

**AEI-Brookings Joint Center for Regulatory Studies**

**MICROSOFT LOOKING FORWARD**  
**A Speech by Steve Ballmer**  
**CEO of Microsoft**

**Falk Auditorium**  
**The Brookings Institution**  
**Tuesday, November 12, 2002**



**MR. BOB HAHN:** Good morning ladies and gentlemen. Thank you for coming today. My name is Bob Hahn. I direct the AEI-Brookings Joint Center and on behalf of Strobe Talbott, Chris Demieux, Bob Litan who you'll hear from shortly, my co-conspirator, I'd like to welcome you here for this special event.

I promised that I would keep my remarks short, in part because our speaker is known for his energized remarks and I want to give him ample time to speak today. Also we wanted to allow ample time for you to ask questions.

Before I turn things over to Bob Litan to introduce our speaker I wanted to thank Aaron Layburn, Ron Nessen and Adriana Pita for putting in extra effort today to make this event a success.

I also wanted to leave you with two words in the spirit of The Graduate. Blue card. If you open up the packets that you collected on your way in you'll see a blue card. If you fill out that card you can be added to our e-mail service. If you don't, I won't go there. But for those of you who do, you can get the inside scoop on a number of important regulatory issues and antitrust issues that the Joint Center addresses including our events as well as some of our books.

For example we have an upcoming event to deconstruct USV Microsoft that will occur in early December. Next week we'll be hearing from one of the brightest individuals in the world who will deliver the Joint Center Distinguished Lecture, that's Judge Posner. In addition we have several books in press, one on antitrust over the last decade in which Microsoft will play a small role. A second on government policy towards open-source software.

Of course if you don't suffer from problems with insomnia but rather have trouble staying awake, Joint Center books can still help and we have a barn-burner coming out by none other than Bob Litan and three of his close friends entitled "Follow the Money: Corporate Disclosure After Enron". Bob tells me that he's expecting to retire based on the royalties that he's going to get from the free downloads of the book.

So all you need to do is fill out the card and the good life is yours.

Without any further ado, I'd like to ask Bob to introduce our future speaker. Thank you.



**MR. ROBERT LITAN:** Thank you very much Bob.

On his behalf and on my behalf as well the Joint Center is pleased to be able to bring to you this historic event today.

It's historic because, as Bob has indicated, we've put out a lot of material about the Microsoft case on our web site over the last several years, but we have not had the good fortune to have a spokesman from a senior position at Microsoft come and speak to us, and today we hit a home run in Steve Ballmer, the CEO of the company.

Now some of you, actually before I give the introduction, some of you who know me may feel that it's somewhat odd that I'm doing the introduction. In an earlier life I helped prosecute Microsoft. I also helped settle the first consent decree with the company. Then I left the government and participated in the case as a private citizen during the remedy phase, urging at various points that the company be broken up -- a position I'm sure that Steve Ballmer vigorously disagrees with. As it turns out he doesn't have to worry about it because the settlement is done and the Court has since approved the settlement.

But I want to just say personally that throughout this experience I've had cordial relations with all the people at Microsoft and in particular Jack Krumholz in the office. I had cordial relations with Bill Newcomb, the former General Counsel. All of our dealings were professional, they were all at an intellectual plane, they were never personal, and I've always felt a personal sense of gratitude for that. As a result, I think we're appreciative that Microsoft has chosen to come here today, here at Brookings together with AEI and present its views about the future of its company.

Steve Ballmer joined Microsoft in 1980 and was the first business manager hired by Bill Gates. Since then his passion and his leadership have become hallmarks of his tenure at the company.

During 20 years, Ballmer has headed several Microsoft divisions including Operations, Operating Systems Development, and Sales and Support. In July 1998 he was promoted to President, a role that gave him day-to-day responsibility for running the company.

He was named CEO in January 2000, assuming full management responsibility for the company and he is in the process of leading the most comprehensive reinvention of Microsoft for the past 25 years.

The Microsoft materials that they gave me describe Steve, and I think accurately so because just a few minutes ago we had the occasion of meeting each other for the first time and I joked to him it was in a non-deposition setting. But the materials describe Steve variously as ebullient, focused, funny, passionate, sincere, hard-charging, and I've certainly read that in many articles, and dynamic, and I've read that as well. I think we'll probably see all of those qualities on display in a moment.

