXHIBIT 2197