GOVERNMENT EXHIBIT 354
PENGAD-Bayonne, N.J.

From: Jim Allchin (Exchange)
Sent: Tuesday, February 18, 1997 5.17 PM
To: Bill Gates
Cc: Paul Maritz
Subject: "Losing a Franchise -- The Microsoft Windows Story" (a new Harvard Case study)

I'm sure this subject got your attention. It's what I worry about every day when I shower, run, eat, etc. Paul knows how worried I am, but I don't think I've told you before.

We all know we have many challenges. I think about the challenges however in two buckets. First, we have challenges that we have a unified strategy for and perhaps an implementation plan underway. Some of these are big issues, like TCO, but they are much less scary to me than the other bucket. You can say we aren't doing things fast enough for TCO or marketing hard enough against the NC (and I'll agree), but our strategy and path is clear. We know that if we can execute fast enough we can stop this disease. The second set of challenges are the ones where we do not have agreement on our strategy within the company and the company is often working cross-wise internally. The cross-platform vision and keeping Windows as the platform and the center of inovation fall into this category. In my opinion, Windows is in the process of being exterminated here at Microsoft.

1. Why are we doing so many things cross-platform? Are there more Macs, OS/2, or Unix clients today as a % or less than a year ago?

I assume the argument is that we have to do things cross-platform because Netscape is (or says they will). So, we move our innovations cross-platform and dillute Windows. The alternative is to say "NO" and push even harder on Windows. I know that we have to do some things cross-platform. But, our default today is to assume functionality needs to go cross-platform instead of assuming it doesn't (and then later reluctantly moving it when necessary). I consider this cross-platform issue a disease within Microsoft. On our current path IE 4 will not be very integrated into Windows. The IE team is not focused on this problem and I was requested to shut down my UI/shell team. Windows will get what the other platforms get UNLESS the IE team finds out they can't do it easily on the Mac, etc.. This is the wrong approach. We should be asking for specific innovations to restricted to Windows. I can't fight this disease alone. The problem is the company is not unified on the strategy.

I am convinced the path we're on is the wrong one. We are playing into Netscape's strengths and against our own. I hear lots of words about how the software will of course be "better" on Windows because we have more people working on Windows, but I can't sell abstract statements like this. We focus attention on the browser battle where we have little marketshare instead of focusing the battle at integrating things into Windows where we have marketshare and a great distribution channel. When IE 4 first was discussed we were "integrating the browser into Windows". That is what we told everyone. That was a strong message for Windows. That message is now gone since IE 4 is going onto all platforms. It won't be as "integrated" (whatever they means technically), but all the words about WebPC and the like convince me we are determined to put a gun to our head and pull the trigger.

I see the same pattern here as with Novell a few years ago. Some people believed we should drop our work in TCP/IP and only do only IPX/SPX work. It took signficant effort in order to convince the PSD team to accept TCP for Windows 95. Why? Because we were in copy mode of Novell. We are doing it again. There is a time for this clone strategy, but the better long term approach is always to attack from a more strategic perspective.

2. The platform is Windows, isn't it? duh.... it would seem obvious. (But is it a browser/IE? or maybe Outlook?)

We are in a head-head competition with Netscape. They claim the platform is Communicator, etc., so that's why we say IE is the platform. However, that fights against our strength and plays to their strength. We are marketing IE as a platform. This is a mistake. The whole "WebPC" concept will totally confuse the platform story. This is another nail the coffin for Windows. No amount of marketing will fix this. The meeting I had with the PR team convinced me of this today.

When Paul asks me what's innovative for developers' in Windows I really struggle. I finally have a team working on this in the areas I control, but it isn't enough. There are two things that are really critical for code running at the client: UI and storage management. We are working on articulating directory access, multimedia (whatever remains non-cross-platform), etc, but UI and storage are the key pieces. We have done a bad job with storage innovation. But, we appear to just be giving up on the UI since it's all going to go cross-platform. I don't support this. I believe smart people here could find ways to do things beyond what AWT or IFC can do if we tie

it more into Windows. Remember these class libraries are layered. For example, no one is working on integrating Trident into the OS in a fundamental way. Maybe this won't amount to much but it's the type of investigation we have to do. (Actually, I think there will be many gains in terms of performance and consistency throughout the system.) We should move as little cross-platform as possible. Without a specific UI focus on Windows I think we are in series trouble. Davidcol agrees he can't support the OS changes we need and he is suggesting that we create a team again. This is not enough if the strategy isn't synchronized -- both marketing and development-wise.

I am available to talk about any of this. On our current path, I just don't feel that Windows can win. Given the exec retreat I thought I would send this to you for your thoughts.

jim