So today Steve is here to describe his vision of Microsoft going forward after the settlement, and Steve, we are pleased that you have chosen AEI-Brookings to be the forum for this event.

Ladies and gentlemen, I give you Steve Ballmer.



**MR. STEVE BALLMER:** Good morning everybody. I want to start by thanking the American Enterprise Institute and the Brookings Institution for hosting me here today; Bob Litan for that nice introduction; and to Bob Hahn for all his support and analysis over the years.

If I sound a little groggy today I apologize in advance. I had a very very important dinner last night in Washington State and had the redevye in. My middle son turned eight yesterday and that was a high priority event, as was being here. So grogginess may be one part of the outcome.

Today what I really want to talk about is the future. I want to talk about the excitement and changes in the technology industry and how Microsoft is moving to embrace those changes. How as a company we're trying to forge a new kind of relationship with customers, with our partners, with our industry, and with government.

The thing I'd like to ask you to think about before I really get started today is what the world will be like from a technology perspective ten years from now. What role will information technology play?

If you'd asked even me that question ten years ago I don't think I would have predicted the progress. I really don't.

Think about it. There's over half a billion personal computers in use around the world today all connected and all able to share information in amazing ways. There's over a billion wireless devices where you can walk anywhere in the world -- except my driveway maybe -- and share a phone conversation with anybody. Telecommunications is really becoming fully integrated with the web and data services and PCs and phones are really coming together. Entertainment is going digital at an incredibly fast pace and the Internet is really becoming ubiquitous.

Ten years ago I'm not sure we would have predicted all of that and yet I sit here today and I'm as optimistic for the next ten years as the last ten. In fact I think we'll do even more in our industry in the next ten years that we did in the last.

A new technology industry is really emerging to rise to those opportunities, and just as the industrial age has had its false starts, the technology industry in some sense is recovering from the excesses of the past few years and is taking its place as one of the most important industries in the world economy. Perhaps second only really to agriculture in terms of importance in job creation and economic development.

I think we're going to see more and more, not less, innovation. I think we'll see long term growth in the technology industry built on the kind of perpetual acceleration of technological advance. Our industry will only move forward. There is no going backward.

On the one hand larger companies like Microsoft and others have a key role to play, making the large investments that are needed for important largescale innovation. At the same time we'll continue to see new companies start up and emerge as greenhouses for smaller scale innovation. Those companies may be here in America, but they may also be in Israel, in India, in China. A good idea in this technology industry really knows no borders. We'll help build the infrastructures that enable software

developers to create amazing technologies that will continue to change the way we live, the way we work, and perhaps even most importantly, the way we learn.

As a company looking forward we see enormous potential both in the next generation of products and in the spread of these digital technologies around the globe. In many developed countries there are actually now more PCs per household than there are automobiles and it continues to be a rapidly growing number.

Also in developed nations the multitude of connected devices will really help us achieve this promise of truly personal computing.

Today's trends will continue to bring forward tomorrow's innovations. PC technology is moving from the desktop to the living room to the hand to the car -- Bill Gates even tells me we'll all have computer technologies in our refrigerators by the end of the decade. I remain a little skeptical on that one.

Businesses are demanding new levels of coordinated data and information. Moore's Law continues to operate, giving us more and more hardware power that will enable new scenarios, speech recognition, voice recognition. Technologies will get faster. With that speed will come more flexibility, more integration and simpler operation. Better use interfaces, new form factors, XML, data standards, processor and bandwidth advances. They're all coming together.

At Microsoft we will spend \$5 billion this year on R&D. That's an increase of about 15 percent, even in this climate. That budget is one of the largest innovation budgets of any company in the world. And our R&D budget is that high for really one simple reason. Despite the fact there's been two decades of unbelievable growth in this business, we continue to believe that we're still really just at the start or barely in the middle of what's possible with technology, and we think we're on the verge of the next quantum step forward.

While innovation and excellence remain at our core, though, our company's also working to grow in other ways, working to become a more responsible leader for our industry and a company better able to manage in the future.

I joined Microsoft what feels now way back in 1980. I called my parents. I'll never forget it, to tell them I was dropping out of the Stanford Business School to go join my friend Bill Gates in this little company he had started that did software for personal computers. My father, who had never gone to college and didn't think it was a very good idea that I was dropping out said to me, "What's software?" My mother actually asked the more interesting question. She said, "Why would a person ever need a computer?"

Today those questions seem unfathomable. My parents were bright folks. Those were sensible questions at the time.

When I joined Microsoft we had 30 employees. Bill Gates and I never in our wildest imagination would have ever believed we would grow to over 50,000 people operating in over 70 countries, and I certainly never dreamed that I'd be CEO of a company as large and complex as this enterprise. But as many of you know, I assumed the role of CEO at Microsoft two and a half years ago. The goal then was clear. I needed to assume responsibility for our overall management and business strategy so that we could let Bill Gates really focus his time on working with our product development and research teams, creating the long-term technical vision for the future not only of our company but in part our industry.

I spend a lot of my time thinking about what it means to be a great company versus just a good company. I definitely think that Microsoft is a very good company, but I want to make Microsoft a great company that is successful and respected not just today but really over the next 50 years. That's why I spend much, maybe even most of my time and energy working on the foundation of the company -- our people, our values, how we work across different groups not only inside the company, but how we work with the industry and with government. If you get those basic things right -- people, values, working relationships -- I think you've really built the foundation for a truly great company.

When we started out our goal was to put a personal computer on every desk and in every home. Today we have a new mission -- to make great software that really helps people and businesses realize their full potential. In many ways this new mission is just an extension of the original vision that drove us from the beginning of the company. We see the opportunity for technology to go from running PCs to connecting people to information they need everywhere in the world, giving people new communication tools, helping people work, smarter on the job and learn better not only inside the classroom but out.

The broader mission is reflected in the way we work internally. Bill and I run a very different organization today than we did five or ten years ago. We've built leadership teams for our business and we're constantly investing in our next generation of leaders. We remain a company unified around a shared technology platform and a shared vision of improving people's lives. But we also have a great deal of accountability to our customers, and each of these leadership teams, and independence for them to strive to be the best in these new emerging areas of technology.

Along with the new management approach we have affirmed a set of basic values that are now part of every one of our employees' personnel reviews. It's a funny thing sometimes for managers. We've learned to sit down and have a discussion with an employee about values, but we found it's incredibly important -- not just what did you accomplish, how did you accomplish it and how will you accomplish it in the future?

It starts with integrity and honesty. We're committed to being up front about what we are doing, who it affects, be open in communicating about every aspect of our business, and certainly sensitive to the new issues of corporate governance or to the issues of corporate governance that have become

increasingly important for market confidence.



One of the hallmarks of Microsoft is that we dream big. We think about big advances, big changes. We're passionate in our belief that technology can positively change the world and improve people's lives. We don't always succeed, but if one of our products or one of our attempts fall short we don't sugarcoat the problem. We try to take accountability for our actions. We dig in. We make things better and better and better. That continuous improvement is key to the way we work.

We've made a commitment to bring the benefits of the digital economy to every community in the world and to hiring more minorities, more women, and people from around the world into our workforce. We can't sell to the broad group of people in the world and serve the broad group of people in the world if we don't represent the broadest group of people in the world. And we're renewing our commitment to improve our communications with our partners and with our customers. We're dedicated to being a responsible leader in our industry.

The settlement with the Department of Justice and the states upheld two weeks ago is a fundamental part of what's different and new at Microsoft. It's a fair settlement achieved through professional mediation with the Department of Justice and the State Attorneys Generals. It was given the full scrutiny of a fair and impartial trial based on a trial on remedies as well.

The settlement contains new obligations, responsibilities and regulations on our company. We fully accept them and we're fully committed to complying with them. We've already made many of the necessary changes and we are dedicated from the top down to really living those obligations.

We've taken a number of steps to disclose additional technical details about Windows and to make the design and contractual changes required by the decree.

Just last week the company's Board of Directors moved to create the required Antitrust Compliance Committee which will be chaired by Dr. James Cash of the Harvard Business School. The committee also has two other members, Ann Corlogis, a former Secretary of Labor who lives here in Washington and is seated up here in the front; and Ray Gilmartin, the CEO of Merck Company.

As CEO of Microsoft I can personally assure you that we will commit all the time, all the energy, and all the resources to follow through on our responsibilities under the decree.

We believe the settlement was the fairest and best way to resolve the case. And even as we worked to resolve the case we tried to keep on, and I think we've been successful in keeping on the innovation path.

Despite all this, people oftentimes still ask me, but what did you learn from all of this? It's a very

very good question and I think we've learned a great deal from our experience over the last few years about our own responsibility in this context as an industry leader.

There's no question that when the lawsuits started most of our industry did not race to support us. We went out and tried to listen both to our supporters and to our critics. We learned that we needed to take a different perspective on being a good industry leader. Even five years ago I think we still tended to think of ourselves as kind of a small company that was just getting started. When you think about where we came from that makes some sense.

Today though we clearly recognize we are an important industry leader whose decisions have an impact on other companies large and small. We have an important leadership role to play and there are new rules that apply, both legally and in terms of the needs and dictates that come from our industry.

We're not stopping there though. We recognize that we need to support industry cooperation in new and creative ways. There is no way that this is more evident than the advances resulting from a new technology called XML or extensible markup language. Our entire industry has embraced XML as the sort of standard lingua franca or how computers talk to one another.

The new rules of the game have companies even like Microsoft and IBM collaborating on enhancing these standards while at the same time really competing to make innovative, easy to use software that implements and helps customer take advantage of these new XML standards.

We're trying to do a better job of industry outreach and partnership. Our recent work with IBM, Verizon, and Novel and others in building and developing an XML standards-based security approach is a model of how I think partnering can work for the benefit of our entire industry.

Last week's Table PC launch was the result of years of partnership with companies like Acer and Toshiba and Hewlett Packard. And with MSN we're partnering with companies like Disney and Verizon, GE, and Dell and many other great companies to offer a broader set of consumer choices.

Working better with our industry is one change. Working more closely with government is yet another. We're working hard to reach out to cooperate with local, national and global governments. In fact I think we're really on the verge of a new era of partnership for our industry with government.

We realize there are issues that need more public/private cooperation. Government realizes that an innovative technology industry is actually the key, or at least one of the keys to economic growth, and that forms the basis for this new partnership.

For example, last August we reached an agreement with the FTC on security and privacy issues, an agreement under which the federal government sets certain standards but permits us to continue to develop new and better technologies and operating approaches to meet those obligations.

What could have been years of wrangling frankly became an agreement that I think will help create a more secure competing environment.

Technology brings a host of wonders and conveniences but it also brings with it new problems and challenges. With PCs now in over 60 percent of households in this country, the challenges have really assumed an important social dimension that is very different from the kinds of issues that our industry confronted when we were younger, when we were still in our infancy.

Our industry can't solve all these problems alone, and we think governments often cannot solve them alone either. We need to work together on a global basis. Let me give some examples, maybe starting with security.

Security is fundamentally an issue about a community of criminals looking to steal people's identity, break into banks, even terrorize the Internet.

Last month we saw a concerted attack on the DNS servers designed to bring down the entire Internet. It failed, thank goodness. But people will try again and again.

Identity theft alone last year cost consumers over \$1 billion and it's one of the fastest-growing crimes in the world. Too often when we all hear the word hackers we think of teenagers trying to do something cute. In fact with more and more critical business transactions done on the Internet, hacking is a big-time crime. So we are stepping up our cooperation with law enforcement at all levels, helping to track down and identify thieves and working with the office of cyberterrorism.

Internally we've adopted trustworthy computing standards to put security, privacy, and reliability really in at the ground floor, at the forefront of everything that we build.

We're sending out security updates to make our products safer from those criminals. But no matter how high we all in our industry build the walls, we also have to work with governments on an effective program to defer cyber crime at its source and make sure that those who commit it are caught and convicted.

Working together industry and government can and will build a secure digital future.

Spam is another emerging issue. To some it's just an annoyance, but two out of three e-mails delivered today are spam. And many spam are scams or worse.

So we're now focused on working with local officials at curbing illegal spam to prevent the situation from getting further out of control. Technology will take us just so far, but what's going on today is really out of control.

Working in partnership we can restore, we think, the integrity of the Internet.

We're making a lot of progress on helping parents help manage the way their children use the Internet. Our new release of MSN, MSN 8 contains state of the art parental controls that really let parents fine tune how their children can use the Internet. My son was reminding me last night how well tuned it was for something he wanted to do and that was just play chess with some folks on-line.

But again, we in the technology industry can't do it alone. The best parental controls don't work if parents don't use them. We need to work all together on these issues.

We're working to help close the digital divide, giving more than a billion dollars in cash and software over the next five years, working with groups like the Boys and Girls Clubs, the United Negro College Fund, and libraries from literally all across the country. In all of those areas we will need a more coordinated approach between public and private sector.

Technology companies can do a great deal both to create tools that address social issues like privacy and security, and to work together proactively through responsible industry self-regulation, and we need to do that. But government needs to assess these situations and carefully fill in the gaps, doing what companies cannot do by themselves, while being careful not to discourage innovation in the process.

More than ever the global character of the Internet requires the governments to really work together on an international basis.

You can tell I'm pretty excited. I can talk for a long time about the challenges and opportunities our industry faces. But I want to leave some time for questions so let me leave you with a couple of summary thoughts.

First, at Microsoft we're excited about the future of technology. Even in this climate we are excited and we think you should be too. We're investing record sums in the future because we believe that technology remains the key driver to our future and the future of our economy.

Everything we do supports our new mission of becoming a global technology provider that helps people realize their full potential.

We're focused on what it takes to be a successful and respected company, not just now but well, well, well into the future. We've fully accepted our responsibilities under the settlement and we're committed to full compliance. And we're forging new partnerships with government to deal with the common problems we face.

As a company, as people, I think we've changed and grown over the past few years. We really are committed to being a great industry partner, a responsible industry leader, and above all, unceasingly optimistic about the future of technology and the positive things that it can do for the world.

Thank you, and I'll look forward to your questions.

**MR. HAHN:** I just want to make one announcement which I neglected to make in the beginning. That is you all are invited to a buffet lunch at the end of this presentation after we do questions and answers, next door.

One just sort of matter of protocol. There are people with microphones so if you'd be gracious enough to wait for them after I call on you and identify yourselves before asking Steve a question. And he tells me that he wants only softballs, is that right? [Laughter]

Let me start by asking, I don't know if this is a softball or not but it's something I want to know the answer to.

You had the launch of this Tablet PC recently. One, where do you see that technology going? Is it a big deal or a small deal? And in particular, I want to know when I'm actually going to be able to talk into my computer easily without having to use some fancy software or whatever.

**MR. BALLMER:** I think the Tablet concept is a big deal. Look around this room. Everybody looks like we're having this meeting just like we would have ten years ago. We're supposed to be giving you technology that helps you. Why didn't most people in the room bring some technical device? Answer. We don't have the right one.

We think our first generation Tablets are great. You'd bring them to meetings like this. You'd take notes on them. Perhaps you'd even want to take a video, an audio of my speech with you with your notes recorded right there with what I was saying. Ballmer made no sense at this point. Send them to your staffs. I don't know what you want to do. But we haven't facilitated that.

So I think the Tablet is a big deal in terms of helping people have access to important tools to help them do what they want to do at other times and in other places. And frankly, I think it will replace the traditional notebook computer over the next several years. I'm probably more optimistic even than our team that built the darn thing about how quickly that will happen, but I think it is a big deal.

The other question Bob asked is when will I not need to have fancy software that helps me talk to my computer? I'm going to actually answer that in two pieces. One, you're always going to need fancy software to help you talk to your computer. The question may be when's the fancy software going to work well enough. The answer is, realistically, over the next three or four years we'll have this stuff in good enough shape.

It turns out that if you really study the way consumer usage works there's a funny [knee to the curve]. Ninety percent isn't good enough. Ninety-one percent isn't a little better than 90 percent. But then you get some place 98, 99, it depends on the technology, and all of a sudden everything is good

enough. There's sort of a critical threshold of quality of recognition where you get over the hurdle. I think we should be there in the next three years of so, but we're notoriously optimistic about this stuff.



**QUESTION:** Drew Clark with National Journal of Technology Daily.

Mr. Ballmer, Microsoft has in some directions been on the other side of some of the copyright debates with the entertainment industry. For instance, you have allowed some of your software to be used on the Kaza On-line file trading service, and you've also played a role in going against the watermark proposal that many Hollywood studios have favored.

On the other hand you are developing Palladium which if I understand it correctly could be used as a kind of lockbox to keep consumers from making use of files that are copyrighted on their own computer.

Could you just comment on whether you see Microsoft's future as directed against or in alliance with the major entertainment industry?

**MR. BALLMER:** I think our interest in a big picture sense are actually quite aligned with the entertainment industry. We are both producers of intellectual property. AT the end of the day we both only thrive, survive, if there's good intellectual property protection. Most of the issues of disagreement, of which there clearly are some, are about the how's not the whether's. It's a complicated set of discussions. I can tell you why our super expert in water markings who used to think it was going to work perfectly six months ago now thinks he can break any watermarking scheme technologically. So our technical views may differ and vary but the fundamental issue of protection of intellectual property rights is an important issue for us and the entertainment industry.

We certainly, I don't know much about the way Kaza is built, but the bad guys in the cyber world also can use our products as much. I'm afraid it's the good guys as they can use our competitors' products as much as the good guys. We certainly don't sanction and condone the illegal copying of intellectual property material even if the people doing it have some software that's built on the Windows platform.

**QUESTION:** My name is Jonathan Zuk. I'm with the Association for Competitive Technology. We represent about 3,000 IT companies around the country.

In talking about the settlement and the kinder, gentler Microsoft, if you sort of boil down what some of the stuff is, it's better relationships with OEMs I guess, right? And allowing greater flexibility. It's perhaps better relationships with developers in terms of access to APIs and things. So it seems to me that given the changes over the past couple of years we already have a case study for this. The Tablet PC launch.

Can you characterize that in more than just a couple of words about how that is an example, if it is an example of how all those people would be happy with how that went and the results for consumers, for developers, and for OEMs.

**MR. BALLMER:** I think it is a good example.

Just take a look at the first few Tablets that are on the marketplace today. We did some preliminary hardware design because before there's general belief we have to do some prototyping, but we were always clear. What we were trying to do was stimulate industry innovation and provide some software.

If you take a look at the kind of designs that you have in the marketplace today from companies like Fujitsu, Acer, HP, Compaq, Toshiba, NEC, they all have very different designs. They're all innovative. They're all doing what they do best -- clever hardware engineers in various and sundry parts of the world with a common software approach and a set of sort of preliminary ideas, but then off innovating and adding value innovating and adding value in exactly the right way. I think that is a model for a good participation.

There needs to be a level of close cooperation between us and the people who design and build these machines if we're going to see next generation innovation. I talked about serving a meeting like this. We could talk just as easily about the way you have access to information when you're watching television or on your wrist or in your pocket. It requires a kind of a rich cooperation between the hardware and the software industries and I think the Tablet, as you highlight, is a good example of that kind of cooperation.

**QUESTION:** I'm Stephanie Woods with Nightly Business Reports.

I'm curious if the idea is to give consumers what they want or something that will make their life easier, why not sell a version of Windows that, some call it stripped down, where consumers can more easily add what they want?



**MR. BALLMER:** It's a very good question. All of our analysis, all of our experience, and all of our study says that what consumers really want out of Windows is to have something that they can depend on. Today if you get a copy of Windows you can depend on it to run certain applications. You can depend on it to have certain capabilities. If you have a friend who says this is how you do something on Windows, the capabilities are there for the user to use. We think the value of that to consumers is very high.

Every time we've tried, and we've tried a few times to do what I'd call Product and Product Jr. Not in the Windows case, per se, always but Product and Product Jr. Unless you're super careful, and

by and large it's hard to be super careful. Unless you're super careful and judicious in what's in Product and Product, Jr., Jr. doesn't sell. Jr. doesn't sell because customers want the thing that everybody else knows and they can depend on.

Today we have a home version of Windows and a professional version of Windows. You could say one is a stripped-down version of the other. But the level of intellectual engineering effort that went into make sure that that seamless for customer was high, and even so there are always some customers who get confused by the distinction.

I think it is one of the things that people talk about, that sounds kind of catchy, but if you really do any kind of real research with real consumers, it's not what the real consumer wants.

**QUESTION:** Steve, I'm not going to ask an antitrust question.

Privacy. Privacy is a hot topic. It's likely to be on the congressional agenda next year. Microsoft has advanced a technological solution to this, software that would allow people to match their privacy preferences with the people that they're doing business with on the Internet. My impression though is that the software that you've developed hasn't taken off as much as maybe you would have expected. I could be wrong about that and I'd like your views about that issue, number one.

But number two, going into the legislative session this year, does the company have a specific view or desire when it comes to legislation? Are you in favor of tougher on-line privacy legislation, whether moving to some kind of generic opt-out requirement or even opt-in requirement for some kind of information?

**MR. BALLMER:** Let me say a couple of things.

First of all I think we have some great new technology that we built in to help people manage privacy on the Internet. One of the things we learned in B, 1, 2 of anything is lots of great ideas sometimes need lots of ongoing tuning to be broadly used.

I think the stuff we did is actually quite good, but until the average user can say yep, I get it and I feel like I've adjusted my privacy level to what I want, I don't think we've achieved our goal.

So I think we have a good first pass, we're getting market feedback, we're going to learn why we don't have more people choosing to do that kind of customization on their system, and we're going to continue to invest.

In terms of a specific agenda, I would say that the issues here are quite complicated and one of the things we're trying to do is be part of a process of educating and understanding government requirements. The privacy thing is important and there does need to be a level of government involvement. There also needs to be a level of choice for people who do business on the Internet. You

can ask very easily the question should there be a mandated approach to what privacy looks like? Should there be a mandated approach to the requirement that everybody disclose what their privacy policy is? How do you take advantage of that? What should the mandates be in terms of how people implement their privacy policy which was some of what we were involved in settling with the FTC this summer. And what we're trying to do is be an informed and important advisor and source of input to the discussion as opposed to having a very specific legislative agenda I would say that we drive.

With that said, there are specific things that our folks here would be glad to go into at the detail level, but what's most important to us is that it be a thoughtful, nuanced thing and people don't over-react. Because any over-reaction will have other negative consequences.

**QUESTION:** Heather Phillips with the San Jose Mercury News.

Several of your competitors have already complained to the Justice Department that you're not living up to the settlement agreement. Specifically they talk about your licensing agreements for communications protocol. They say they're just commercially unfeasible. So I'm wondering what your response is and if you're at all willing to change those licensing agreements if in fact no competitors even sign up to use them.

**MR. BALLMER:** We put a lot of very careful thought into the license offers because it's not one offer. There are about 113 different protocols that we licensed as part of -- or that we've opened up for license as part of the consent decree. Those are packaged in a variety of different ways so that people don't need to take all 113 of them commercially as part of any arrangement. And given that we are super focused, super focused on 100 percent compliance with the settlement, the level of care and thought and concern and I would say reasoned judgment that went into making that offer was very high.

We are in active discussions with a number of companies about licensing those protocols. I expect those discussions to bear fruit. It does not surprise me that some of our competitors might be sort of taking a different tack, but certainly we're out there in the marketplace so to speak today, and so far the feedback from the marketplace is of great interest and we're working through right now some of those license.

**QUESTION:** James Harding from the Financial Times.

Two questions about government. You mentioned what you learned as a result of the antitrust process. I wonder what you thought you taught them through the antitrust process. [Laughter]

The second question was, you talk about being optimistic. These are quite pessimistic times, aren't they? There are great concerns about security. I wonder how that has changed Microsoft, how much of that \$5 billion R&D is now being spent about thinking how you track communications, how you deal with real security concerns and how technology is going to play a part in this process. Thank you.

**MR. BALLMER:** I have to say in answer to your first question, that's the first time anybody's asked me, and it's definitely the first time I've ever thought about it. [Laughter] I'll bet at the end of the day we haven't taught anything to anybody. At least we didn't set out to do so. I think it's been an important process for all concerned. Reaching the kind of negotiated approach to how to move forward that we reached with the Department of Justice and the States about a year ago, I would anticipate there was some learning on all sides.

We focused more on what we need to learn and what we need to do on a go-forward basis.

In terms of our R&D spending and how it has been affected by world concerns about security I would say the level of investment that we're making in making our products secure as well as new security technology has definitely been dialed up over the course of the last year and a half or so. Particularly the memo that Gill Gates sent out to all of our employees about a year ago on trustworthy computing. We really rang the bell for our employees and said look, we really have to understand that the importance of these issues to our customers is much greater than it was.

Some world security matters, what happened on September 11th, other world security issues, cyberterrorism, and some of it was just customer reaction to some of the viruses that had attacked our software and their input that said you guys just need to do better.

But if you ask today versus a year ago I can tell you we've got 20,000 plus software development people who understand a whole lot better what it means to do very very secure software, and I think people -- it will take time, but I think our customers and users will see a lot of improvement, frankly, not only in our own products but in the sort of security of all products in our industry.

**QUESTION:** Karin Carlson with [inaudible] Magazine.

Could you elaborate a little bit on compliance with the ruling, given that there are actually two judgments issued, the structure of the compliance, are you doing it simultaneously or do you sort of have two teams overseeing the two judgments? Or is it completely integrated?

**MR. BALLMER:** Until 12 days ago we had one team very focused in on complying with the proposed settlement that we had reached with the Department of Justice and the states and so we've been moving on as committed and required under the proposed consent decree, we'd been moving into compliance for over a year.

With the Judge's ruling 12 days ago we have already moved to be in compliance on matters in the second ruling, the formation for example of the Board Committee on Antitrust Compliance comes out of the second part of the states actions. I'd say we are very thoughtfully working through what can be shared, what needs to be different, and what different mechanisms we will need under the two rulings.

Our legal and technical experts are very hard at work at sorting that through and we will do what is required under both rulings.

**QUESTION:** Ed Black, Computer and Communications Industry Association.

With regard to the Antitrust Compliance Committee, it's clear I think that it's supposed to focus on enforcing the settlement, per se. Will Microsoft also charge in and give it responsibility to make sure that overall antitrust laws are complied with as well?

**MR. BALLMER:** A small -- and I'm not the technical expert but I'll still make a small technical correction. The settlement actually didn't have the notion of a Board Committee so it's really as a response to the Judge's ruling in the second part of the case that the Board Committee was formed.

We had a Board meeting last Tuesday. We formed the committee. We gave it what I'd call a very rough charter at this stage because we're trying to flush out all the details of what that committee needs to do. We've asked our legal team to really study what's not only our best practices in this area in terms of antitrust compliance but other regulatory issues that companies have faced and the Board Committee has said they want a very concrete proposal on all of the things they need to consider here in the very imminent future.

So the breadth of what that committee will take a look at I'd say is still work in progress at this point.

**QUESTION:** Jim Prendergast with Americans for Technology Leadership.

In the years following the antitrust case against IBM many observers thought that that company sort of had no compass, they were still recovering from 13 years of litigation.

How do you keep Microsoft competitive in the marketplace yet comply with the settlement agreement?

**MR. BALLMER:** That's our job, I would say. And I don't say that in a silly way.

This settlement is very important to us and our compliance is very important to us. At the same time we understand that if we're going to continue to be the kind of company we want to be that's helping people realize their potential, people have got to use our software. They've got to find value in what we do compared to other alternatives they see in the market. That we have to come to work every day and say how do we do more for our customers? How do we appeal to people who are not our customers today and put an offer that's so compelling in front of them in terms of the value it delivers, the technology, the innovation, the price that says yes, I want that?

So we've tried to be pretty clear with our employees. We're here at an important milestone, we

are absolutely committed to compliance but that does not mean that we're going to stop innovating. It doesn't mean we're going to stop competing in terms of trying to win new customers and provide incredible value to our existing customers.

At the face of it I don't actually find much of a contradiction there. The settlement gives us a framework under which we understand how to provide the kind of openness and technical disclosure, the kind of licensing, openness that addresses issues the government has had with where we've been. But at the same time it lets us continue to do innovative work, add new capabilities into our Windows products and generally try to put absolutely the best offer we can in front of customers around the world.

With that I guess we'll wrap. I want to say thanks again to Bob and Bob for this opportunity, and thanks to all of you for your time. We appreciate it.